Effects of implementing The Matheo Solution (TMS)

By André ten Dam

Preface

The consequences of the implementation of The Matheo Solution (TMS) are described in this paper. It assumes that you are familiar with TMS.

The Matheo Solution, first published in English in November 2010 presents a comprehensive proposal to save the Euro zone. Since then many of its proposals have been accepted or implemented in some form. But the core-concept of TMS is yet to be accepted and implemented.

The core-concept of TMS involves an adaptation (flexibilization) of the current rigid Euro Pact: A flexible exchange-rate mechanism will be introduced, and interest-rate differentiation at a national level will be possible. Each Euro country will have a *new* National Currency Unit for calculation purposes of prices and wages. The NCU's will function *alongside* the already *existing* Euro Currency Unit (ECU).

The exchange rate of the NCU of the economically strongest Euro country will be equal to the ECU. The Euro will remain the *only* legal tender (notes, coins and electronic transfers) in the entire Euro zone. But prices and wages are calculated in NCU's. The ECB determines the value of each NCU vis-á-vis the ECU.

A weak country's NCU can devalue against the ECU. When a NCU is devalued, prices and wages decline in ECU/Euro. The prices of imported goods become a little more expensive in NCU and therefore will only incidentally rise somewhat extra in NCU, depending on the proportion of the 'import component' in the final price. But exports will become cheaper in ECU/Euro and therefore more attractive and more competitive, so that economic growth in the devaluing Euro countries will rise and their current accounts and state budgets will improve.

For further explanation of TMS see the most recent publication ***'The Matheo Solution: European monetary flexibility, power and unity'*** d.d. 19 December 2011.

http://www.inmaxxa.nl/resources/site1/General/TheMatheoSolutionEnglish_19_12_2011.pdf

1. PORTUGAL, as a representative of an economically weak nation (at present)

Initially, the Portugese NCU is equal to the ECU. But the Portugese NCU will directly be devalued by the ECB. The ECB determines the percentage of the devaluation against the ECU.

The Euro will remain the only legal tender in Portugal.

Prices and wages in Portugal decline in ECU/Euro. But the purchasing power of the Portugese people will initially decline only marginally. The competitiveness of the Portugese economy improves instantly. Portugal gets an immediate perspective of real economic growth, new jobs and increasing tax revenues.

The ECB keeps the Portugese national interest rate low to stimulate economic recovery.

The national debt is reduced to a sustainable level by means of a 'clean haircut', supervised by the IMF. The IMF is also responsible for extending emergency loans to the Portugese government when necessary. Also private debts, when and where necessary, or the interests to be paid on these debts are reduced to a sustainable level.

Portugese banks which encounter difficulties will receive temporary financial liquidity support from the ECB and, if necessary, Portugese or European temporary financial solvability support. For the European financial solvability support an ECB-financed 'European Bank for Bank Capital Support' (EBBCS) will be set up which provides temporary capital support for troubled Portugese banks. This new EBBCS will receive equity in the troubled banks, which serves as collateral for the ECB loans (see # 5).

As a result of the calculation in NCU's, Portugese production and products will become cheaper in ECU/Euro. This makes Portugese products more attractive, not just in Portugal but also internationally. Increased exports will improve Portugal's balance of payments.

In combination with economic reforms, the introduction of the Portugese NCU will make Portugal more interesting for local and foreign investors. Production costs in ECU/Euro decline, so exports increase. Tourism will flourish. New jobs will be created and sound structural real economic growth will follow. Imports into Portugal will become more expensive and therefore decline. The balance of payments of Portugal will improve.
Social security payments will decline because of improving economy. Tax revenues will increase. The Portugese budget deficit will decline and head for a budget surplus. The Portugese national debt, which will already have been reduced to a sustainable level, will further decline.

The recovery of the Portugese economy also means that Portugal will be able to access the financial markets in order to (re)finance the national debt. New Portugese state bonds can be issued optionally either in Portugese NCU or in ECU/Euro.

In the growing Portugese economy Portugese banks will recover sufficiently to repay Portugese and/or EBBCS participations and the ECB liquidity support. The same applies to emergency loans from the IMF.

2. GERMANY, as a representative of the stronger euro countries

Germany will also get its German NCU. The German NCU will equal the ECU (which equals the value of the NCU of the strongest Euro country, which is currently Germany).

As long as the German economy remains the strongest in the Euro zone, the German NCU remains equal to the ECU.

The Euro will remain the only legal tender in Germany.

Interest rates in Germany will increase, in order to prevent the overheating of the economy and prevent inflation.

The value of the ECU/Euro and the German NCU will increase. The German purchasing power and domestic spending will increase without inflation and wage rises. Imports from weak euro countries will increase, at the expense of imports from low-wage non-Euro zone countries. German citizens will rediscover southern European nations as tourist destinations.

As a result of the high quality of German products and the superior expertise and innovation, Germany will remain a leading exporter. When the weaker euro countries have recovered, the German exports to those countries will increase again. The German economy will continue to grow.

As a result of the 'Debt-brake' which has already been adopted in the German constitution, the budget deficit and the German national debt will decline and eventually disappear. New German state bonds can be issued optionally either in German NCU or in ECU/Euro.

German banks which encounter difficulties will receive temporary financial liquidity support from the ECB and, if necessary, German or European temporary financial solvability support. For the European financial solvability support an ECB-financed 'European Bank for Bank Capital Support' (EBBCS) will be set up which provides temporary capital support for troubled German banks. This new EBBCS will receive equity in the troubled banks, which serves as collateral for the ECB loans (see # 5).

Financial aid with German tax-money to the troubled Euro countries - via the IMF - will be incidental and limited in quantity. The prospect of the pay back in full of this financial support, with interest, is credible.

3. The Euro zone

When the Euro Pact has been adapted in accordance with The Matheo Solution, the Euro zone will become a much more balanced economic union. All euro countries will have a better perspective of sound real economic growth. Each individual euro country maximizes the use of its own economic, geographical and climatic advantages. The stronger Euro countries continue to concentrate on high quality, innovative products. The weaker euro countries will become more competitive and attract investments and production which would otherwise go to low-wage non-Euro countries.

Southern nations will also attract export oriented production of sustainable energy (production *and* systems), such as solar electricity and solar heating. The application of renewable energy sources will reduce the dependence on imported fossil fuels and reduce the emission of harmful gases.

The growth and diversification of member nations will benefit the balance of payments of the entire Euro zone.

A primary cause of the Euro crisis is that the present Euro Pact is not suitable for 'The Europe of different economic speeds'. But The Matheo Solution will turn this aspect into an advantage, because the diversity of the member states will become an economic advantage instead of a burden.

The Euro remains the only legal tender in all Eurozone nations. The Euro (zone) can remain whole and the European ideals intact. The Euro zone will not become a permanent 'Transfer Union'. The Euro will recover its position as a stable and reliable international currency.

4. The European Banking Sector

As a result of the 'clean haircuts' of the national debts of the weaker Euro countries and the reduction of private debts in these countries, European banks will incur substantial losses. Some European banks will experience solvability and liquidity problems. In addition to the existing re-capitalization programs, national governments will offer capital support. And the ECB will offer liquidity support or - via the new 'European Bank for Bank Capital Support' (EBBCS) - temporary capital support (see # 5).

National governments and European authorities will have an opportunity to reform the troubled European banking system. Risky 'investment banking' activities will be separated from the key functions of banks. Banks should not only be reliable, but moreover their primary focus should be serving the interests of citizens, businesses and governments. Obviously, the exorbitant earnings, including the ridiculous 'bonus culture' causing the damaging focus on short-term profitability will be terminated.

The Matheo Solution will help to refocus the activities of banks to serve, instead of harm the interests of their the European citizens, businesses and governments.

The economic recovery of the Euro zone will in return benefit the banks, allowing them to regain their health, repay loans, buy back shares and make structural sound profits.

5. The European Central Bank (ECB)

The ECB will return to a focus on its statutory monetary-economic objectives of combating inflation, as prescribed by the EU Treaty and the statutes of the ECB. The ECB will respect the 'No bail out' clauses of the Treaty. The purchases of state bonds will stop.

Since 2010, the ECB has lost credibility and compromised its independent image. The massive purchases of state bonds of the weaker Euro countries on the secondary markets and the submission to political pressure will cease.

The ECB will continue to regulate the money supply in all euro countries. But the ECB shall have several new responsibilities. It will monitor and set the exchange rates of the new NCU's against the ECU. The ECB will also play a crucial role regarding the periodic determination of interest rates at national levels in every individual euro country.

The Matheo Solution introduces a so-called 'ECB-Safety Net' as part of its role of 'Lender of Last Resort' for financial liquidity support for troubled banks. The ECB may support European (system) banks with temporary liquidity support. This support will feature a mechanism to prevent inflation.

Specifically, a 'European Bank for Bank Capital Support' (EBBCS) will be created. It is effectively a capital support fund for troubled European (system) banks, which is to be financed by the ECB (as a lender of last resort with unlimited means). The EBBCS provides the necessary capital to troubled banks, in exchange for shares. These shares will serve as collateral to the ECB. Because the finances are only used for capital support, there will not be an inflationary effect. As soon as these banks have recovered an can obtain sufficient capital normally, the temporary capital support will flow back to the EBBCS. And the EBBCS will repay the ECB-loans.

The ECB will, in conjunction with national governments and the EBBCS, focus on the restructuring of the banking sector (see # 4).

6. The EU-Treaty

The Euro Pact shall be adapted, where necessary, in order to incorporate The Matheo Solution's concepts. This will permit the full implementation of The Matheo Solution, without any conflict with the EU-Treaty.

The Stability and Growth Pact (SGP) shall be tightened. Every euro country must realize a balanced budget (the 'debt brake'). National debts shall gradually be reduced and crisis buffers shall be formed. Political influence and pressure to allow a violation of the SGP by a Euro country without sanctions will be eliminated, by implementing a fully automatic mechanism of warnings and sanctions.

The 'ultimum remedium' shall involve elimination of a non-complying euro country from the Euro (zone), but not necessarily from the European Union. For this purpose, a new, politically independent Euro zone authority will be established.

The EU-Treaty will be adapted to permit a voluntary exit ('Opt-out') by a country from the Euro zone in an orderly fashion, also without the need to leave the European Union.

The 'No Bailout' provisions will be tightened.

If necessary, the creation of the EBBCS will be integrated in the EU-Treaty.

The Euro zone will remain whole and the European ideals intact. The Euro zone will not become a permanent 'Transfer Union'.

With the implementation of The Matheo Solution, the monetary union will become self-regulating with a common interest. All concerned individual countries will not only be responsible, but also accountable.

7. The International Monetary Fund (IMF)

The IMF will aid the weaker euro countries with their insolvency problems and restructuring processes. Where necessary, the World Bank may be involved. The IMF will manage the process of 'clean haircuts' of state creditors. It will also manage the economic reform programs.

The IMF will (exclusively) provide emergency loans and temporary credits until countries can access the financial markets again. Member countries of the IMF will provide the necessary finances.

8. The Financial Markets and Rating Agencies

The credit ratings of the weaker euro countries will improve rapidly when national debts are reduced, sound economic growth occurs, and state budgets have been balanced with the professional help of the IMF.

The financial markets will rapidly regain confidence in all Euro countries. Not just in the public sector, but also in the private sector. The hectic scenes on the financial markets during recent years will be replaced by tranquility, stability and optimism.

All Euro countries will rapidly be able to appeal to the financial markets for the (re)financing of national debts at acceptable interest levels. Emergency loans by the IMF can be repaid.

Investors will recognize the positive changes and see the potential. So they will be prepared to invest in all Euro countries. The European Investment Bank (EIB) can play a leading role in the weaker Euro countries in the economic recovery.

9. The Political Leaders

European political leaders will cease their stubborn adherence to the *present* Euro Pact, which has led to the disastrous situation. Instead, they will implement The Matheo Solution and integrate it in the Euro Pact. Where necessary, this will obviously be done with democratically obtained legitimacy via national parliaments or referenda.

As the core-concept of The Matheo Solution is not in conflict with the EU-Treaty, the implementation and execution of it can start today.

The aspects of TMS which are in conflict with the present EU-Treaty must be introduced and implemented in a adapted EU-Treaty.

Support for The Matheo Solution will be found throughout the Euro zone, because all citizens and enterprises in all Euro countries will benefit, directly or eventually.

Perhaps the banking sector shall initially resist. But as bankers start to recognize that there is no *other* viable solution to the Euro crisis, they will also embrace TMS and its consequences. The banks will eventually benefit from the economic recovery and the improving perspectives.

The present political instability and polarization throughout the Euro zone will change into stability and unity.

Politicians will not have to deal any more with issues they do not understand.

10. The Citizens and Enterprises of the Euro zone

The need to tax citizens and enterprises to finance deficits and aid programs will quickly decline. In addition, the improving economic performance will increase the probability that temporary IMF-emergency loans to troubled Euro countries and temporary capital support to troubled European banks can be repaid.

The new perspectives will restore the confidence in - and support for - the Euro, European cooperation, European unity, and solidarity.

Enterprises will flourish, citizens will find more job opportunities and prosperity, and the new positive developments will foster social stability.

English editing by W.P. Levenbach