FINANCIAL TIMES

June 11, 2012 7:10 pm

177

We isolate and overload Germany at our peril

By Gideon Rachman

Visiting the Financial Times a couple of weeks ago, Luis de Guindos, Spain's economy minister, predicted: "The battle for the euro will be fought in Spain."

With Spain's decision this weekend to accept international aid to save its banks, the battle is now joined. The stakes are very high. Writing in this paper, Niall Ferguson and Nouriel Roubini warn that Europe is "perilously close" to "repeating the disasters of the 1930s".

As in the 1930s, a conflict in Spain is now seen as critical to a wider struggle for the fate of Europe. It cannot be long before an international brigade of Keynesian economists sets off for Catalonia. Once again, Germany is cast as the villain in a pan-European drama.

Of course, nobody questions modern Germany's democratic credentials. Only in the wilder fringes of the Greek press has Chancellor Angela Merkel been compared to Adolf Hitler. But the picture that emerges from the world's press is of a stubborn Germany, whose actions threaten the world. This weekend's Economist magazine cover showed the global economy as a sinking ship and beseeches Ms Merkel to "start the engines".

The magazine summarises an international "consensus on what Ms Merkel must do", including "shifting from austerity", "a banking union with euro-wide deposit insurance" and a "limited form of debt mutualisation". Privately, world leaders from London to Washington and Rome are urging similar actions on Berlin.

The demands being made of the German government spring from a sincere desire to avoid a rerun of the 1930s, when economic disaster provoked political catastrophe.

However, while these demands may make economic sense, they are politically unrealistic and dangerous. They are textbook solutions that fail the real-world test. Worse, if enacted, they would risk provoking the very political radicalisation they are ultimately meant to prevent.

Consider just one of the proposals on the shopping list: a Europe-wide bank deposit insurance scheme. As a senior Dutch politician who shares the German view, puts it: "We cannot push through a banking union when the French have just cut their retirement age to 60 and we have raised ours to 67." From the Dutch and German point of view, it is unfair for their citizens to underwrite the banks of countries using their own money to pay social benefits that are more generous than those on offer in Germany or the Netherlands.

This dilemma illustrates why a relatively technical-sounding exercise such as bank-deposit insurance has profound implications for national sovereignty. Once you take a big step towards the mutualisation of debt across Europe, you are forced towards much deeper political union. It is not just the much-discussed need for a European "minister of finance", with the power to override national governments. To avoid bitter disputes over fairness, you would also need to harmonise European social-security systems. That would be the work of decades.

The Merkel government is not ruling out eurozone bonds or EU deposit insurance for ever. It is arguing that any such moves can come only as part of a bigger project – the formation of a political union. Anything else will feel like giving southern Europe a German credit card, without setting a credit limit.

It is hard to see how European politicians could achieve such profound reforms within weeks or months – as the Americans and others are urging. A recent Pew opinion poll showed strong majorities across Europe against ceding national sovereignty over budgetary matters to a central authority. The same poll showed that Ms Merkel was widely admired – not just in Germany but across Europe.

On this, the public shows more sense than the intellectuals who are lining up to give Berlin a kicking. While Ms Merkel's handling of the crisis has not been faultless (whose has?), she has one huge achievement to her name. She has prevented the political extremes from gaining a foothold in the country.

Anybody who thinks that is a phantom danger should take a look at Germany's neighbours. In France, a third of the electorate recently voted for a far-right or a far-left candidate for the presidency. In the Netherlands – like Germany, a creditor nation that is sick of bailing out southern Europe – the far right and the far left are running first and second in the opinion polls. In Austria, the far right are at nearly 30 per cent in the polls.

Germany has all the conditions for a similar backlash. The country's voters have every reason to feel misled about the euro. They were once promised that the single currency involved a no-bailout clause that would prevent German taxpayers from having to support other eurozone countries. But Germany has already had to accept potential liabilities of €280bn to fund Europe's various bailouts – and there will be further demands to come. Simply funding Germany's capital contribution to the European Stability Mechanism will increase the country's budget deficit this year from €26bn to €35bn.

And yet despite the burdens and risks that Germany has already taken on, the country's government finds itself abused for not doing even more. Isolating and berating Berlin, while trying to force the country to underwrite the finances of the whole of the eurozone, is a politically dangerous course. The rise of far-right nationalists in Greece or the Netherlands is deeply regrettable. The rise of the far right in Germany would be a disaster.

You may be interested in

Berlin is ignoring the lessons of the 1930s

Cameron to urge Merkel to act on eurozone

Spanish government no longer in denial

A Eurobond medicine Ms Merkel could swallow

Bundesbank: Germany walks fine line in euro crisis

Printed from: http://www.ft.com/cms/s/0/bfc6959c-b158-11e1-bb9b-00144feabdc0.html

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© **THE FINANCIAL TIMES LTD 2012** FT and 'Financial Times' are trademarks of The Financial Times Ltd.