



Germany's 'Self-Defeating' Policies Toward Southern Europe

Adam S. Posen assesses the impact of Germany's pursuit of costly terms for bailing out Greece, Cyprus, and other troubled economies in Europe.

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Steven Weisman: The tumultuous situation with the Cyprus debt crisis has come to a boil. This is Steve Weisman at the Peterson Institute for International Economics with Adam Posen, president of the Institute, to discuss a very important aspect of that crisis: the role of Germany. Adam, many analysts said, that Germany played perhaps even an outsized role in dictating the terms of the rescue on to Cyprus. That has caused a lot of anger in Cyprus directed at Chancellor Angela Merkel. What do you make of that?

Adam Posen: I think both the attention and some of the anger are merited, Steve. Throughout the euro crisis throughout the last few years, it has been the German government, particularly Chancellor Angela Merkel, who has been making a number of the calls. And she unquestionably is pro-European and wants the euro and wants Europe to succeed. And as my colleagues, Jacob Kirkegaard and Anders Aslund, who you've interviewed many times, have said, you know, she has a strategy here.

The problem is the strategy consists of brinkmanship in every case up to the last minute, trying to extract the maximum accommodations and so-called reforms out of whoever is on the other end -- be it Ireland, Portugal, Greece, Spain, or now Cyprus; and clearly trying to do the maximum amount to protect German assets and German savers. You know, nice work if you can get it.

But in a supposedly equal union of sovereign member states, when it just seems to be happening through arbitrary bullying time after time, with no consistent rules and no consistent process and no democratic accountability, it starts to become a problem. So it may be delivering stabilizing or decent economic results, that's debatable. But it certainly is reinforcing the impression that the big player is calling all the shots and it's not an equal union.

Steven Weisman: What was Germany actually demanding of Cyprus in terms of the sacrifices or the cost that the banks or the citizens of Cyprus had to pay in order to get bailed out by the so-called Troika of the European authorities and the IMF?

Adam Posen: I think the key thing that was new with Cyprus, but not entirely new, was to say that depositors, at least the richer depositors in the banks, and bank shareholders and bank bondholders and bank management had to put or sacrifice the money. It wasn't going to be a pure protection of the savers and a shifting of the bank losses onto government balance sheet.

Now in theory, one can make an argument, that is actually a good thing to do both in ethical terms -- it's also not hammering the small savers -- and in terms of what economists call moral hazard, teaching people to pay attention to where they put their money, whose banks take deposits from whose mafia, and things like that.

But this was again framed as sort of an arbitrary last-minute demand in the part, seemingly reflecting German popular opinion about sticking it to the banks and not any principled decision by the Troika on what is the right way to bail in or bail out involved parties.

Steven Weisman: Where would you come down on how much cost should be borne by the creditors and the stakeholders in Cyprus in this case?

Adam Posen: I think like most people, I was very shocked by the idea that there should be a tax on depositors who have deposits less than the euro area wide deposit insurance limit of €100,000. That is wrong on a number of levels. I think the “bailing in” of other depositors, particularly since many depositors in Cyprus were using Cypriot banks to avoid paying taxes and launder money, I mean frankly, is somewhat desirable.

But the bottom line is as a number of our people have written about going back to the so-called PSI decision, the private sector involvement decision, with Greece a year and a half ago. If you do this in each case rather than doing this on a Europe-wide standard, you have the propensity to provoke panic. It hasn't quite happened yet. That's probably good for the short term. But if I were a Portuguese or a Spanish bank depositor now, I'd be worried that my deposits were not as safe as I thought they were. Again, it's not really about who the German government has chosen to hit. It's about how you do it rather than doing it all at once on everybody.

Steven Weisman: But Germany remains the most powerful economy in Europe. You've studied Germany for decades. The internal politics with an election in the offing have driven Chancellor Merkel's response to some degree. Do you worry that, as you mentioned earlier, Germany is overlooking the need to be statesmanlike and to show solidarity toward the troubled economies on the southern tier of Europe?

Adam Posen: No, indeed, Steve, I think Germany is pursuing what ultimately will be seen as a self-defeating policy. It's not really just the elections. I want to push back against that. It is pandering to the German public opinion. And you can say it's about the election. But European policy and willingness to accommodate or show solidarity with the troubled southern countries has been driven entirely by German public opinion years before the elections.

There is no question in my mind that Germany and Europe would both be better off if Germany had cut a more generous deal with each of these countries. What do I mean by a more generous deal? More of the losses from the bailout showing up on the German budget, because it was German banks and Austrian banks and French banks and Dutch banks that made a lot of the bad loans rather than having them show up on the balance sheets of all these poor countries' governments, and more fiscal transfers than are currently underway.

Why is this better for Germany and better for Europe? Three reasons: First, just as with mortgage restructuring in the U.S., when you have a set of bad loans that are unpayable overhanging in economy, it's very tough to recover. If these loans had been restructured so that the bulk of them were owed by the people who did the borrowing, but they weren't so insurmountably large, just as if the banks in the U.S. had restructured the mortgages of people, you would have a faster recovery, which would be better for everyone.

Second, the issue of moral hazard runs in both directions. Germany has set up a system where the banks in northern Europe are getting off scot-free. We're punishing the Cypriot banks, but large numbers of German, Dutch, French, Belgian, Austrian banks are not being punished for their bad loans. And that's going to cause problems in the future.

Third, going back to where you started, it's politically disruptive. It's saying that there isn't solidarity in Europe, or there's only solidarity on German terms, and it's all limited by how much Germany is willing to give, which is not a very European notion.

Steven Weisman: Thank you very much, Adam.

Adam Posen: Thank you, Steve.

