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Germany knows way to solve crisis

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By Guy Verhofstadt

European Union leaders are meeting in Brussels on Friday for their regular Spring economic summit and should finally sign off – Ireland excepted – on the latest bail-out deal for Greece. But as they prepare to put their pens to paper, it is clear that we have not solved the debt problem at the heart of the eurozone.

Greece's bail-out is optimistically forecast to reduce its debt to gross domestic product ratio to about 120 per cent by 2020. But, even assuming that this is plausible, what next after Greece? What if Spain or Italy went bankrupt? Can the eurozone's firewall contain the conflagration?

There is €250bn left in the kitty of the European Financial Stability Facility and potentially a further €500bn in the European Stability Mechanism being introduced in the summer. Despite some wavering, Germany is still opposed to combining these two funds. And with the International Monetary Fund refusing to stump up any more money to bail-out Europe, we face stalemate once more.

Meanwhile, we continue to ignore a cheaper and more effective solution, a system of eurobonds where the bondholders themselves bear the risks (and the costs) instead of the taxpayers. Mutualising part of sovereign debt would enable payments to be made at a more reasonable rate than is available on the market.

A study by Natixis investment bank has shown that a system of eurobonds could produce savings in the order of €13.4bn per year for the eurozone as a whole. It could be based on an insurance model with a no-claims bonus for states performing well, whereby they would pay lower rates than poorly performing ones, so addressing the problem of moral hazard.

The cumulative efforts of the EU, ECB and private sector lenders to overcome the eurozone's sovereign debt crisis have already amounted, over the past 24 months, to more than €1tn, yet we are no nearer solving the crisis than in December 2009, when Greece's debt situation first became apparent. It is high time structural solutions were examined and countries were helped to honour their debts.

Greece cannot dig its way out of its enormous debt hole alone. If it is accepted that Greece should remain part of the eurozone – because a return to the drachma would be 10 times worse (a view I share) – then heads of government in the eurozone must accept the inevitable logic that – in a single currency area – there must be a common economic policy, a single system of governance and a common bond market, at least for handling debt in excess of 60 per cent.

If a system of eurobonds is only possible in the longer term once all the elements of a common fiscal policy are in place, then a more immediate solution is required to make inroads on the debt mountain.

Ironically, it is a German-inspired proposal (from Chancellor Angela Merkel's own economic advisory council) for a European Collective Redemption Fund that offers the most workable solution. In it, €2.3tn would be available for the mutualisation of debt above 60 per cent for those countries that were not part of a bail-out programme.

It would be a temporary facility (until debts had been brought back down to sustainable levels), thus meeting the concerns of the German constitutional court and the letter of the EU treaties, and it would marry the necessary discipline (repaying debts) with solidarity (sharing low interest rates).

This would also be enough to act as a firewall for the likes of Italy or Spain, for whom the current EFSF and permanent ESM bail-out funds combined, totalling only €750bn, would be insufficient. Italy, for instance, currently owes just under €2tn and Spain some €700bn.

Without such a debt redemption fund or similar system of eurobonds, which rewards the good performers while penalising the bad, we will continue to have recourse to the ECB, injecting hundreds of billions of euros into the banking system every two or three months. Further, appeals to the IMF or foreign investors for further handouts will only continue, and the hope of an end to the European debt crisis will remain an elusive dream.

The writer is leader of the Liberal and Democrat group in the European Parliament and former prime minister of Belgium