

operational blindness in the eurocrisis

One of the main obstacles in the eurocrisis is the economic dogma of the free market. The free market would always be right. Any violation of the dogma is cursed. This is a fatal policy.

The debt problem

The industrialized countries are in debt. The United States, Japan and several European countries have large debts. Not only the households have got into too large debts, but also the governments. They have put out bonds and get in serious troubles. The markets lose their confidence in the debtors and withdraw. The interest rates for bonds increase. This makes it difficult for governments to pay off. But also the market values of old bonds decrease if the interest rate increases. The financial institutions of a country possess these bonds and get in a position of lower ratings. A lower rating by the rating agencies undermines the confidence by the market further. More capital flight will follow. The whole process is unstable. The one step provokes the next. How will the process end?

Guarantee funds

The classic way out from such a situation is a large buffer stock, a 'big bazooka'. Several large countries contribute to a buffer of capital. A country in payment problems obtains money from that buffer fund. So it may meet its obligations and gain time to arrange a reorganization of its financial management. Well known are the IMF and the recent European funds. Alas today the guarantee behind a big bazooka is a problem. The United States are in debt, both the households and the central government. After the crisis of 2008-09 the shortage of export increases. So the United States, the traditional guarantee behind the IMF, have their own debt problems. Japan has a government debt of more than 200% of its GDP. Will China solve the problem? The capital flow from China, with its export excess, is one of the causes of the American debt problem and several years ago the US government desired less capital supply from China. May India or Brazil contribute? Who knows, if one waits several decades. The guarantee behind a big bazooka is no easy matter. Now there are the high interest rates for Spain and Italy. For the rescue of these countries during several years the available funds may be insufficient. Germany, with its export excess, may contribute. But the support for this policy by the German public is problematic.

Let the governments set their own interest rate

May the debt problem be solved by putting aside the holy principle of the free market? A European government may oblige its domestic financial institutions to buy portions of its bonds, against a moderate interest rate. In the first place the states rescued the trade banks in the crisis of 2008. So a reverse rescue of the state by the trade banks seems not to be unfair. But also the self-interest of the financial institutions may play a role. Which trade bank

would be happy with a crash of its whole country? If a ship leaks, all the passengers have interest in keeping it floating. How will the free market, the secondary trade of the state bonds, react on this policy? If the governments reduce the risk of getting bankrupt, the premium for the risk may decrease. So the secondary market will react with lower interest rates. Of course the banks will desire a solid financial policy by the government. The trade banks will require the necessary budgetary reorganizations. A government will not escape from a sound budget policy. But it may gain time and tolerable interest rates.

Let the market follow the government initiative

The fatal point is that the governments are used to follow the market. The interest rates by the free market are their leading principle. That policy should be left. The governments should take the lead and manage the interest rate for their new bonds. Then the free market will follow the lower rates, as the risk of the bonds has been diminished. The current policy of the euro countries is to follow the free market. This shows an operational blindness. When the governments manage the interest policy, they reduce the risk and bring the secondary market to moderate interest rates. The initiative should move from the market to the governments.

External or internal solutions?

The debt problem of a country may be solved externally or internally. A country may obtain financial guarantees from abroad. Then it is a central question how far the debt country may be compelled to meet its obligations. Suppose that a debt country receives help and then refuses to satisfy the conditions. What are the power resources for the lending countries if the debtor fails? In the eurocrisis there is the possibility that a country obtains help and then leaves the eurosystème, introduces an own currency unit and devaluates. The foreign lenders are left with a damage. An internal solution of the crisis is safer. If a government in debt comes to an agreement with its own trade banks, both parties are tied to each other. No country will ruin its economy by damaging its own banks, but also no bank will earn profit by the ruin of its government. In an internal solution of the debt crisis both parties sail on the same boat. That makes an agreement safer than an external help strategy. Also an offered security in a transaction is more realistic when domestic, than at another side of the world. An internal solution may bring the safety that an external solution never can give.

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july 2012, revised august 2012

chart: divergence of the interest rates in the eurosystème

