To Deal with Collapse: 'We Don't Need A *Bad* Bank, But a *Good* Bank'

Professor Wilhelm Hankel was Secretary of State in the German Finance Ministry under Karl Schiller, and, for ten years, was the chief economist of the Kreditanstalt für Wiederaufbau. His most recent book is Die Euro-Lüge und andere volkswirtschaftliche Märchen *(*The Euro Lie and Other Economic Fairy Tales*). Helga Zepp-LaRouche interviewed him on April 9, and we publish a translation here. The video interview, in German, is posted at www.bueso.de. Mrs. LaRouche also interviewed him in January (*EIR*, Jan. 30, 2009); and he spoke at a Schiller Institute conference in February on "The Future of the Euro" (*EIR*, March 27, 2009).*

Zepp-LaRouche: Professor Hankel, we all followed the G20 Summit attentively, where it was decided to lay out a $5 trillion rescue package, in addition to tripling IMF deposits to a total of $750 billion, plus another $250 million in special drawing rights. [German Finance] Minister Steinbrück had previously warned about inflation. Is the danger of inflation now past—or if not, why did he go along with the agreement?

Hankel: No, the danger of inflation is not past, but it has been made even greater, since, as every child knows—and therefore a German finance minister presumably also knows—more money, with fewer goods, means inflation. And we certainly do have inflation. We have had it less in the cost of living, but very much in asset prices, in the bubbles—bubbles on the stock exchanges, bubbles on the real estate markets. And this inflation is, of course, not eliminated by such "cures," but rather the opposite: It will increase; and not only that, it will escalate, and that is the dangerous part of the story.

Zepp-LaRouche: Even the chief economist of the European Central Bank, Jürgen Stark, said afterward that this was "helicopter money," and that something like that ought to have been carefully scrutinized, and now it threatens to cause irreparable damage. Why do you think this was handled so recklessly?

Hankel: Out of helplessness, I suppose. Since there is no rescue for the rescuers, they act like "Dr. Eisenbart,"[1] as we say in Germany. Dr. Eisenbart is notorious for having said: "I don't care what the disease is, but I have a therapy, and the disease has to adapt to my therapy." Where that led was obvious 300 years ago: to the death of the patient.

Zepp-LaRouche: What do you think of the new role for the International Monetary Fund? It had already suffered a widespread loss of credibility among many states of the Third World, for example, by worsening the conditions of the developing countries by imposing its austerity conditionalities; then it failed miserably to predict the crises—whether the Asia crisis of 1997, or the global crisis now; and now it is supposed to function as the rescuer.

Hankel: Yes, you said it. The IMF should be the world economy's red warning light, which gives a timely warming that a crisis is looming somewhere, and recommends countermeasures—and, if necessary, enforces them. But what it is now doing is the reverse of such a policy. In the past, it urged countries not to allow themselves to become unbalanced—i.e., not to do things that they absolutely cannot afford; but now it does the opposite, encouraging states to rescue their damaged banks. And that is the opposite of reform. What we need now is to reform the financial system, not to prop it up, or even to allow its further hypertrophy.

Germany Cannot Be Europe's Banker

Zepp-LaRouche: It is also interesting that the IMF itself, after getting such a large upgrade, joined George

1. A physician of the early 18th Century whose name has become synonymous with quackery.

Professor Hankel is interviewed by Helga Zepp-LaRouche, April 9.

Soros in demanding that Germany rescue the east European states. This is just outrageous: that now the German taxpayer should have to pay for the wrong actions of bankrupt banks.

Hankel: "The German character will restore the world to health again."[2] That has proven wrong in the past, but it is now becoming downright grotesque.

It's becoming grotesque, because we are misusing Germany as the banker of the Eurozone. Germany is the country that has the largest surpluses—only the Netherlands, Austria, and Finland also have surpluses, but it is mainly the German surplus that has stabilized the euro up to now. The fact that the euro is the leading currency internationally, after the U.S. dollar, and that it has been stable, is thanks solely and exclusively to the German surpluses. But German surpluses are no longer sufficient to cover also the new deficits of the old deficit countries, which, of course, are being created because of capital flight. This is the same situation—with more and more money leaving these deficit countries—that we have already seen in Iceland. It is having an impact on Ireland, Portugal, Spain, Italy, Greece, and even on our neighbor, France. And Germany can no longer cope with this; so if Mr. Soros says that we also have to deal with countries that are not even using the euro, but want to join it so as to recapitalize, then Germany is the banker—or better, the innkeeper—who dispenses free beer, until he himself goes bankrupt.

Who Will Be First To Ditch the Euro?

Zepp-LaRouche: You just mentioned Ireland, which now has a deficit of 13% of its gross national product and Eu80 billion of toxic waste in its banks, and now is supposed to ram through the most brutal austerity policy; and since Ireland is part of the euro system, of course it no longer has any capability whatsoever of doing anything else—it can neither devalue its currency nor print money, so the only thing left is to proceed with brutal austerity against its own people.

Hankel: Yes, there are only two possibilities: Either the "deficit brothers"—Greece and Ireland are the worst—force their deficits onto others, and that includes the European Central Bank, since the ECB would buy up this junk. Naturally that would mean completely devaluing and debasing the euro. Or, these countries should be advised to do the only realistic thing: to use the only therapy that helps, and that is self-help. That means they would have to leave the euro, since they can only carry out urgently necessary reforms with a monetary policy of their own, with a currency exchange rate of their own, and also with an economic stabilization policy of their own. So, they have to get out. Now, I don't know who will be the first to leave the euro: the overextended banker countries such as Germany, or the countries that are now in the deepest crisis, such as Ireland, Greece, and others. But one or the other will occur.

Zepp-LaRouche: You have, as we have, opposed the euro since its inception, as an unworkable concept. Now you are also vindicated by developments in Greece, Spain, and Italy, as you have just said. How long do you think this process can continue?

Hankel: That really depends only on how long it takes the politicians' brains to understand this process. When the euro was introduced, people talked about the "theory of constraint," especially in Germany. All German politicians, whether from the right or the left, were at that time convinced, that the constraint of a European currency would lead to the formation of a United

2. *"Am deutschen Wesen soll die Welt genesen"* was a slogan originating during World War I, and then used by the Nazis.

States of Europe, i.e., a political union. But now, we can see that this constraint operates in the opposite direction: Since the European currency is not viable, the concepts of the Common Market and the European Union also have to be reexamined.

What we need is a return to the situation before the euro—and that was not bad at all. The first 40 years of the European Economic Community were quite a success story, and that is because each country, having its own currency, was forced to solve its crises (which also existed then), on its own, with its own national means. And that always worked. Back then we had crises in Greece, in Italy, in Spain; and these countries, through devaluation of their currencies, created the potential and the time to deal with their problems in the real economy; partly, they solved them, and partly, not (such as Italy, in the case of the Mezzogiorno).

Zepp-LaRouche: Then when, in your view, does the situation become so critical that things collapse?

The KfW and Germany's Postwar Reconstruction

Dr. Wilhelm Hankel, as noted in the accompanying article, worked for ten years as the chief economist of the Kreditanstalt für Wiederaufbau (KfW, or Reconstruction Finance Agency). The history of that organization provides an object lesson in how credit can be generated for priority national reconstruction projects, under emergency conditions. The following brief summary is drawn from "How Germany Financed Its Postwar Reconstruction," *EIR*, June 25, 1999.

After World War II, the German economy was in a catastrophic condition. Industrial production was one-third of 1936 levels. More than one-fourth of housing had been destroyed, as 9 million refugees streamed in from the East. During the bitterly cold Winter of 1946-47, food rations dropped at times below 1,000 calories per capita, per day.

Immense investments were necessary if Germany were ever to get back on its feet economically, and these investments would require amounts of financing far beyond the U.S. Marshall Plan. In November 1948, the KfW was formed, to provide medium- to long-term loans, "to enable the completion of reconstruction projects, insofar as other credit institutions are not able to provide the required financing."

The KfW loans were to run primarily on a separate track from the normal banking system. If other banks shied away from the risks of a project, the KfW was empowered to provide credit. The KfW was expressly excluded from other bank services, such as taking deposits and managing customers' bank accounts.

But where was the KfW's capital to come from? The U.S. Truman Administration, after relentless pressure from Germany, allowed the "Countervalue Funds" of the Marshall Plan to be used, and, from 1949 to 1953, the KfW obtained 3.7 billion deutschemarks from this source. Principal and interest payments on KfW credits were paid back promptly into a special fund, which was then available for the next project.

One of the KfW's two directors, Hermann Abs, underscored the "targeted planning" in the KfW's policy. "The activity of the KfW was not exactly oriented to the ideal model of a free market economy," he said. "Taken in the precise sense, what it did was to steer investment."

In 1949, the KfW set the highest priority on production of coal, iron, steel, gas, water, and electricity. Abs declared, with respect to the devastated coal-mining sector, that it was irrelevant to whom the mines belonged, and whether their production yielded a profit or a loss. The important thing was that production of coal be cranked up as quickly as possible; and it was. In 1949 and 1950, forty percent of all West German investment in energy, coal, and steel, was financed by the KfW.

And, by the end of the 1950s, Germany had become one of the world's leading economic and industrial nations.

Hankel: Either if cars burn and shop windows rattle, if people take to the streets with loud expressions of despair, and social tensions intensify to the point that every government leaves the euro group, or—but I don't think this likely—Mr. Steinbrück or his successor grasps the fact that he absolutely cannot carry the burden of the deficit of the remaining euro countries and those that are not yet members. That, he most certainly cannot do. We could not allow Germany to become impoverished, just to enable "Europe" to succeed. That is the story of Saint Martin, who divided his cloak with the beggar, as a result of which, both saint and beggar froze to death. That will happen to Mr. Steinbrück.

HypoRealEstate.com

German Chancellor Angela Merkel called Hypo Real Estate a bank deserving of bailout because it is "systemically relevant." But it is a repository of financial waste! Why not provide credit to the bankrupt municipalities, which are responsible for maintaining most of Germany's infrastructure?

No Bank Bailouts

Zepp-LaRouche: Yes. Then we also have the problem of bank bailouts. Why do you think that Chancellor Merkel called Hypo Real Estate a systemically relevant bank? Because I recall that Hypo Real Estate [HRE] was originally founded as a "bad bank," because it was split off from the Bavarian Hypovereinsbank, when Unicredit took it over. I think Opel is more systemically relevant than such a bank. How do you see it?

Hankel: I agree. I think that Mrs. Merkel is a victim of her bad advisors. Because they either come from this very bank or primarily from this bank's clients—let's say from Allianz, or some of the others. What she considers as a systemic problem are the secondary failures that insolvency of HRE would cause among financial institutions that hold HRE stock, especially in the insurance industry. And also many pensions, life insurance policies, and civil servants' pensions are affected.

Zepp-LaRouche: It seems very important to clarify this somehow. Because we notice, including at our literature tables, that people always say: "Yes, the banks have to be bailed out, because they are systemically relevant." How would you approach this from a real economic standpoint?

Hankel: Just as you do, in the case of the Pecora Commission. We need an independent commission, not of bankers, but of certified public accountants, experienced auditors, and of course older macroeconomic professors—I say older, because they are well versed in crisis management, whereas the younger ones, unfortunately, don't know a thing about it. The commission must investigate, first of all, the bank itself, but much more importantly, what would really happen if all our "bad banks," especially those in the private sector, had to deal with their own losses, and if these banks' few good investments were transferred to a new one.

I would strongly argue for a "good bank," rather than a "bad bank." We should take the good assets from the "bad banks" and transfer them to a new, second Kreditanstalt für Wiederaufbau—in other words, a bank for reconstruction of the banking system—and leave the job of liquidating the "bad banks" to the original shareholders. That would show that the systemic losses in the banking sector are much smaller than the systemic losses will be, if this system is "rescued" and the crisis transferred to the real economy.

Zepp-LaRouche: That's like the case of Opel—it is

This former power plant in Essen, Germany, has been turned into an amusement park. "For decades, German infrastructure has not been maintained as it should have been," said Dr. Hankel.

not just a question of Opel, but of the entire auto sector throughout Europe, and actually, worldwide. How would you approach saving industrial capacities? Because I think that is truly systemically relevant, and not some gambled-away financial toxic waste.

Hankel: I agree with you there, too. But the mistake of this government, as with most of the European governments and, I think, also the U.S. government, is that they are spraying money about hither and yon, cherry-picking this ailing company or that ailing sector.

Build Up the Domestic Market

No, this is the hour for a general offensive, an economic offensive on the domestic market. Germany is a tragic case, since the domestic market has long been neglected because we thought that the foreign market, the export market, was more important than the domestic market. Before reunification, that might have plausible to a degree, since Germany was overindustrialized, with respect to its domestic market, so that to utilize its full industrial capacity, Germany had to export. But since reunification, at the latest, this has no longer been the case, and what is even worse, the German domestic market has atrophied since then. That can be very clearly seen in our rotting infrastructure. For decades, German infrastructure has not been maintained as it should have been.

And now I come to the real starting point of a German anti-crisis program: the municipal sector. Seventy percent of our infrastructure has to be financed by the cities and municipalities. And these cities and municipalities are not included in the German tax code. Their share of tax revenues, +/–10%, is really minimal.

So, Mr. Steinbrück would be well advised not to rescue the banks, but to provide financial support to the municipalities instead. This doesn't have to be new money at all, but would be a larger portion of tax revenues. The municipalities would be the starting point for a German infrastructure program that benefits the whole domestic economy and, especially, German citizens. And that is how I see the way to begin overcoming this crisis. It's not about banks, but about the domestic market, infrastructure, reforms in social policy, such as health care and education. All this can only be done *nationally,* not on the European level, and certainly not globally.

Zepp-LaRouche: The German Institute for Urban Studies, I believe, cited figures to the effect that in the municipal sector alone, there is an investment backlog of Eu650 billion, while on the federal level it is in the trillions. In other words, an economic recovery program could be started up immediately, just through domestic policy.

Hankel: Yes, indeed. Most municipal projects have been lying on the shelf for decades; they just have to be brought out again. They have been on hold for lack of financing. So, if Mr. Steinbrück secures the financing—which he is doing, although unfortunately for the wrong recipients, namely the banks—if he reallocated it to the municipalities, then we wouldn't have to be so anxious about Germany's future.

Changing the Way People Think

Zepp-LaRouche: It is really also inconceivable, that the Eu2 or 3 billion needed to build the Transrapid maglev from Munich to its airport supposedly cannot be found, and yet hundreds of billions are spent on financial toxic waste. How can a change occur in the way people think in Germany?

Hankel: Well, by our having more of these conversations!

No, this is a question of the public. I have long complained that the German media always toe the government line, reflecting only the politically correct or sought-after opinion, permitting no alternative thinking whatsoever, inviting no critics onto the talk shows. That is a bad thing and has led to one-track thinking, which is what the authorities want. As if this were a crisis with no alternative solutions! But there are alternatives; they are just not along the lines of high finance, which is [in the government's view] supposed to be saved at all costs.

Zepp-LaRouche: Unfortunately, I have to agree with you; my husband, at any rate, has long forecast the crisis, and if you read today's *Spiegel*, about who was supposedly important in this respect, you find Professor Unsinn[3] of the IFO sounding off.

As you know, my husband is also calling for a new, worldwide financial architecture, a New Bretton Woods; and it is not only a new financial architecture that we need, but also construction of the Eurasian Land-Bridge, which would provide a concrete investment framework for such a new financial structure. Perhaps you could comment on that.

Hankel: Well, the Eurasian Land-Bridge is just as important as securing supplies of raw materials from Siberia, and part of the same process. The Eurasian Land-Bridge, the new pipelines that former Chancellor Gerhard Schröder stood for: These are all very important projects, which would not only guarantee supplies to Europe, but would also provide orders for German machine builders and pipe producers, thereby securing jobs. That is very important. Naturally, in the long term, the stabilization of the international financial system is also important and indispensable.

But I think we have to stick to a timetable of priorities. The first thing to do is to get our national house in order. Then, the cancerous sores of the Western system must be eliminated. I am referring to "overbanking": When it comes to the financial sector, we are oversubscribed. And that is also the structural explanation of this crisis. Where there is "underbanking" instead of "overbanking"—as, for example, in the Third World—this crisis does not exist. Of course, they have other problems: inadequate national investment and too much "dead capital." But we have made sure that because of overbanking, our financial resources are not steered toward the real economy, but have remained in the financial sector and used as fuel for speculation, hence, bubble-creation, with the downright perverse notion that assets are created by money, and not by hard work. This notion must be eradicated, and for that, we naturally need a new financial system.

Develop Africa

Zepp-LaRouche: We also think that part of the auto industry could be retooled to produce tractors and agricultural machinery for the development of Africa; there is no reason that China should be the only country developing Africa's infrastructure. We could conclude contracts, for example, for long-term supply of raw materials, and we would build important infrastructure to that end. Wouldn't that be a reasonable thing to do?

Hankel: Absolutely reasonable. And we should also incorporate the healthy part of our financial apparatus into providing funds for it, since what our Far Eastern neighbors, the Chinese, are doing in Africa is by no means the latest word in modernization, and so this would only be useful to the Africans with certain reservations, whereas its primary function would be to secure China's raw material supplies.

So I think we have to do more for Africa, and that we *can* do it too. But that presupposes that we first do what we have hitherto criminally neglected: create the lacking financial infrastructure. Because all these countries—for 40 years I have been in this business, and advising governments and central banks—have quite considerable national savings, on the average about 5% of gross domestic product. But these savings remain dead capital; they are invested in bazaar products, or in dollars, or are hoarded. That is simply

3. Hans-Werner Sinn is the head of the Institute for Economic Research at Munich University; the pun on his name could be translated as "Professor Poppycock."

www.chinese-embassy.org.uk

Young Tanzanians are trained by a Chinese instructor in construction of technology for coal mining. This was the first Chinese-sponsored heavy industrial enterprise in Africa. If China can develop Africa, why can't the West?

because these countries are not in a position to transform their savings into national investment credits, through an efficient banking apparatus. That is the main problem of the African states: to eliminate their underbanking, and place themselves in a position to use their own savings potential themselves.

Values and Economics

Zepp-LaRouche: You have said that we have to look to the older generation for expertise. Perhaps you could say something more about the values that have to be returned to the economy, if we are to emerge from this crisis.

Hankel: We old-timers have always known that economic science is a moral science: It was oriented toward the common good, and not to the private egoism of an individual businessman, nor to the maximization of the profits of enterprises. The common good is the basis of economics, and the economist is a social doctor, who has to have the mission and also the ethos to keep his patients healthy, and if they get sick, to get them healthy again. That should never be lost sight of.

But it *has* been lost sight of in Germany, such that the field of economic science has been senselessly split between business administration and economics, with the result that the business managers know too little about the national economy, and the economists are not well enough informed about issues of accounting law, management, and the problems of HRE.

So, it's not just that we must go back to the older generation of economists in Germany, but we must also reestablish the field on the basis of the micro- and macroeconomy. That is a request that generally has to be made of the universities. And I, among others, am addressing a special request to my own alma mater in Frankfurt: We should not have a substantial part of the faculty funded by private sponsors! We have a newly established House of Finance in Frankfurt, that has had virtually nothing to say about the misery of the financial sector, because the professors are afraid of making their financial backers angry.

Zepp-LaRouche: Therefore, we need this new Pecora Commission. Maybe you could say a bit about that, in conclusion.

Hankel: It is needed today in all the financially hard-hit countries, practically in all the big Western industrial countries. Not only in the United States, but maybe even a lot more in Great Britain, and in the Germany, which is dominated by the EU.

The financial fundamentals in Germany are significantly better than in most of the Western industrial countries. We have a strong public savings bank sector and credit unions organized as cooperatives. They have done better in this crisis than the private banks—not least, because they have the greater ethos. But we too need a commission to investigate the sins of the private banks, and then, we will be able to draw reasonable conclusions about what a future banking system, suitable to our situation, would look like.

One thing is already certain, however: It should be less oriented toward the stock market, and much more toward the needs of the real economy and the domestic market. That is what has been lacking in this crisis, and it is now taking its revenge.

Zepp-LaRouche: Thank you.