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Restoring confidence

by Michael Heise

The EU justifies the colossal stabilization mechanism for the euro with exceptional events beyond the control of the state (Article 122 of the Lisbon Treaty). The financial markets and the real economy had indeed become parallel worlds in recent weeks. Of late the news from the real economy has been overwhelmingly positive, even the “potential crisis candidates” Spain and Italy reported economic growth and Greece a marked drop in new borrowing. But the financial markets remained unimpressed, increasingly questioning the willingness to consolidate and the competitiveness of a number of EMU member states. When the interbank markets also got caught up in the maelstrom, a downward spiral loomed.

For the time being, the stabilization package has interrupted the chain reaction. But it is hopefully clear to all parties that, however large the sums involved, the mechanism can only buy time to address the real problem, namely restoring market confidence in the manageability of government debt. This calls for swift and courageous steps: firstly, forceful and credible consolidation and reform programs on the part of debt-laden countries. The austerity measures already announced should be swiftly followed by structural reforms. We are in the midst of a crisis of confidence, in which there is no genuine alternative to slashing deficits. Secondly, the EU should not make do with minor modifications to the Stability and Growth Pact which has proved to be a toothless tiger. More information rights for Eurostat or a tightening of sanction procedures are fine, but do not take reform far enough. This should include: Requirement on all EMU countries to present binding long-term plans outlining when the public-sector deficit will be reduced to zero (not 3%), accompanying spending plans for various growth scenarios, control and intervention rights of a newly-created institution (e.g. a Finance Commissioner under the aegis of the EU Council), stiffer sanctions including potential exclusion from monetary union. If policymakers show the same grit as they did when setting up the stabilization mechanism, markets could indeed quickly regain confidence in the medium-term reduction of debt. The picture in the euro area is by no means worse, in fact in many respects better than in the USA or indeed Japan. In the positive scenario, with spirited reforms, the mechanism could remain purely a deterrent against speculation without having to be activated. In the absence of reforms, the EU will be weakened even with the mechanism or, rather, precisely because of the mechanism, as a form of collective debt assumption would create completely wrong incentives. Of course, the steps needed at national and European level will require much political strength and courage. But if, even in the gravest crisis, the eurozone does not manage to launch a new era of fiscal discipline and cooperation, the euro-critics predicting disintegration of the euro area will be proved right. We should not let it come to that.

The author is chief economist at Allianz