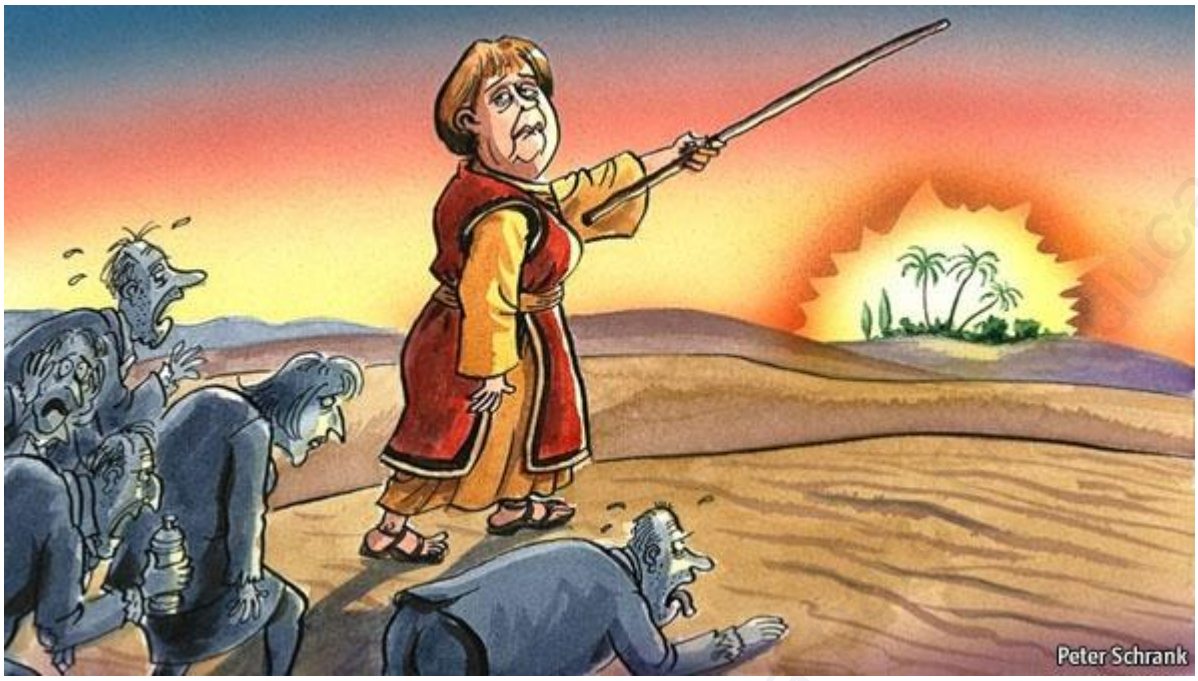
Angela's vision

The promised land that lies ahead keeps receding into the distance



In these times of tribulation for the euro, Germany offers a prophecy. One day, when the euro zone has got beyond the wilderness of austerity and structural reform, it will be rewarded with prosperity. Europe will have worked off its debt and become more competitive. Markets will see that the real problems of the world economy lie in debt-laden America and Japan.

The more the outside world criticises Germany, the more fervently senior German officials cling to this vision. Others have reason for doubt. In the third year of the euro crisis things are getting worse. Even good news brings no relief. Greece avoided the meltdown that an election victory by the anti-austerity Syriza party might have brought. But the new government of Antonis Samaras, leader of the centre-right New Democracy party, may not be able to halt Greece's death spiral. An agreement to give Spain up to €100 billion ($127 billion) of euro-zone loans to recapitalise its banks did not stop the slide for long. Markets jumped at hints from the G20 summit that European rescue funds might start buying Spanish and Italian bonds, but for how long?

All along the fundamental doubt remains. What stands behind the euro: Germany, the European Central Bank (ECB), or nothing at all? Investors in euro-zone bonds want to be sure they will be repaid, and in euros, not devalued drachmas, liras or pesetas. National currencies are backed by national treasuries with the power to tax and central banks with the power to print money. But the euro is a single currency without a single government, and the ECB cannot lend to sovereigns.

For Angela Merkel, the German chancellor, the answer is to show that the single currency is backed by the commitment of all members to budget discipline and structural reform. Cutting debt and boosting competitiveness will, in time, win back market confidence, she says. Quick-fix solutions are ephemeral and often counterproductive. The ECB's €1 trillion of cheap loans for banks was soon exhausted. Fiscal stimulus only adds debt. Enlarging the euro zone's rescue funds raises questions about the creditworthiness of even its most solid backers.

Almost everybody disdains quick fixes. But they favour other routes to the promised land. France and others want some mutualisation of liabilities: a "fiscal union" through joint Eurobonds to cut troubled countries' borrowing costs, a "banking union" to be a joint backstop for the banks. Either of these (preferably backed by the ECB as lender of last resort) could

create a European lifesaver to prevent weak sovereigns and weak banks from drowning each other.

The germ of a banking union is the most likely outcome of the European summit on June 28th and 29th. This is partly because Spanish banks are the biggest threat to the euro right now. The European Commission is already working on essential elements, such as a system to wind up failed banks. Banking integration presents fewer political and legal problems if banks (not taxpayers) pay into a European fund to provide deposit guarantees.

But that may not be enough to stop a Europe-wide run on banks by depositors who fear a currency break-up. Only the full power of sovereigns and central banks can do that. Germany is right to say that, in the end, banking union is the start of fiscal union. Germany may be strong, says Mrs Merkel, but not strong enough to stand behind trillions of euros' worth of European debt. For her, market pressure is the best incentive for belated reforms. After all, it was the decade of cheap credit when financial markets barely distinguished between Greek and German bonds—behaving as if Eurobonds already existed—that created the imbalances that lie behind the crisis.

Germany's price for any mutualisation of liabilities is greater economic and political integration. Do Europeans want a banking union? Better to start with a strong European supervisor to stop the farce of national regulators applying stress tests that hide more than they reveal. Do Europeans want fiscal union? Well, first they should reduce debt levels, and get fit enough to keep up with Germany. In short, European countries must surrender much economic sovereignty before Germans will trust them to share their bank account. The Germans are already debating the future of the European project, including how to make it more democratically accountable. Others would be wise to think beyond just begging them for more unconditional support.

Time is running short

For the moment, Germany will provide no more than limited remedies that, at best, buy more time. There is much to be said for its belief in fiscal stability and reform, but playing for time may do more harm than good. The countries of the euro zone are not going through a normal adjustment. Their crisis is existential. Delay also raises the cost of salvaging the single currency (if Greece is to stay in the euro it will surely need yet another bail-out or debt-restructuring). Procrastination saps confidence in the euro. Loss of confidence, in turn, weakens growth in the core and deepens recession in the periphery.

All this makes it harder for countries to balance their books, antagonises those who must endure austerity and exasperates those who must provide more credit. A chronic crisis, moreover, erodes citizens' belief in the European project, and thus their readiness to accept the integration that is needed to save it.

Austerity and structural reforms will be of little help unless confidence returns. That requires an unequivocal, if limited, sharing of liabilities. The proposal by Germany's council of economic advisers to pool part of the euro zone's stock of debt is a good start. Mrs Merkel is understandably worried about the risks her country would be taking on. But if she does not show faith in the euro's future, neither will the markets.

Fonte: The Economist, London, v. 403, n. 8790, p. 59, June 23th-29th, 2012.