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Home
This week's print edition
Daily news analysis
Opinion
All opinion
Leaders
Letters to the Editor
Columns
KAL's cartoons
Correspondent's diary
Economist debates
World
All world
Politics this week
United States
The Americas
Asia
Africa
Middle East
Europe
Britain
Special reports
Business and finance
All business and finance
Business this week
Economics focus
Management
Economics A-Z
Business education
All business education
Which MBA?
Markets and data
All markets and data
Daily chart
Weekly indicators
World markets
Currencies
Rankings
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All science and technology
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Style guide
People
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Diversions

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Germany

Europe's reluctant paymaster

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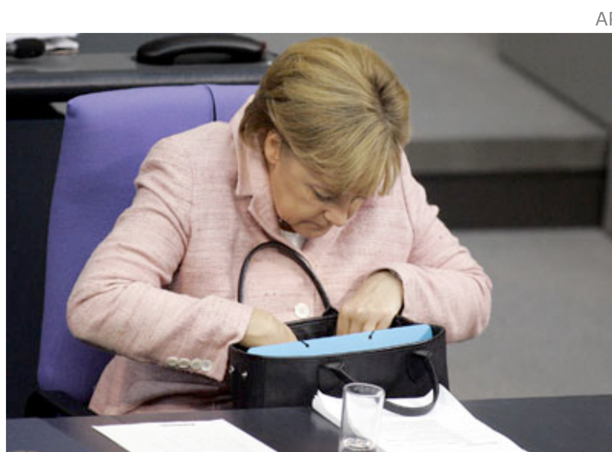
From *The Economist* print edition

The German government may have to concede, through gritted teeth, that it cannot avoid helping financially strapped governments in Europe

AP



ITS place on the map once worried its generals. Now Germany feels encircled by economic menace. To the east lie ex-communist economies suffering from tumbling currencies and a drying-up of foreign capital. To the south and west are countries that are in the euro but have kept their profligate ways. Their cost of borrowing has shot up, stirring fears of default. Some now talk of a possible break-up of the euro area.

At times like these people turn to Germany, the biggest and most creditworthy economy in Europe. Austria, where the banks have risked more than most in eastern Europe, wants the European Union to provide €150 billion ($191 billion) of aid, part of it to countries that are not even members of the EU. Robert Zoellick, president of the World Bank, thinks east European banks need €120 billion of fresh capital, much of which may have to come from western Europe. The clamour for assistance to weaker countries in the euro is almost as loud.

For Germany, this poses a

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Germany's central bank publishes a speech on the financial crisis, delivered by the bank's vice-president on February 23rd (second site in German). See also the European Central Bank.

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dilemma. It championed both the single currency and the EU's eastward enlargement and now sends most of its exports to countries that are in the EU. But such partnerships bring the risk of instability, and Germany has long insisted on safeguards against infection. East Europeans are welcome to buy goods from Germany but not freely to find jobs there. At German insistence, countries in the euro must tame their public finances and cannot be bailed out.

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The credit crunch makes it harder for Germany to practise this form of economic safe sex. In October the finance minister, Peer Steinbrück, brusquely rejected a French-backed plan for a common fund to rescue banks, fearing that Germans would pay for the mistakes of bankers in other countries. Loth to give up its goal of balancing the budget by 2011, Germany was at first reluctant to adopt a fiscal stimulus. Now it is being asked to help partners that did less to control debt or adapt to the euro's discipline. Otmar Issing, a former chief economist of the European Central Bank, spoke for many when he said that making euro members pick up others' debts "would take an axe to the stability of the currency union". Such admonitions can frighten voters, an especially pertinent concern seven months before an election.

Yet Germany may in reality have little choice. On February 16th Mr Steinbrück admitted that some countries in the euro, especially Ireland, were in trouble. If one were in danger of defaulting, he said, "the collective would have to help." These comments were interpreted as a signal that Germany would agree to circumvent the no-bail-out rules. *Der Spiegel*, a magazine, claimed that the Finance Ministry was contemplating several alternatives, including aid from the EU (with tough conditions attached) and a "common bond" that would exploit the financial strength of the most creditworthy to assist the weakest.

Mr Steinbrück was misinterpreted, said his ministry. Countries in difficulty should adopt the "normal policy mix" of reducing budget deficits and improving their competitiveness. Assistance, if required, would be decided case by case; in any event, no country was in immediate danger. Mr Steinbrück's ambiguity may have been deliberate. The mere hint that aid might be available caused the financing costs of weaker countries in the euro to fall.

If conditions worsen, discussion may shift from whether to bail out countries to how. It may paradoxically be easier to help east Europeans than those bound by the euro's no-bail-out rules. The EU, with the IMF and World Bank, has given support to Hungary and Latvia. In November it raised the ceiling for balance-of-payment loans to non-euro countries to €25 billion.

But the idea of a common bond to help weaker countries, which would raise the financing costs of stronger ones, may be a non-starter. "If you want to stir anti-European sentiment, a European bond is the way to go," says Sebastian Dullien, an economist at the University of Applied Sciences in Berlin. Hans Eichel, a former finance minister, suggests instead a lending facility with IMF-style conditions run by the European Commission.

Indeed, bail-outs may be a roundabout means to get the stability Germany craves. Borrowers would have to improve their finances and competitiveness. EU countries, in and outside the euro, would have more reason to co-ordinate economic policies (which for Germany might mean relying less on exports and more on domestic demand). Borrowers outside the EU might inch closer to membership. Europe could "use this crisis to strengthen integration", says Mr Eichel. Perhaps, but only with Germany's help.

Back to top ^^

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