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Debating the Common Currency

'Euro Bonds Would Destroy the Euro'

Many in Europe would like to see the introduction of euro bonds to help indebted euro-zone member states borrow money on international markets. Germany, however, has refused. SPIEGEL listens in as two top German economists debate the issue.

SPIEGEL: Hans-Werner Sinn, Henrik Enderlein, do we need shared sovereign bonds, so-called "euro bonds," to end the financial crisis?

Enderlein: By all means. Correctly construed, euro bonds are the best instrument for preventing the collapse of the euro zone.

Sinn: The opposite is true: Euro bonds would destroy the euro zone. If all countries -- regardless of their creditworthiness -- were to pay the same interest rate, the last impediments to excessive state indebtedness would fall away.

Enderlein: If we were dealing with a functioning economic environment, Mr. Sinn, your assumption would be correct. But we have a crisis, and to end it, we need to swiftly restructure the debts of Greece, Portugal and most likely Ireland, as well. We need to give these countries' creditors a reliable type of security. My suggestion would be having one euro bond for every two Greek sovereign bonds. For investors, that would mean a loss of roughly 50 percent. But, in return, they would get a security that banks could deposit as collateral, including at the central bank and for inter-bank transactions.

Sinn: In 1995, shortly before the exchange rates for the euro were fixed, the interest rates on Italian and Spanish debt were on average about 5 percentage points above Germany's. At the end of July 2011, at the height of the turbulence, the difference was only 3.4 percent -- and that at an interest-rate level that is much lower on the whole than it was at that time. These interest-rate differentials are good for the euro zone. Indeed, it was only out of fear of interest-rate premiums that the Italians finally instituted a cost-cutting program after years of disregarding the rules of the Stability and Growth Pact. Euro bonds would eliminate this disciplining effect.

Enderlein: But Mr. Sinn, you can't compare the Europe of 1995 with the one we have today. Back then, each country could pursue its own monetary policies and print money to devalue its own currency. Today, that's no longer possible, which is also why interest rates are lower.

Sinn: The very fact that we have a common currency today is why we need interest-rate differentials in order to keep capital flows in check. Every government has it in its power to bring its public finances into order and, in doing so, to convince its creditors that the money will also be paid back. There is absolutely no reason to communitize debts via euro bonds. Euro bonds are like a little piece of socialism. They don't belong in our economic system.

Enderlein: It doesn't have anything to do with socialism. It's about bringing the absurdly high interest rates that some countries have to pay on today's markets down to a normal level. That obviously has to be tied to certain conditions so that tax revenues go up and state expenditures go down. But the countries need the prospect of growth. What's going to happen when Greece, Ireland, Portugal, Spain and Italy simultaneously pursue the kind of brutal austerity course you're calling for? The economy in the entire euro zone would collapse. Germany would be sucked into the wake of the recession. And, in the end, we would all be worse off.

Sinn: Heavily indebted countries need to finally face reality. They can no longer maintain the artificial boom they've been financing with other people's money.

Enderlein: That's right, but a recession would hit Germany's economy very hard, especially because it's so export-dependent.

Sinn: But our economy is relatively well-positioned. Under the euro, Germany initially lost a lot of capital. The money flowed into the countries on the periphery of Europe, where it fueled economies to the point of overheating. In the meantime, Germany suffered from mass unemployment, lagged behind (in terms of economic performance) and had to implement painful social reforms to get more competitive. Now, during the current crisis, which involves heavily indebted countries, German banks and the other capital investors no longer have faith in what lies beyond the borders. There will once again be investing more in Germany. If we drive the money back abroad with euro bonds, we'll see a return of economic stagnancy while the southern countries will carry on with their inflationary boom.

SPIEGEL: Mr. Sinn, how do you think euro bonds would affect Germany's national budget?

Sinn: Depending on how they were designed, over the long term, their higher interest rates would bring about an additional burden of roughly €30 billion ($43 billion) and possibly up to €47 billion. If euro bonds were designed in a way that made Germany jointly and severally liable, the sum would be smaller -- but at what a price! Then we would bear the whole risk.

Enderlein: It surprises me that you, as an economist, are only looking at part of the equation. When you renovate your house, you don't just calculate the costs associated in doing so. Don't you also calculate what it would cost if the house fell into disrepair? What would it cost Germany if this crisis went on for years or if the euro zone broke apart? You say nothing about the harm we could expect. Incidentally, your figure for the supposed additional costs is highly speculative. A European bond would be coveted around the world. In that case, interest rates would only go up marginally for us, or they could even go down.

Sinn: You view euro bonds as a tool for restructuring. I say that euro bonds would destroy the euro. They would only encourage profligacy. The countries on the periphery would go on living above their means. I'm in favor of keeping the euro.

Enderlein: I'm glad to hear that.

Sinn: The euro is needed for business and trade. If we don't want to damage it even further, we have to put an end to all this debt creation.

Enderlein: There is one possibility for devising euro bonds in such a way that they help crisis-stricken countries without communitizing their debts. The proposal envisions having euro bonds that cover state debt only up to a maximum of 60 percent of GDP. The states would have to finance anything over that with their own sovereign bonds, even if that might require them to pay much higher interest rates. In this way, euro bonds would even have an educational effect. Not allowing one's debt burden to exceed 60 percent of economic output would correspond to the limit laid down in the Maastricht Treaty.

Sinn: But, for the coming years, this kind of rule would only be on paper. The states would take advantage of the euro bonds to gradually exchange their old debts for them -- and to the limit, too. As soon as the first states hit the 60 percent limit, they would do everything they could to raise this limit even further.

Enderlein: That's why it should be a European finance minister, rather than the states, who decides on the limit. The euro bond has to be tied to tough conditions. Deeply indebted countries must give up part of their sovereignty; that's the price they have to pay.

SPIEGEL: And what's the price the Germans will have to pay?

'This Is About Europe's Survival'

Enderlein: Growth is already stagnating in Germany. Losses on the stock markets are affecting all of us. With the euro bond, we would have an effective means of ending the crisis.

Sinn: Effective means? Taken together, Greece, Ireland, Portugal, Spain and Italy have €3.1 trillion in state debt. That's twice as much as German reunification cost. Do you seriously want our children to be liable for those debts?

Enderlein: My children are European, and, taking the long view, an Italian default would be much more expensive for them than introducing euro bonds. You, Mr. Sinn, say you're in favor of the euro. But, at the same time, you intend to do as little as possible to help it survive. You only like the euro as long as it doesn't cost us Germans anything. But that's not how it works.

Sinn: With euro bonds, you are creating a danger of contagion via public finances. It's a basic principle of the market economy that one is liable for the decisions that one takes. In the mid-1970s, New York was forced to put its tax revenues up as security because no one lent a hand.

Enderlein: But the United States is a federation which keeps everything together. Why don't we try to follow that example?

SPIEGEL: Mr. Sinn, are you opposed to increased European integration?

Sinn: No, on the contrary, I share the vision of the United States of Europe. If we can create a European federation with the appropriate constitution, I'm all for it. But, first, the voices of all the inhabitants of EU countries need to have equal weight. "One man, one vote," as the Americans say. Germany is underrepresented in practically all EU bodies.

Enderlein: German already has a veto right on all key issues. But, yes, let's strengthen the European institutions!

SPIEGEL: Should Greece return to using the drachma, its former currency?

Sinn: Greece is far too expensive to be competitive. It has to become cheaper by about 20 to 30 percent, but that can't be pulled off with the euro. Without long-term assistance, things could get like they were during the Weimar Republic in Germany. Greece would be driven to the brink of civil war.

Enderlein: A return to the drachma makes this scenario much more likely. The country could never service its high euro-denominated loans, and the banking system would be broken. Giving the Greeks a chance will require a haircut, euro bonds and tough constraints on economic policies there.

Sinn: The fact that the country is too expensive doesn't change the slightest thing. There's no alternative to a devaluation. If Greece abandons the euro, the balance sheets of a few banks might go up in flames, but at least the bank buildings themselves will remain intact. The worst would be over after six months. Then, Greece's economy could grow like that of Turkey, which has always kept itself competitive by devaluing its lira. If Greece retains the euro, it will never stand on its own two feet. The country would be permanently dependent on others.

Enderlein: That's exactly what the American government thought when it decided to let Lehman Brothers go broke -- that it would be a purifying storm and then the matter would be settled. As we now know, they had misjudged the situation.

Sinn: A case like the Lehman one can never happen again. In 2008, an agreement was made in Washington to rescue the banks that are too big to fail. The financial market got moving again. This agreement is still valid.

Enderlein: It's nice that you have so much faith. On the drawing board, it might not seem like such a bad idea for Greece to launch a clandestine, overnight operation to reintroduce the drachma and start over again at zero. But, in reality, things wouldn't go that way. The Greek parliament would have to decide on it, and it would be debated for a long time. Meanwhile, you would trigger an exodus of capital from Greece and Europe with incalculable consequences. For me, the risks associated with that kind of experiment are too big. Instead, we should build a functioning euro zone.

SPIEGEL: Is the "true economic government" that German Chancellor Angela Merkel and French President Nicolas Sarkozy have proposed a step in this direction?

Enderlein: Yes, but a small one. We need a whole new dimension of European integration. Part of that are common economic policies and a European finance minister whose job it is to make sure that individual countries can no longer just do what they want when it comes to their financial and tax policies. I don't want harmonization but, rather, minimum standards when it comes to things such as taxes and retirement ages. It can't be that one country with a ridiculously low corporate tax rate, such as Ireland, gets money from the rest of Europe.

Sinn: I agree. Merkel's proposal that European countries anchor debt brakes (into their constitutions) is also a good idea. But it would be more important to create a framework that would allow for orderly national bankruptcies.

SPIEGEL: What do you propose?

Sinn: I propose that we help the crisis-stricken countries step by step, to a limited degree and only when their creditors are willing to relinquish a portion of their claims. At a fundamental level, the countries have to learn to live without our loans. The German taxpayer cannot ensure the living standard of people in these countries over the long term.

Enderlein: My feeling, Mr. Sinn, is that your economic thinking is too nationally based. We live in a world whose regions and currency zones are so closely intertwined that problems in neighboring countries become our problems as well. That obliges us to find a solution for Europe as a whole.

Sinn: Previous decisions have already made Germany liable for almost €400 billion. And now there is also the issue of an additional €3.1 trillion that we are supposed to be joint and severally liable for. At some point, even Germany's power is exhausted. It's about the survival of our political system. You shouldn't forget that.

Enderlein: It's about Europe's survival.

SPIEGEL: Mr. Enderlein, Mr. Sinn, thank you for speaking with us.

Interview conducted by Alexander Neubacher. Translated from the German by Josh Ward.