FINANCIAL TIMES

February 13, 2012 7:13 pm

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Germany faces a machine from hell

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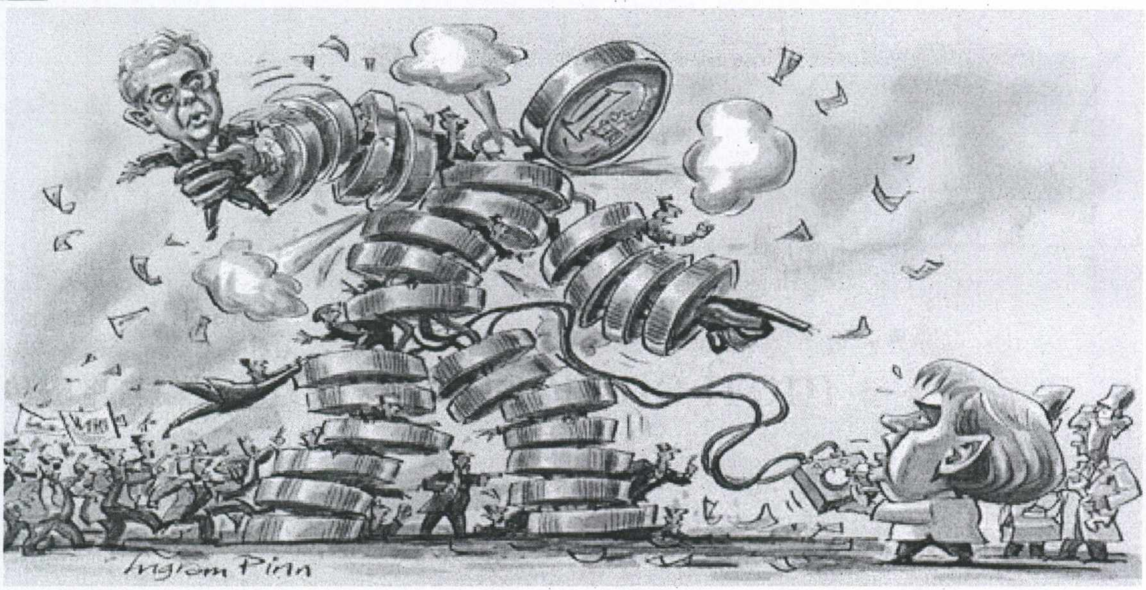

The press review from around Europe does not make pleasant reading for the German foreign ministry these days. “Look at this stuff, it’s just unacceptable,” laments one diplomat – pointing to a front-page article from Il Giornale, an Italian newspaper owned by Silvio Berlusconi. The piece links the euro crisis to Auschwitz, warns of German arrogance and says that Germany has turned the single currency into a weapon. The Greek papers are not much better. Any taboos about references to the Nazi occupation of Greece have been dropped long ago.

Across southern Europe, the “ugly German” is back – accused of driving other nations into penury, deposing governments and generally barking orders at all and sundry.

There is also a much more polite form of German-bashing going on at the official level. At the recent World Economic Forum in Davos, Christine Lagarde, the International Monetary Fund’s head, Tim Geithner, the US Treasury secretary, and David Cameron, the British prime minister, all made essentially the same point. Germany has to pay up. The argument goes that if the eurozone is to survive – and the world economy is to avoid disaster – Germany has to do much more, and pay much more, to keep the single currency afloat.

These arguments are deeply unfair. They fail to recognise how much Germany has already done for southern Europe. And they make demands for financial commitments that would risk economic and political disaster back in Germany.

Three main policies are being urged on the Germans. First, they should commit more money to a “firewall” – creating a fund so large that it would frighten the markets from speculating against southern European bonds. Second, they should commit to Eurobonds – mutualising the national debts of the eurozone. Third, they should stimulate their own economy, so that German consumption provides a market for southern European goods.

As it happens, Germany has already committed €211bn to the various European rescue funds – which is equivalent to about 70 per cent of its annual national budget. By contrast, many of the countries urging Germany to be more generous are notably backward in coming forward. Britain is not participating in the bail-outs for southern Europe – and is agonising about committing an extra £15bn to the IMF. The US has made it clear that it will provide no more money for the IMF to use in Europe.

More German money is likely to be forthcoming. But the Germans are wary, knowing that loans to southern Europe may never be repaid and that, if things go wrong, Germany could also be on the hook for billions more to bail out the European Central Bank. The argument that by building a bigger firewall of euros, Germany will ultimately save money, is rightly treated with deep scepticism. As one adviser to Angela Merkel puts it: "The southern Europeans don't want this money just to frighten the markets, they want to spend it."

The Germans are also right to resist Eurobonds. Under current EU structures, this amounts to a demand that Germany and other solvent euro users should underwrite the debts of southern European countries, while being given no control over their spending. When a leaked German paper suggested that an EU overseer should be given some control over the Greek budget, the proposal was shot down amid the usual volley of complaints about resurgent Nazism.

The third demand is that Germany must do more to rebalance the European economy. German consumption is, in fact, already rising. But it is difficult to see how Germans can be commanded to buy more goods from southern Europe. Perhaps they could all be given a tax cut in the form of a voucher, redeemable only for a package holiday by the Mediterranean?

Much of the current German-bashing is wild and unfair. But there is one respect in which Germany does bear responsibility for the current crisis. Germany was in the forefront of the countries pushing for the creation of the euro. And yet it is increasingly apparent that creating a single currency, without a single nation behind it, is at the root of the current crisis.

When Chancellor Merkel talks of the need for "political union" in Europe as the long-term solution to the current crisis, she is acknowledging this design flaw. But political union must involve deep losses of national sovereignty. And the current crisis shows that Greeks, Germans and Italians do have one important thing in common – a deep aversion to ceding control of their national budgets.

The result is that the euro is in a dangerous and unstable position. The actions that are being urged on Germany are unreasonable. But Germany's own solution – structural reform now, political union later – is unworkable.

Amid all these dangers, German officials remain outwardly calm. They shrug off the insults, while continuing to pledge financial aid to southern Europe and to make the case for supply-side reforms as the only long-term solution to the woes of the European periphery.

Behind the scenes, however, some of the brightest minds in the German government have a sense of deep foreboding. Twice in the past year I have found myself sitting next to different senior German officials at a dinner who have proceeded to tell me that the whole single currency was a terrible mistake. Speaking of the euro, one of my companions said: “It seems to me that we have invented a machine from hell that we cannot turn off.” The image was so bleak and Strangelovian that I laughed. But, I am afraid, it’s not really very funny.