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May 30, 2012

For: Hillary

From: Sid

Re: Germany and the European economic crisis

Below are two memos that may contain some new information on German policy on the Eurozone crisis. This information is based on conversations with German Finance Minister Wolfgang Schauble and those close to him.

SOURCE: Sources with excellent access to the highest levels of the European political and security communities.

THE FOLLOWING INFORMATION COMES FROM AN EXTREMELY SENSITIVE SOURCE AND SHOULD BE HANDLED WITH CARE. THIS INFORMATION MUST NOT BE SHARED WITH ANYONE ASSOCIATED WITH THE GERMAN GOVERNMENT.

MEMO #1

1. During late May, 2012, following meetings with political and economic leaders in Europe and the United States, senior officials of the German Government began a series of discreet internal meetings in an effort to develop comprehensive policy solutions regarding the issues addressed during their mid-May 2012 sessions in Europe and the United States. In the opinion of a particularly well placed individual, the officers of the German Chancellery, Ministry of Finance, and the Foreign Ministry are struggling with this effort; concerned that their initial plans to delay any serious policy decisions on the Euro-zone/sovereign debt crisis until late June are unrealistic. According to this source, German Minister of Finance Wolfgang Schauble stated in confidence to Chancellor Angela Merkel that between twelve (12) and fifteen (15) of the member states of the European Union (EU) are moving irresistibly into recession and world

financial markets will not wait for the results of the June Greek, French, and German election cycles before demanding serious policy decisions regarding the future of the currency union.

2. (Source Comment: This particular individual noted that Schauble repeatedly warned Merkel that this “European pace” of crisis management would lead to frustration among investors and place the EU leaders in a position where they face a crisis of international confidence, and are forced to make policy decisions that have not been fully considered. Schauble’s senior staff officers came away from meetings with U.S. officials with the idea that, while the U.S. Government is concerned over instability in the EU they do not intend to become deeply involved in the crisis, preferring to act as a sounding board and advisor for the various EU leaders. They also believe that the U.S. position on Greece is ambiguous, stating that the Americans realize Greece must stay in the Euro-zone, while also stating that it can only remain if it meets its obligations. Accordingly, Schauble and other financial officials in Berlin, London, and Brussels are beginning to see the upcoming Greek national elections as a plebiscite on whether or not Greece wants to remain in the Euro-zone. Schauble stated privately that despite their professed commitment to the Euro, if the Greek people vote for a government led by the anti-austerity Syriza party, they must bear the consequences of their actions.)

3. According to a sensitive source, Schauble is looking for a way to deal with the potential fallout from a problematic result in the Greek elections. He sees two paths available, neither of which is pleasant for Germany and the other states of the EU. Realizing that a Greek withdrawal from the currency union may set the stage for Portugal, Spain, and Ireland to follow, Schauble is moderating his opposition to a larger shared solution within the EU. First, while he remains, in the opinion of a sensitive source, strongly opposed to the issuance of Eurobonds, Schauble has asked his staff to revisit a proposal put forward by the German economic experts, “the Five Wise Men,” regarding a European Redemption pact. This idea was developed throughout 2011, but was initially opposed by Schauble because of his concern for its internal political ramifications in Germany while failing to address the problem of sovereign debt in real terms. The second course of action is even more problematic for Schauble, as it involves planning for a two tiered EU, with a much smaller currency union. This plan will be difficult and dangerous for the Merkel Government, especially following the election of Socialist Francois Hollande as President of France. (Source Note: Hollande and Merkel continue to hold

divergent views on the roles of growth and austerity in resolving the crisis.) In any event, Schauble continues to believe that a complete collapse of the currency union is unacceptable for Germany, as the newly reconstituted Deutsche Mark would be considerably more valuable than the Euro; seriously damaging Germany's export driven economy.

4. In the opinion of this individual, Schauble's staff is drawing up contingency plans for addressing the possible outcomes of the crisis: an enhanced EU wide redemption project, a two tiered Euro-zone, and the possible collapse of the union. At the same time, the Minister of Finance is concerned by the Chancellor's desire to draw the matter out until late June or early July. Schauble stated in private that Merkel, and Foreign Minister Guido Westerwelle of the coalition partner Free Democratic Party (FDP) were badly shaken by the recent electoral defeats suffered at the hands of the opposition Social Democratic Party (SPD)/Green Party alliance. In the opinion of this individual Schauble is finding it difficult to persuade Merkel to consider serious policy moves, with the chancellor preferring to wait to take action. The Minister of Finance believes the Chancellor must continue to engage other national leaders, including the SPD/Green representatives and at least appear to be looking for new ideas. To this end he has asked her to consider the European Redemption Plan proposed by the five wise men, which is also popular with the SPD/Green leadership. Again, the source noted that while this plan is not what Schauble considers the best option in this matter, it is preferable to both the concept of Eurobonds, and the collapse of the currency union.

5. (Source Comment: In the opinion of a well placed individual, Merkel will continue to study the European Redemption Plan and other policy options, but Schauble fears that she will delay any decisive actions. He noted that Italian Prime Minister Mario Monti, who is close to Merkel, is also raising an alarm regarding the need for activity as the EU slides into recession. Monti has a great deal of credibility with Merkel as he has implemented serious austerity measures in Italy, and he is favorably disposed toward the redemption plan. Schauble repeated in private conversation that the Chancellor, Hollande, and other EU leaders continue maintain the hope that the U.S. economy will increase its rate of growth, which will have a similar affect on the EU economies. Schauble believes that U.S. growth will continue at a measured pace and noted that U.S. officials attempted to make this clear during the recent meetings in the United States.)