**Europe Needs a Gestalt Shift**

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Angela Merkel has gained support for measures to penalise EU member states with debt in excess of 60% of GDP – the nominal limit of the stability and growth pact or SGP – while Germany has introduced a balanced budget provision into its constitution.

This is not unrelated to debt in German - *Schuld* - also meaning guilt. Yet what is needed also is German - a *Gestalt* shift to recognise that while EU member states are deep in debt since salvaging banks and hedge funds, the European Union itself has next to none. It had none at all until May this year when the European Central Bank began to buy up tranches of some member states' national debt.

But this both costs, and is not working. Spreads on Greek bonds have risen to 10% which is unsustainable. A serial default of several eurozone member states is in prospect.

A simpler and costless solution would be to cut the Gordian knot on national debt by transferring a share of it to the European Central Bank. If this were up to 60% of GDP, as allowed by the stability and growth pact, it would reduce the default risk for the most exposed member states, lower their debt servicing costs and signal to financial markets that European governments have a proactive response to the current crisis rather than are passive victims of unelected credit rating agencies.

A 'tranche transfer' would not be a debt write-off. The member states whose bonds are transferred to the ECB would be responsible for paying the interest on them, but at much lower rates.

Yet debt stabilisation alone is not the answer to Europe's current crisis. EU governments are aiming to cut both debt and fiscal deficits on a scale which threatens beggar-my-neighbour deflation, denies their 2008 commitment to a European Economic Recovery Programme, risking a double dip recession and massive crisis of confidence both on markets and in governments.

What is needed is to learn up from the Roosevelt New Deal, whose success gave Truman the confidence to fund the Marshall Aid from which Germany herself was a beneficiary. The key to it was borrowing to invest through US Treasury bonds. These do not count on the debt of US states such as California or Delaware. Nor need European bonds count on the debt of EU member states.

Many economists have claimed that Europe cannot save itself unitl it has fiscal federalism to transfer resources from stronger to weaker member states. Germany is strongly opposed to this. Yet Europe neither needs such fiscal federalism nor the 'economic government' called for by Nicholas Sarkozy to finance a New Deal style recovery programme. The institutions and powers already are in place.

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The European Investment Bank - already twice the size of the World Bank - issues bonds which are its liability rather of member states, which is why national governments need not count funding from it on their national debt.

From 1997 the EIB has been given a joint cohesion and convergence remit by the European Council to invest in health, education, urban regeneration, green technology and support for small and medium firms. Since when it has quadrupled its annual lending to €80 billions or two thirds of the ‘own resources’ of the European Commission and could quadruple this again by 2020 which would be equivalent in funding terms to postwar Marshall Aid.

The EIB only co-finances investments. But this could be matched by net issues of EU bonds or € bonds by the ECB which would attract surpluses from the central banks and sovereign wealth funds of emerging economies and stabilise the eurozone. When Jacques Delors proposed such bonds in 1993 both Germany and France were opposed. Now only Germany is so.

Nor does this depend on the ECB rather than governments. The Lisbon Treaty confirms that the ECB’s primary objective shall be to maintain price stability. But also that ‘without prejudice to that objective, it shall support the general economic policies of the Union in order to contribute to the achievement of the latter's objectives’.

This mirrors the constitution of the Bundesbank which obliges it ‘to support the general economic policies of the government’ while the European Council also is Treaty empowered to define ‘general economic policies’ of which one already is the European Economic Recovery programme. With the EU heading for recession there is no risk to price stability.

This calls for a German *Gestalt* shift both on debt stabilisation and on issuing EU bonds. Or, if Germany will not shift, their introduction - like the euro itself - by some rather than all member states both to safeguard the eurozone and to make a reality of a European recovery programme.

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