

SAVING THE EUROPEAN UNION: ARE EUROBONDS THE ANSWER?

A DEBATE BETWEEN GEORGE SOROS AND
HANS-WERNER SINN¹

In a speech given at the Goethe University, Frankfurt on 7 April 2013 and in a Project Syndicate contribution that was published online by The Guardian on 9 April 2013, US investor George Soros argues that Germany should accept Eurobonds or exit the euro. In his reply Hans-Werner Sinn firmly rejects this claim.

George Soros

How to save the European Union

The euro crisis has already transformed the European Union from a voluntary association of equal states into a creditor-debtor relationship from which there is no easy escape. The creditors stand to lose large sums should a member state exit the union, yet debtors are subjected to policies that deepen their depression, aggravate their debt burden and perpetuate their subordinate position. As a result, the crisis is now threatening to destroy the European Union. That would be a tragedy of historic proportions which can only be prevented with German leadership.

The causes of the crisis are so complicated that they boggle the mind. They cannot be properly understood without realising the crucial role that mistakes and misconceptions have played in creating them. The fatal flaw of the euro is that by creating an independent central bank, member countries have become indebted in a currency that they don't control.

¹ George Soros is Chairman of the Soros Fund Management and of the Open Society Foundations, New York. Hans-Werner Sinn is President of the Ifo Institute. Copyright Project Syndicate 2013.

The risk of default relegates some member countries to the status of third world countries that became over-indebted in a foreign currency. This feature of the euro was ignored both by the authorities and market participants until the Greek crisis and it is still not properly understood today.

At first, both the authorities and market participants treated all government bonds as if they were riskless, creating a perverse incentive for banks to load up on the weaker bonds. When Greece revealed the extent of its deficit, financial markets discovered the risk of sovereign debt default and raised risk premiums not only on Greek bonds but on the bonds of all heavily indebted euro members with a vengeance. Since European banks were heavily loaded with exactly those bonds, this precipitated a twin sovereign debt and banking crisis.

Subsequently the so-called periphery countries were treated as if they were solely responsible for their misfortunes and the structural defects of the euro remained uncorrected. Germany and the other creditor countries did the minimum necessary to preserve the euro but they continued to apply the treaties that proved to be flawed and imposed new rules that prolonged and aggravated the recession. The pain and suffering is almost entirely self-inflicted by the eurozone. It has the quality of a nightmare.

The burden of responsibility falls mainly on Germany. The Bundesbank helped design the blueprint for the euro, whose defects put Germany into the driver's seat. This has created two problems. One is political, the other financial. It is the combination of the two that has rendered the situation so intractable.

The political problem is that Germany did not seek the dominant position into which it has been thrust and it is unwilling to accept the obligations and liabilities that go with it. Germany understandably doesn't want to be the 'deep pocket' for the euro. So it extends just enough support to avoid default but nothing more, and as soon as the pressure from the



financial markets abates it seeks to tighten the conditions on which the support is given.

The financial problem is that Germany is imposing the wrong policies on the eurozone. Austerity doesn't work. You cannot shrink the debt burden by shrinking the budget deficit. The debt burden is a ratio between the accumulated debt and the GDP, both expressed in nominal terms. And in conditions of inadequate demand, budget cuts cause a more than proportionate reduction in the GDP – in technical terms the so-called fiscal multiplier is greater than one. This means for every that for every million euro reduction in the budget deficit, the country's GDP falls by more than a million euros, leading to a rise in the ration of national debt to GDP.

The German public finds this difficult to understand. The fiscal and structural reforms undertaken by the Schröder government worked in 2006; why shouldn't they work for the eurozone a few years later? The answer is that austerity for a single country works by increasing its exports and reducing its imports. When everybody is doing the same thing it simply doesn't work: it is clearly impossible for all members of the eurozone to improve their balance of trade with one another.

In the bailout of Cyprus, Germany went too far. In order to minimise the cost of the bailout it insisted on bailing in bank depositors. This was premature. If it had happened after a banking union had been established and the banks recapitalised, it might have been a healthy reform. But it came at a time when the banking system was retreating into national silos and remained very vulnerable. What happened in Cyprus undermined the business model of European banks, which relies heavily on deposits. Until now the authorities went out of their way to protect depositors. Cyprus has changed that. Attention is focused on the impact of the rescue on Cyprus but the impact on the banking system is far more important. Banks will have to pay risk premiums that will fall more heavily on weaker banks and the banks of weaker countries. The insidious link between the cost of sovereign debt and bank debt will be reinforced and a banking union that would re-establish a more level playing field will be more difficult to attain.

Chancellor Merkel would have liked to put the euro crisis on ice at least until after the elections, but it is

back in force. The German public may be unaware of this because Cyprus was a tremendous political victory for chancellor Merkel. No country will dare to challenge her will. Moreover, Germany itself remains relatively unaffected by the deepening depression that is enveloping the eurozone. I expect, however, that by the time of the elections Germany will also be in recession. That is because the monetary policy pursued by the eurozone is out of sync with the other major currencies. The others are engaged in quantitative easing. The Bank of Japan was the last holdout but it changed sides recently. A weaker yen coupled with the weakness in Europe is bound to affect Germany's exports.

The solution for all these problems of the eurozone can be summed up in one word: Eurobonds. If countries that abide by the fiscal compact were allowed to convert their entire stock of government debt into Eurobonds, the positive impact would be little short of the miraculous. The danger of default would disappear and so would the risk premiums. The balance sheets of the banks would receive an immediate boost and so would the budgets of the heavily indebted countries. Italy, for instance, would save up to 4 percent of its GDP. Its budget would move into surplus and fiscal stimulus would replace austerity. Its economy would grow and its debt ratio would fall. Most of the seemingly intractable problems would vanish into thin air. It would be truly like waking from a nightmare.

With some modification, the fiscal compact would provide adequate safeguards against the risks involved in a joint and several obligation. It would allow member countries to issue new Eurobonds only to replace maturing ones, but nothing more; after five years the outstanding debt would be gradually reduced to 60 percent of GDP. Non-compliant countries would be penalised by restricting the amount of Eurobonds they are allowed to issue, forcing them to borrow the balance in their own name and pay heavy risk premiums – a powerful inducement to adhere to the fiscal compact's terms.

Eurobonds would not ruin Germany's credit rating. On the contrary, they would favorably compare with the bonds of the United States, Britain and Japan.

Eurobonds are not a panacea. First of all, the fiscal compact itself needs some modifications to ensure that the penalties are automatic, prompt and not too

severe to be credible. Second, the boost derived from Eurobonds may not be sufficient, necessitating additional stimulus but it would be a luxury to have such a problem. Third, the European Union also needs a banking union and eventually a political union. The Cyprus rescue made these needs more acute by calling into question the business model of European banks that relies heavily on large deposits. The main limitation of Eurobonds is that they would not eliminate the divergences in competitiveness. But Germany accepting Eurobonds would totally change the political atmosphere and facilitate structural reforms. Unfortunately Germany is adamantly opposed to Eurobonds. Since chancellor Merkel vetoed them, the arguments put forward here have not even been considered. People don't realise that agreeing to Eurobonds would be much less costly than doing only the minimum to preserve the euro.

It is up to Germany to decide whether it is willing to authorise Eurobonds or not. But it has no right to prevent the heavily indebted countries from escaping their misery by banding together and issuing Eurobonds. In other words, if Germany is opposed to Eurobonds it should consider leaving the euro and letting the others introduce them.

This exercise would yield a surprising result: Eurobonds issued by a eurozone that excludes Germany and other like-minded countries would still compare favourably with those of the United States, Britain and Japan.

Let me explain why. Since all the accumulated debt is denominated in euros, it makes all the difference which country remains in charge of the euro. If Germany left, the euro would depreciate. The debtor countries would regain their competitiveness. Their debt would diminish in real terms and, if they issued Eurobonds, the threat of default would disappear. Their debt would suddenly become sustainable. Most of the burden of adjustment would fall on the countries that left the euro. Their exports would become less competitive and they would encounter stiff competition from the euro area in their home markets.

By contrast, if Italy left, its euro-denominated debt burden would become unsustainable and would have to be restructured. This would plunge the global financial system into a meltdown, which may well prove beyond the capacity of the monetary authori-

ties to contain. The collapse of the euro would likely lead to the disorderly disintegration of the European Union and Europe would be left worse off than it had been when it embarked on the noble experiment of creating a European Union. So, if anyone must leave it should be Germany, not Italy.

There is a strong case for Germany to make a definitive choice whether to accept Eurobonds or to leave the euro. The trouble is that Germany has not been put to the choice, and it has another alternative at its disposal: it can continue along the current course, always doing the minimum to preserve the euro, but nothing more. That is not the best alternative even for Germany, except perhaps in the very near term. Nevertheless, that is chancellor Merkel's preferred choice, at least until after the elections.

In sum, I contend that Europe would be infinitely better off if Germany made a definite choice between accepting Eurobonds or leaving the euro. That holds true whether Germany chose Eurobonds or exit; and it holds true not only for Europe but also for Germany, except perhaps in the very near term. Which of the two alternatives is better for Germany is less clear-cut. Only the German electorate is qualified to decide.

If a referendum were called today the eurosceptics would win hands down. But more intensive consideration could change people's mind. They would discover that authorising Eurobonds would actually benefit Germany and the cost of leaving the euro has been greatly understated.

I have made some surprising assertions; notably how well Eurobonds could work even without Germany. My pro-European friends simply cannot believe it. They can't imagine a euro without Germany. I think they are conflating the euro with the European Union. The two are not identical. The European Union is the goal and the euro is a means to an end. Therefore the euro ought not to be allowed to destroy the European Union.

But I may be too rational in my analysis. The European Union is conflated with the euro not only in popular narratives but also in law. Consequently the European Union may not survive Germany leaving the euro. In that case the German public needs to be persuaded to abandon some of its most in-

grained prejudices and misconceptions and accept Eurobonds.

I should like to emphasise how important the European Union is not only for Europe, but for the world. The EU was meant to be the embodiment of the principles of open society. That means that perfect knowledge is unattainable. Nobody is free of prejudices and misconceptions; nobody should be blamed for having made mistakes. The blame begins only when a mistake or misconception is identified but not corrected. That is when the principles on which the European Union was built are betrayed. It is in that spirit that Germany should agree to Eurobonds and save the European Union.

Hans-Werner Sinn

Should Germany exit the euro?

Last summer, the financier George Soros urged Germany to agree to the establishment of the European Stability Mechanism, calling on the country to 'lead or leave'. Now he says that Germany should exit the euro if it continues to block the introduction of Eurobonds.

Soros is playing with fire. Leaving the eurozone is precisely what the newly founded 'Alternative for Germany' party, which draws support from a wide swath of society, is demanding.

Crunch time is fast approaching. Cyprus is almost out of the euro, its banks' collapse having been delayed by the European Central Bank's provision of Emergency Liquidity Assistance, while euroskeptic parties led by Beppe Grillo and Silvio Berlusconi garnered a combined total of 55 percent of the popular vote in the latest Italian general election.

Moreover, the Greeks and Spaniards are unlikely to be able to bear the strain of economic austerity much longer, with youth unemployment inching toward 60 percent. The independence movement in Catalonia has gathered so much momentum that a leading Spanish general has vowed to send troops into Barcelona should the province hold a referendum on secession.

France, too, has competitiveness problems, and is unable to meet its commitments under the European

Union's Fiscal Compact. Portugal needs a new rescue program, and Slovenia could soon be asking for a rescue as well.

Many investors echo Soros. They want to cut and run – to unload their toxic paper onto intergovernmental rescuers, who should pay for it with the proceeds of Eurobond sales, and put their money in safer havens. The public is already being misused in an effort to mop up junk securities and support feeble banks, with taxpayer-funded institutions such as the ECB and the bailout programs having by now provided 1.2 trillion euros in international credit.

If Soros were right, and Germany had to choose between Eurobonds and the euro, many Germans would surely prefer to leave the euro. The new German political party would attract much more support, and sentiment might shift. The euro itself would be finished; after all, its primary task was to break the Bundesbank's dominance in monetary policy.

But Soros is wrong. For starters, there is no legal basis for his demand. Article 125 of the Treaty on the Functioning of the European Union expressly forbids the mutualization of debt.

Worst of all, Soros does not recognize the real nature of the eurozone's problems. The ongoing financial crisis is merely a symptom of the monetary union's underlying malady: its Southern members' loss of competitiveness.

The euro gave these countries access to cheap credit, which was used to finance wage increases that were not underpinned by productivity gains. This led to a price explosion and massive external deficits.

Maintaining these countries overdrawn prices and nominal incomes with artificially cheap credit guaranteed by other countries would only make the loss of competitiveness permanent. The entrenchment of debtor-creditor relationships between the states of the eurozone would fuel political tension – as occurred in the United States in its first decades.

In order to regain competitiveness, the Southern countries will have to reduce their goods prices, while the Northern countries accept higher inflation. Eurobonds, however, would hinder exactly this outcome, because relative prices in the North can be

raised only when Northern savers invest their capital at home instead of seeing it publicly escorted to the south by taxpayer-financed credit guarantees.

According to a study of Goldman Sachs, countries like Greece, Portugal, and Spain will have to become 20 to 30 percent cheaper, and German prices will have to rise by 20 percent relative to the eurozone average. To be sure, if Germany were to leave the common currency, the road back to competitiveness would be easier for the Southern countries, since the remaining euro would undergo devaluation, but the crisis countries' fundamental problem would remain as long as the other competitive countries remain in the eurozone. Spain, for example, would still have to cut its prices by 22 to 24 percent relative to the new eurozone average.

From this perspective, the crisis countries would not be spared painful retrenchment as long as they remain in a monetary union that includes competitive countries. The only way to avoid it would be for them to exit the euro and devalue their new currencies. But, so far, they have not been willing to go this route.

Politically, it would be a big mistake for Germany to exit the euro, because that would reinstate the Rhine as the border between France and Germany. Franco-German reconciliation, the greatest success of the postwar period in Europe, would be in jeopardy.

Thus, the only remaining option, as unpleasant as it may be for some countries, is to tighten budget constraints in the eurozone. After years of easy money, a way back to reality must be found. If a country is bankrupt, it must let its creditors know that it cannot repay its debts. And speculators must take responsibility for their decisions, and stop clamoring for taxpayer money whenever their investments turn bad.

George Soros

Hans-Werner Sinn has deliberately distorted and obfuscated my argument. I was arguing that the current state of integration within the eurozone is inadequate: the euro will work only if the bulk of the national debts are financed by Eurobonds and the

banking system is regulated by institutions that create a level playing field within the eurozone.

Allowing the bulk of outstanding national debts to be converted into Eurobonds would work wonders. It would greatly facilitate the creation of an effective banking union, and it would allow member states to undertake their own structural reforms in a more benign environment. Moral Hazard Countries that fail to implement the necessary reforms would become permanent pockets of poverty and dependency, much like Italy's Mezzogiorno region today. Yes, Dutch Disease, like East Germany.

If Germany and other creditor countries are unwilling to accept the contingent liabilities that Eurobonds entail, as they are today, they should step aside, leave the euro by amicable agreement, and allow the rest of the eurozone to issue Eurobonds. No problem. Whoever wants to have Eurobonds can introduce them. The bonds would compare favorably with the government bonds of countries like the United States, Britain and Japan, because the euro would depreciate, the shrunken eurozone would become competitive even with Germany, and its debt burden would fall as its economy grew. Yes, but who exits?

But Germany would be ill-advised to leave the euro. The liabilities that it would incur by agreeing to Eurobonds are contingent on a default – the probability of which would be eliminated by the introduction of Eurobonds. No, present value would become bigger. Germany would actually benefit from the so-called periphery countries' recovery. Recovery will not happen by having lower interest rates. By contrast, were Germany to leave the eurozone, it would suffer from an overvalued currency and from losses on its euro-denominated assets. No, Bundesbank could buy assets, maintain the exchange rate and accumulate marketable assets instead of Target claims.

Whether Germany agrees to Eurobonds or leaves the euro, either choice would be infinitely preferable to the current state of affairs. The current arrangements allow Germany to pursue its narrowly conceived national interests but are pushing the eurozone as a whole into a long-lasting depression that will affect Germany as well.

Germany is advocating a reduction in budget deficits while pursuing an orthodox monetary policy

whose sole objective is to control inflation. This causes GDPs to fall and debt ratios to rise, hurting the heavily indebted countries, which pay high risk premiums, more than countries with better credit ratings, because it renders the former countries' debt unsustainable. Debt-GDP ratio is irrelevant. What matters is current accounts. From time to time, they need to be rescued, and Germany always does what it must – but only that and no more – to save the euro; as soon as the crisis abates, German leaders start to whittle down the promises they have made. So the austerity policy championed by Germany perpetuates the crisis that puts Germany in charge of policy. Germany does not carry out austerity. The market does that.

Japan has adhered to the monetary doctrine advocated by Germany, and it has experienced 25 years of stagnation, despite engaging in occasional fiscal stimulus. With flexible exchange rates austerity does not work. It has now changed sides and embraced quantitative easing on an unprecedented scale. Europe is entering on a course from which Japan is desperate to escape. And, while Japan is a country with a long, unified history, and thus could survive a quarter-century of stagnation, the European Union is an incomplete association of sovereign states that is unlikely to withstand a similar experience.

There is no escaping the conclusion that current policies are ill-conceived. They do not even serve Germany's narrow national self-interest, because the results are politically and humanly intolerable; eventually they will not be tolerated. There is a real danger that the euro will destroy the EU and leave Europe seething with resentments and unsettled claims. The danger may not be imminent, but the later it happens the worse the consequences. That is not in Germany's interest. That is well true.

Sinn sidesteps this argument by claiming that there is no legal basis for compelling Germany to choose between agreeing to Eurobonds or leaving the euro. He suggests that, if anybody ought to leave the euro, it is the Mediterranean countries, which should devalue their currencies. That is a recipe for disaster. They would have to default on their debts, precipitating global financial turmoil that may be beyond the capacity of authorities to contain. Defaulting means that German banks suffer. States will not default, as citizens are rich.

The heavily indebted countries must channel the rising their citizens' discontent into a more constructive channel by coming together and calling on Germany to make the choice. The newly formed Italian government is well placed to lead such an effort. As I have shown, Italy would be infinitely better off whatever Germany decides. And, if Germany fails to respond, it would have to bear the responsibility for the consequences.

I am sure that Germany does not want to be responsible for the collapse of the European Union. It did not seek to dominate Europe and is unwilling to accept the responsibilities and contingent liabilities that go with such a position. Which liabilities. Can you not read the Maastricht Treaty? That is one of the reasons for the current crisis. But willy-nilly Germany has been thrust into a position of leadership. All of Europe would benefit if Germany assumed the role of a benevolent leader that takes into account not only its narrow self-interest, but also the interests of the rest of Europe – a role similar to that played by the United States in the global financial system after World War II, and by Germany itself prior to its reunification.

Hans-Werner Sinn

A riposte to George Soros

Germany will not accept Eurobonds. The exclusion of debt-mutualization schemes was its main condition for giving up the Deutschmark and signing the Maastricht Treaty (Article 125 TFEU).

Moreover, the German Supreme Court has indicated that Germany will require a referendum before Eurobonds can be introduced. The Bundestag does not have the right to make that decision, because it would change the constitutional basis of the Federal Republic of Germany. And, even if a referendum on Eurobonds were held, it would never win a majority, unless it was coupled with the founding of a common European state – a step to which France strongly objects. Angela Merkel, who will in all likelihood be re-elected in September, has said that Eurobonds will not come in her lifetime. George Soros should know all of this. By suggesting that Germany should choose between adopting Eurobonds and leaving the euro, he is effectively advocating the euro's destruction.

If Germany exited the euro, the competitiveness problem of some of the eurozone's Southern countries *vis-à-vis* the economically stronger countries in the North would still be substantial, and they would still have to undergo a process of real devaluation *via* austerity. Soros dodges the competitiveness problem by concentrating on the financial side of the crisis. But calming markets by offering public guarantees for investors will not solve the competitiveness problem. On the contrary, it will exacerbate it by strengthening the euro.

Furthermore, in all likelihood, Germany's exit would prompt the countries of the former Deutschmark bloc (the Netherlands, Austria, Finland, and perhaps Belgium) to follow suit. When France proposed in 1993 that Germany leave the European Monetary System, a forerunner of the euro, the Netherlands and Belgium immediately declared that they would also be leaving, leading France to withdraw its demand. Thus, the result of Germany being forced to exit would be Northern and Southern euro blocs. The only question is which bloc France would choose to join.

That said, Soros's suggestion that a sub-group of euro countries could issue joint Eurobonds if they wished to do so is good. Every country should be free to organize a two-speed eurozone if it so wishes. Whether that would improve the credit ratings of the jointly issued bonds is another matter.

His accusation that Germany is imposing austerity is unfair. Austerity is imposed by the markets, not by the countries providing the funds to mitigate the crisis. By now, the overall sum of credit provided *via* intergovernmental rescue operations and the European Central Bank has reached 1.185 trillion euros (707 billion euros in GIPSIC Target liabilities minus GIPSIC claims from under-proportional banknote issuance; 349 billion euros in intergovernmental rescue funds; including those from the IMF; and 128 billion euros in GIPSIC government-bond purchases by non-GIPSIC national central banks). And this total does not account for the unlimited guarantees that the ECB has given to Southern countries through its Outright Monetary Transactions program, which imposes the expense – and the risk – on the taxpayers of Europe's still-sound economies.

If the euro broke up and the GIPSIC countries defaulted, Germany alone would lose about 545 billion

euros – nearly half of the total sum of credit – because the Bundesbank has carried out most of the net payments that are reflected in the Target balances on behalf of the GIPSIC countries. Germany has by far the biggest exposure among the countries rescuing the eurozone's crisis-stricken countries, and thus helps to mitigate austerity more than any other country.

Soros underestimates the risks that debt mutualization would pose for the future of the eurozone. When Alexander Hamilton, the first US finance minister, mutualized state debts in 1791, he thought that it would cement the new America. But the mutualization of debt gave rise to huge moral hazard effects, inducing the states to borrow excessively, fueling the creation of a credit bubble. When it burst in 1838, most of the US states were driven into bankruptcy. Nothing but animosity and strife resulted.

The euro crisis arose because investors mispriced the risks of investing in Southern Europe. This was the reason for the inflationary credit bubble that deprived a number of countries of their competitiveness. Eurobonds are a way of perpetuating this mispricing, keeping the markets from correcting their mistakes. Eurobonds would imply lingering soft budget constraints and huge political moral hazard effects that would destroy the European model.

Soros says that countries that fail to implement the necessary reforms after the introduction of Eurobonds would become permanent pockets of poverty and dependency, much like Italy's Mezzogiorno region today. Indeed, this is what will happen. Given the cheap financing available, a number of countries will become like the Mezzogiorno – or like East Germany, for that matter – and will permanently suffer from the so-called 'Dutch Disease', with chronic unemployment and underperformance but an acceptable living standard.

Soros says that Germany will suffer from exiting the eurozone, because of the revaluation of the Deutschmark. This is not true. First, Germany is currently undervalued and would benefit from a limited appreciation *via* the terms-of-trade effect. The advantage of imports becoming cheaper would more than outweigh the losses in export revenue.

Second, the Bundesbank can always prevent an excessive revaluation by selling Deutschmarks and buying foreign assets, just as Switzerland did last year. Germany would be far better off than it is now, because real foreign assets would replace the Target claims that it currently holds. Such assets would be safer and generate a higher return. That said, I re-emphasize that, in my opinion, Germany should not exit the euro, because of the political value of the euro as a European integration project and because of its potential trade benefits should the current crisis be resolved.

Soros claims that the exit of Southern countries would exacerbate their external debt problems, leading them to default on their debt. This is also not true. While exiting and devaluing the new currency would increase the debt-to-GDP ratio, so would remaining in the euro and cutting prices to enact a real devaluation. Outside of producing inflation in the eurozone, a depreciation – whether external or internal *via* price cuts – is an uncompetitive country's only option to regain competitiveness and to generate a structural current-account surplus, which is the only possibility for orderly debt redemption.

Seen this way, a temporary increase in the debt-to-GDP ratio is unavoidable if a country wants to repay its debt and attain a sustainable foreign-debt position. In my opinion, we should tolerate more inflation in the eurozone's Northern countries in order to help make the eurozone South competitive. But, if we try to escort the Northern savings to the South *via* Eurobonds, exactly the opposite will happen. We would destroy the German building boom, which is beginning to lead to higher wage demands and has the potential to inflate the country.

On another point Soros raises, I do not see why Italy should exit the eurozone, and why it would be 'infinitely better off' if Germany exited. Italy has a very low level of foreign debt, and northern Italy has a highly competitive economy. According to the study by Goldman Sachs that I cited, it needs only to depreciate against the eurozone average by 10 percent or less. Italy's problems are manageable. If it was true that Germany would suffer after its own exit, Italy would suffer, too, because Italy and Germany are closely interlinked *via* supply chains. The two countries are complements, rather than competitors.

Soros points to Japan's unsuccessful attempts to solve its problems by monetary austerity of the German kind, and warns against repeating the experiment. Japan clearly did not choose austerity after its banks collapsed in 1997. The Bank of Japan has kept interest rates close to zero since then, while government debt has increased from 99 percent of GDP in 1996 to 237 percent in 2012, because of permanent Keynesian deficit spending. Apart from that, the ineffectiveness of austerity in a country with a flexible exchange rate does not apply to the situation of a country in a currency union. While the flexible exchange rate would sterilize all attempts at increasing competitiveness *via* deflation, price cuts in a currency union do work wonders, as the Irish example has shown. Ireland has cut its prices relative to the rest of the eurozone by 15 percent since 2006, and it succeeded in saving its economy.

One final word. Soros said that I had 'distorted and obfuscated' his argument. If that was the case, I apologize, for the public discourse would make no sense if the antagonist's view were purposefully distorted. But I still do not see where, and in what sense, that could have been the case.