

The eurozone really has only days to avoid collapse

By Wolfgang Münchau ([FT](#))

In virtually all the debates about the eurozone I have been engaged in, someone usually makes the point that it is only when things get bad enough, the politicians finally act – [eurobond](#), debt monetisation, quantitative easing, whatever. I am not so sure. The argument ignores the problem of acute collective action.

Last week, the crisis reached a new qualitative stage. With the spectacular [flop of the German bond auction](#) and the alarming [rise in short-term rates](#) in Spain and Italy, the government bond market across the eurozone has ceased to function.

More

The banking sector, too, is broken. Important parts of the eurozone economy are cut off from credit. The eurozone is now subject to a run by global investors, and a [quiet bank run](#) among its citizens.

This massive erosion of trust has also destroyed the main plank of the rescue strategy. The [European Financial Stability Facility](#) derives its firepower from the guarantees of its shareholders. As the crisis has spread to France, Belgium, the Netherlands and Austria, the EFSF itself is affected by the contagious spread of the disease. Unless something very drastic happens, the eurozone could break up very soon.

Technically, one can [solve the problem even now](#), but the options are becoming more limited. The eurozone needs to take three decisions very shortly, with very little potential for the usual fudges.

First, the European Central Bank must agree a backstop of some kind, either an unlimited guarantee of a maximum bond spread, a backstop to the EFSF, in addition to dramatic measures to increase short-term liquidity for the banking sector. That would take care of the immediate bankruptcy threat.

The second measure is a firm timetable for a eurozone bond. The

European Commission calls it a “[stability bond](#)”, surely a candidate for euphemism of the year. There are several proposals on the table. It does not matter what you call it. What matters is that it will be a joint-and-several liability of credible size. The insanity of cross-border national guarantees must come to an end. They are not a solution to the crisis. Those guarantees are now the main crisis propagator.

The third decision is a [fiscal union](#). This would involve a partial loss of national sovereignty, and the creation of a credible institutional framework to deal with fiscal policy, and hopefully wider economic policy issues as well. The eurozone needs a treasury, properly staffed, not ad hoc co-ordination by the European Council over coffee and desert.

I am hearing that there are exploratory talks about a compromise package comprising those three elements. If the European summit could reach a deal on December 9, its next scheduled meeting, the eurozone will survive. If not, it risks a violent collapse. Even then, there is still a risk of a long recession, possibly a depression. So even if the European Council was able to agree on such an improbably ambitious agenda, its leaders would have to continue to outdo themselves for months and years to come.

How likely is such a grand deal? With each week that passes, the political and financial cost of crisis resolution becomes higher. Even last week, [Angela Merkel](#) was still ruling out eurobonds. She was furious when the European Commission produced its own proposals last week. She had planned to separate the discussion about the crisis from that of the future architecture of the eurozone. The economic advice she has received throughout the crisis has been appalling.

Her own very public opposition to eurobonds has now become a real obstacle to a deal. I cannot quite see how the German chancellor is going to extricate herself from these self-inflicted constraints. If she had been more circumspect, she could have travelled to the summit with the proposal of the German Council of Economic Advisers, who produced a clever, albeit limited and not

yet fully worked-out-plan. They are proposing a “debt redemption” bond – another candidate for this year’s top euphemism award. The idea is to have a strictly temporary eurobond, which member states would pay off over an agreed time period. At least this proposal would be in line with the more restrictive interpretation of German constitutional law.

Ms Merkel’s hostility to eurobonds certainly resonates with the public. Newspapers expressed outrage at the commission’s proposal. I thought both the proposal itself and its timing were rather clever. The Commission managed to change the nature of the debate. Ms Merkel can get her fiscal union, but in return she will now have to accept a eurobond. If both can be agreed, the problem is solved. It is the first intelligent official proposal I have seen in the entire crisis.

I have yet to be convinced that the European Council is capable of reaching such a substantive agreement given its past record. Of course, it will agree on something and sell it as a comprehensive package. It always does. But the half-life of these fake packages has been getting shorter. After the last summit, the financial markets’ enthusiasm over the ludicrous idea of a leveraged EFSF evaporated after less than 48 hours.

Italy’s disastrous bond auction on Friday tells us time is running out. The eurozone has 10 days at most.