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Requirements Concerning the Financial Restructuring of the Euro Countries

Debt Brake Plus Side Conditions

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Key Points

- The main causes of the Euro crisis lie in the irresponsible indebtedness policy of the affected Euro states and in the real economy structures which threaten not only the creditworthiness of those states but of entire economies.
- A lasting solution to the Euro crisis is possible only if:
  - the Euro states restructure their state budgets;
  - the Euro states accomplish real economy reforms;
  - the too-big-to-fail problem with financial institutions is solved; and
  - if credits to states are granted in a risk-sensitive manner.
- The Stability and Growth Pact (SGP) has failed as a tool to ensure solid state budgets. The planned fundamental reform of the SGP, which was intended to force states to restucture their state budgets, failed. The introduction of debt brakes at national level would be an alternative solution.
- In principle, anchoring debt brakes in national constitutions is appropriate for prompting states to reduce non-sustainable debts.
- However, as a condition it is not enough. More important than the concrete definition of constitutional debt brakes is their public acceptance.
- Debt brakes have an impact only if flanked by the following measures:
  - States threatened by insolvency must urgently adopt real economy reforms in order to enhance their competitiveness and thus remove current account deficits. Only then can the overall economic credit demands – of which state demands make up only a part – be reduced to an acceptable level. A further requirement is the reduction of inflated unit labour costs.
  - The risk that systemically relevant financial institutions must be saved by the states undermines the ability to comply with debt brakes. Therefore, this risk must be minimized, in particular through sufficient capital requirements and European rules for winding up insolvent institutions.
  - The granting of credits by financial institutions must be risk-oriented. The rules on capital deposit must be amended so as to ensure that financial institutions also cover the default risk of investments in state securities with their own capital.
- The German Bundestag should link its approval of financial aid – within the framework of the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) – to the condition that the state demanding help anchors a debt brake in its constitution before applying for financial aid, and that it has initiated profound real economy reforms.