The other moral hazard

If the euro zone is to survive, Germany too must keep its promises to reform

Stitch by stitch, Germany is unravelling the carefully knitted deal that offered the euro zone the best chance yet of overcoming its crisis. Until this week European officials dared to imagine they had got ahead of the markets with two big moves. First, the ECB declared that it will act as a lender of last resort for troubled countries like Spain (if they agree to a reform programme). And second, the euro zone pledged to create a banking union to sever the death loop between weak banks and weak sovereigns. Now that the ECB had averted the threat of the euro breaking up, others have space and time to repair its design flaws.
If only it were so easy. Protests and strikes against austerity have restarted in debtor states, and secessionism is stirring in Spain. Just as worrying, creditor states are showing every sign of going slow, and even reneging, on their promises to strengthen the euro zone. Rückfall, the German word for backsliding, is one reason the euro zone is being pushed back into an acute phase of the crisis.

Start with the conditional promise of intervention by the ECB's president, Mario Draghi. This is designed to hold down a country's borrowing costs, especially for short-dated bonds, and dispel "unfounded fears" about the future of the euro. In his campaign to delegitimise the policy, Jens Weidmann, the Bundesbank chief, has resorted to drawing a parallel between Mr Draghi and Mephisto in Goethe's "Faust". The German government, though in favour of the ECB's scheme, is uncomfortable. It has told Spain not to ask for more help—the essential first step that would allow the ECB to act.

Worse, the Rückfall over banking union seems almost designed to rekindle the crisis. At a summit in June euro-zone leaders declared that it was "imperative to break the vicious circle between banks and sovereigns". To do so, they would create a single banking supervisor "as a matter of urgency". And once established, euro-zone rescue funds could be used directly to recapitalise troubled banks. It is no secret that the plan was meant to help Spain, by shifting some of the burden of supporting crippled banks to the euro zone—retroactively if necessary. Ireland was told it could expect similar assistance.

This bargain was done on terms that Germany has always advocated: more central control in exchange for more solidarity. But even before the European Commission this month rushed out its proposals for a banking supervisor (an offshoot of the ECB), Germany was undermining the deal. Drafts of the commission's plan included a commitment to complement the new supervisor with a euro-zone resolution authority to wind up failed banks (known as Edira), and

a European bank-deposit guarantee scheme (aka, Edgar). Under German pressure, these were removed from the final version.

Many worry that, with the abortion of Edira and Edgar, the ECB will be responsible for overseeing banks but lack the means to deal with the bad ones. At the same time, Germany is fighting the commission's plan for the ECB to have authority to supervise all 6,000-plus banks in the euro zone. Berlin wants to exclude smaller banks, including its own often-troubled regional lenders.

And Germany has tried to slow down the timetable for the supervisor to start work on January 1st 2013, on the grounds that such an important task should not be rushed. Thereafter, direct bank recapitalisation should only take place once the system has shown itself to be effective. This week, Wolfgang Schäuble, the German finance minister, and his über-hawkish colleagues from the Netherlands and Finland, sought greatly to limit the scope of the commitment: direct bank recapitalisation should apply only to new problems, not "legacy assets" and should only be a "last resort", after using private capital and then national funds.

Germany knows it has to look after its own banks, so it wants to limit its liability for those of other countries. Angela Merkel, the German chancellor, has already staked much treasure on helping others. At some point, Germany may have to write off part of the loans it made to Greece. Mrs Merkel already lost her "chancellor's majority" in this summer's vote to lend Spain up to €100 billion ($129 billion) to restructure its banks. She is not rushing back to the Bundestag to ask for more money, not least because any debate would turn to the ECB and Mephisto.

Economics and morality

Mario Monti, Italy's prime minister, quips that, for Germany, "economics is a branch of moral philosophy". Countries must pay for sins of commission (budget deficits) and omission (poor bank supervision). Only then can there perhaps be more European integration to avert problems in the future.

Yet there is little point in worrying about tomorrow's woes when today's crisis is unresolved. Germany is right to fret that relieving market pressure on debtors could create moral hazard and slow down badly needed reforms. Equally, though, moral hazard applies to creditors. When the pressure is off, Germany shows too little urgency about repairing the euro.

There is a cost to delay and prevarication. It is harder for countries to reform without hope that their agony will end. Germany's unwillingness to act except in the most dire moments condemns the euro zone to one acute crisis after another. In the short term Mrs Merkel may thus find herself fighting for re-election next year with the euro zone back in flames. In the longer term a chronic crisis is already creating permanent damage: prolonged economic stagnation and depression in deficit countries, loss of confidence in the credibility of governments and the future of the euro, and increasingly poisonous politics. Germany may fear the "legacy" costs of past mistakes. But it should also worry about the legacy of its hesitation and inaction.

Fonte: The Economist, London, v. 404, n. 8804, p. 61, 29 Set. a 5 Oct. 2012.