The euro area must not founder on the narrow-mindedness of the German government

1. For months now the German government has pursued a one-track policy in the euro crisis. As a result the European financial markets have been severely destabilised with the euro area teetering on the brink of recession. In its latest Economic Outlook the OECD warns of devastating outcomes. By sticking to its policy the German government is jeopardising Europe's economic and political future and damaging Germany's reputation.

2. The fundamental problem dogging German policy is the woefully inadequate diagnosis of the four-year-long crisis. The German chancellor considers uncontrolled government debt to be the sole cause of the current difficulties in the euro area. Hence it follows that the crisis can only be resolved if each country systematically endeavours to reduce its debts as quickly as possible. In the future, adverse developments are to be avoided by amendments to the European Treaties designed to ensure that unsound fiscal policies in any member country will entail sanctions that are as rigorous as possible and will ideally be imposed automatically.

   Given the German government's one-track approach, it is only logical that it should reject any form of collective liability or the purchase of bonds by the ECB because this would weaken the pressure to consolidate, which is deemed to be urgently necessary.

3. No in-depth analysis is needed to appreciate that the present upheavals in the euro area are the outcome not just of member states' willingness to embrace excessive debt, but also – and to a considerable extent – of the serious adverse developments in the financial markets. In 2007, the public finances of Ireland and Spain were deemed to be exemplary. They had budget surpluses and their debt ratios were 29% and 42% respectively – well below the 60% limit specified in the Treaty of Maastricht. The problem they had was unbridled lending, which produced a gigantic real estate bubble. After it burst, the countries not only had to stabilise the banks, but also provide extensive public funds to support the unemployed.

4. The resulting high deficit levels and the associated increase in the debt ratio are not exclusive to the euro area, however. They can be found in a similar and, in some cases, more radical form in the United Kingdom and the United States. The very serious destabilisation of the euro area was largely the result of the wrong signals sent out by the German government, which merely strengthened doubts about the security of European government bonds. Yet it was precisely the security of government bonds in Europe and the euro zone that made them a rock-solid investment in all the regulations imposed on banks and insurance companies. The long period of time during which this fundamental security of government bonds was called into question – especially by the German government – has spawned a feeling of insecurity throughout the euro zone. The only response to the European challenge has been to insist on national austerity programmes, which is one of the main reasons why the crisis has assumed such dramatic proportions.

This is a particularly dangerous development for the member states of the currency union, because – in contrast to Japan, the United Kingdom and the United States – they cannot fall back on a national central bank which, in an emergency, is willing and prepared to guarantee the repayment of mature bonds at their nominal value and combine this with a common financial, fiscal and stability policy which is enforceable and binding on all the countries involved. Moreover, confidence in euro area bonds was undermined by the 'leverage' of the EFSF, which sent out a clear signal to the markets that Italian or Spanish bonds would involve a debt cut of 20% or more.

5. The uncertainty this unleashed in the markets was so great that no notice was taken of the impressive austerity drives introduced by the problem countries in 2010 and 2011. Despite a partially sharp economic downturn, Greece, Ireland, Portugal and Spain managed to reduce their budget deficits in 2011 by up to 6.8 percentage points below the level of 2009. One of the major failures of the German government has been that it has kept the German public largely ignorant of these successful efforts, which have been extremely painful for the people in the countries concerned. Just how hard the problem countries are trying becomes abundantly clear if their efforts are compared with budgetary developments in Japan, the United Kingdom and the United States, which can point to no more than a modest improvement over the same period of time; Japan's deficit has increased even.

6. It is therefore very naive to imagine that the situation in the financial markets and developments in the real economy can only be stabilised by means of further consolidation in the problem countries. It is only right and proper that consolidation measures should be taken. However, it is absolutely essential that they be accompanied by unambiguous statements on the future of the euro zone and on common liability within the currency union. Relying on consolidation in economically uncertain times is like riding a razor blade. That is particularly true in the case of Italy. Based on current plans, the country's deficit will improve by two percentage points in 2012. At the same time, the OECD expects that Italy's gross domestic product will shrink next year. If more savings are made in the public sector in such circumstances there will be a major risk of a further economic slide. Since this will have a negative impact on the deficit and the debt ratio, the country's financial problems will probably be exacerbated. In Italy it would certainly make sense to introduce a wealth tax at a level which would ensure that the very rich contribute to efforts to reduce the national debt. This would raise the level of acceptance for the other austerity measures and for possible financial aid.

7. A sober analysis of the problems in the euro area makes it clear, firstly, that they are largely the outcome of adverse developments in the financial markets over the past decade. Secondly, there can be no overlooking the fact that the current serious aggravation of the situation is attributable not just to the inadequate austerity schemes introduced by the problem countries, but also to the insecurity felt by banks, insurance companies and other investors, which has been caused by unclear and misleading political signals. This has given rise to a vicious circle in which, as a result of higher interest rates for government bonds, more and more countries are facing both a liquidity problem and a solvency problem. The questioning of government bonds as the safe core of the financial system threatens the

stability of banks and insurance companies too. Since this triggers restrictions on lending, additional negative impacts are felt in the real economy.

8. By constantly calling for more and more consolidation in such a situation, while at the same time categorically rejecting any steps that might help to calm the financial markets, the German government is jeopardising the stability of the European currency union and the entire European financial system. At the same time it is willing to accept that this may lead to a serious recession in the euro area. In the problem countries with their already frighteningly high youth unemployment rates, this would pose a threat not only to budget consolidation but also to political stability. The political responsibility for such developments would rightly be attributed to Germany and the reputation of our country would consequently suffer considerable damage abroad.

9. The resolution of the acute crisis requires an approach similar to the one that was successfully adopted in the stabilisation of the banking system in autumn 2008. First the system was stabilised and then changes were made in the regulations that were needed to avoid adverse developments in the future.

   At that time, the threat of a run on the banks was averted by governments pledging to safeguard all bank deposits. At present there is a need to re-establish trust in the government bonds of the member states of the European area. The joint proposal of the German government's council of economic experts on the setting up of a common European debt repayment fund is the right way forward. The rapid establishment of such a debt repayment fund – involving initial steps towards a genuine fiscal union within the euro zone – is the last chance to re-build confidence in government bonds in the euro area. The debt repayment fund combines an unambiguous political commitment to the common euro zone and common liability with the necessary solidarity-inspired endeavours of the countries to create sustainable budgets. To the German government's fiscal union we would add a union of solidarity. For it is only through solidarity between the euro countries that we will be able to guarantee the stability of our currency. The provisional rescue package must be used to that end in the short term, while the permanent stability mechanism must be brought as far forward as possible. The European stability mechanism could form the nucleus of a European currency fund. Without an instrument of this kind the European Central Bank would be forced to avert the threat of a meltdown of the financial system. Instead of engaging in legally and democratically legitimised activities determined by political responsibility, the ECB Board members would assume the role of politicians. Moreover, the risk faced by the German taxpayers would increase with every further purchase by the ECB of bonds issued by crisis governments. That must be prevented.

10. What we need now is a European recovery programme with a clear priority on investment in the real economy. What we need in Europe is a social and ecological transformation with the establishment of a value chain in the leading markets of the future. We need a European initiative to combat youth unemployment. We need taxation of the financial markets. The perpetrators of the crisis must play a part in its resolution. If this proves impossible within the Europe of 27, the euro group must go it alone.

11. Solidity is needed as urgently as solidarity. For that reason the efforts made by the German government to have greater fiscal discipline written into the treaties must be welcomed. However, to that end it is not enough for the stability and fiscal regulations already in place in the EU to be incorporated into the European Treaties. The currency union must be transformed into a genuine political union with a common financial and fiscal policy and common development goals for the economic, social and cultural development of the currency area. However, all this must be accompanied by the willingness to put the state financing of the member countries on a common footing. That is the only way they can escape from the stranglehold of panic-stricken financial markets. It is also the only way to re-establish the stability of the government bonds of the euro area, which is a key requirement for its ability to function and for the international competitiveness of the European financial system.

12. This presumes that we can trust our partner countries. That Greece forged its statistics is beyond any doubt. All the crisis countries have shown over the past few months that they are prepared to make major sacrifices to help stabilise the currency union. The history of modern-day Europe, which has arisen from the ashes of the Second World War, offers the prospect of a new beginning rooted in solidarity. Germany now holds the key to the future of European integration and the prosperity of 300 million people in the euro area. It would be fatal if Europe were to founder on the narrow-mindedness of a German government.

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