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THE OMFIF COMMENTARY



A BACKGROUND BRIEFING ON THE STORIES BEHIND
THE WORLD'S ECONOMIC AND FINANCIAL NEWS



Germany is treading a thin dividing line between solidarity towards errant states in the euro area – and solidarity towards its own citizens

By David Marsh

President Nicolas Sarkozy and Chancellor Angela Merkel both announced in Davos that the euro will not fail. The French and German finance ministers have proclaimed that the euro has turned a corner. European leaders are preparing a 'grand bargain' on the future of the European Financial Stability Fund.

But on whose terms will the bargain be? The sceptical tones in Germany are unmistakable: from the anti-inflationary sabre-rattling of German representatives on the Governing Council of the European Central Bank, through to profile-seeking Ministers from the junior coalition partners, the Free Democratic Party plugging a populist 'hard euro'.

In addition, the debate over extended German rescue operations is still heavily influenced by judicial process on various Maastricht treaty lawsuits brought by anti-euro plaintiffs to the Federal Constitutional Court.

Indeed, the observed drying up of ECB purchases of weaker countries' government bonds in the last few days – despite a further rise in Portuguese yields – may have something to do with ECB fears that it is contravening constitutional niceties.

Germany's position over euro rescues is at once terrifyingly simple and terrifyingly complex. A clear commitment by Berlin to widen and deepen the rescue umbrella for troubled states, coupled with an 'economic government' for the euro area (as regularly urged by the French) could end up saving taxpayers a lot of money. As in the Cold War, a potential assailant has to be deterred with the threat of massive retaliation.

But the problem is obvious. The earlier and the more generous such offers of assistance, the lower the willingness of the countries concerned to pursue persistent reforms that will end

up changing matters for the better. So if Germany as the largest euro creditor shows too much German solidarity with the errant states, that could be counter-productive.

Equally, too much solidarity with Germany's own electorate could encourage citizens in problem states to rise up against the lenders and their credit terms – as is already starting to happen in Ireland ahead of early elections later this month. An almost insoluble dilemma – and one that will probably loom ever larger during the euro's 2011 year of destiny.

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