This week's Outside the Box is in the tradition of showing the other side of the argument. Normally, anything George Soros says or does politically has my blood pressure up about 20 points. Yet, I posted another piece of his today in Over My Shoulder – and then ran across this longer piece from *Der Spiegel.* Note this is from a dedicated Europhile wanting to save the euro. He succintly outlines what must be done if it is to be saved, and does it as well as anyone. (I know that among my readers there are both likers and haters of Soros, but as an observer of markets he is to be respected. And this is an article in which his acumen is in evidence.

I refer you to last week's regular letter (one of my more important ones: http://www.johnmauldin.com/frontlinethoughts/the-beginning-of-the-endgame) and also to the Outside the Box piece I passed on from Michael Lewis, in which he points out that to survive, the rest of Europe must learn to behave more like Germans. This is the great objection of the euro-skeptics, since the rest of Europe does not want to be like Germans. But Soros is right to some extent when he says, "There is simply no alternative. If the euro were to break up, it would cause a banking crisis that would be totally outside the control of the financial authorities. So it would push not only Germany, not only Europe, but also the whole world into conditions very reminiscent of the Great Depression in the 1930s, which was also caused by a banking crisis that was out of control."

We find ourselves in a binary world. Either Europe goes to a fiscal union with the various countries losing control of their budgets, or the Eurozone breaks up. As I recently wrote, we must not underestimate the commitment of the European elites to do whatever it takes to hold their project together. Neither must we underestimate the ability of voters to change their leaders. This is a very volatile situation with far more implications than our subprime problem.

I continue to say that a euro crisis will lead to a recession (or worse) in the US. Attention must be paid. Soros lays out the Euro-elite agenda. I suggest you read.

Your euro-skeptic analyst,

John Mauldin, Editor
Outside the Box

SPIEGEL Interview with George Soros

'You Need This Dirty Word, Euro Bonds'

In a SPIEGEL interview, billionaire investor George Soros criticizes Germany's lack of leadership in the euro zone, arguing that Berlin must dictate to Europe the solution to the currency crisis. He also argues in favor of the creation of euro bonds as a way out of the turbulence.

SPIEGEL: Mr. Soros, we currently see a global banking crisis, a currency crisis and a sovereign debt crisis. Has the financial dilemma become too big to handle? How can politicians on both sides of the Atlantic be expected to solve such a multitude of crises?

Soros: The politicians have not really tried to fix any crisis; they have so far tried only to buy time. But sometimes time actually works against you if you refuse to face the relevant issues and explain to the public what is at stake.

SPIEGEL: Are you talking about the Germans? Many experts think Chancellor Angela Merkel has been particularly hesitant to address the euro crisis.

Soros: Yes. The future of the euro depends on Germany. This is the point I really want to drive home. Germany is in the driver's seat because it is the largest country in Europe with the best credit rating and a chronic surplus. In a crisis, the creditor always calls the shots. Sure, this is not a position Germany or Chancellor Merkel ever desired and they are understandably reluctant to embrace it. But the fact is that Germans are now in the position of dictating to Europe what the solution to the euro crisis is.

SPIEGEL: Why should Berlin embrace that idea?

Soros: There is simply no alternative. If the euro were to break up, it would cause a banking crisis that would be totally outside the control of the financial authorities. So it would push not only Germany, not only Europe, but also the whole world into conditions very reminiscent of the Great Depression in the 1930s, which was also caused by a banking crisis that was out of control.

SPIEGEL: What, then, needs to be done to fight this crisis?

Soros: I think there is only one choice. It is not a question of whether Europe needs a common currency. The euro exists, and if it were to break apart, all hell would break loose. Germany has to make it work. To make it work, you have got to allow the members of the euro zone to be able to refinance the bulk of their debt on reasonable terms. So you need this dirty word: "euro bonds". But when you study what it involves to have euro bonds, you really have a problem because each European country remains in control of its own fiscal policy, and you have to rely on the country to meet its financial obligations.

SPIEGEL: Germans hate the euro bonds idea. They fear that under this scenario they will ultimately need to bail out everyone, even large nations like Italy.

Soros: That is why you need to establish fiscal rules that will ensure the solvency of every member. This should make the euro bond acceptable to German voters. Europe needs a fiscal authority that has not only financial but also political legitimacy. The difficulty is agreeing on the rules. Unfortunately, Germans have some funny ideas. They want the rest of Europe to follow their example. But what works for Germany can't work for the rest of Europe: No country can run a chronic surplus without others running deficits. Germany must propose rules that other countries can also follow. These rules must allow for a gradual reduction in indebtedness. They must also allow countries with high unemployment, like Spain, to continue running cyclical budget deficits until they recover.

SPIEGEL: More and more economists, especially in Germany, would like to see Greece leave the European Union. Do you consider that to be a viable option?

Soros: I think that the Greek problem has been sufficiently mishandled by the European authorities that this may well be the best solution. Europe, the euro and the financial system could survive Greece leaving. It could survive Portugal leaving. And the remainder would be stronger and more easily managed. But the financial authorities have to arrange for an orderly exit in order for the European banking system to survive it. That will cost money because the European banking system including the European Central Bank has to be indemnified for its losses. Depositors in Greek banks also need to be protected. Otherwise, depositors in Irish or Italian banks will not feel safe.

SPIEGEL: Is the current crisis even worse than the one in 2008?

Soros: This crisis is still the continuation of the same crisis. In 2008, the financial system collapsed and it had to be put on artificial life support. The authorities managed to save the system. But the imbalances that caused the crisis have not been removed.

SPIEGEL: What do you mean?

Soros: The method the authorities rightly chose three years ago was to substitute the credit of the state for the credit in the financial system that collapsed. After the failure of Lehman Brothers, the European financial ministers issued a declaration that no other systemically important financial institutions would be allowed to fail. That was the artificial life support; it was exactly the right decision. But then Chancellor Merkel stated that such support would only be granted by each EU member state individually, and not by the European Union.

SPIEGEL: That undermined the concept of a strong European response to the crisis. Has that been the biggest mistake so far?

Soros: That Merkel statement was the origin of the euro crisis. It shattered the vision that the EU will protect the euro in a joint effort.

SPIEGEL: Where will the current crisis stop? Even France now seems to be threatened by a financial meltdown.

Soros: Of course it is spreading. Markets fear uncertainty. Germany has to realize that it has no alternative but to defend the euro. The longer it takes, the higher the price Germany will have to pay.

SPIEGEL: You have been very critical of how the crisis has been handled by governments. Many European citizens, however, blame speculators like you for their attempts to bring down the euro. Huge hedge funds like yours have waged massive bets against the European currency over the past year. And in recent days, several European countries have even imposed temporary bans on short selling, bets on falling share prices.

Soros: You are confusing markets and speculators. At the moment, the biggest speculators are the central banks because they are the most important buyers and sellers of currencies. Hedge funds have definitely been supplanted by central banks. Markets expect the authorities to produce a financial system that actually holds together. If there is any hole in that system, speculators will rush through that hole.

SPIEGEL: That sounds very noble. But in reality, speculation makes any crisis worse. Look at the credit default swaps (CDS) market where speculators can bet on a further decline of currencies and economies. How can that be helpful?

Soros: Of course, speculation will always make a crisis worse. If there is a weak point, it will expose it. And you are right, the CDS market is a very dangerous instrument and I think it should not be allowed. I am one of the very few people who argue that the CDS is a dangerous instrument because it is so lop-sided in favor of a negative outcome.

'You Can Count on China To Back the Euro'

SPIEGEL: Do you think the European Central Bank is part of the solution or part of the problem when it comes to the dealing with the euro crisis?

Soros: It is part of the solution, but which part? Any central bank should only be in charge of liquidity. Solvency is a matter for the treasury. But because there is no European treasury, the ECB was pushed into that arena. To keep the financial system alive they overstepped their limits, as the former German Bundesbank president Axel Weber pointed out, by discounting the government bonds of a country that was clearly bankrupt.

SPIEGEL: You are referring to the purchase of Greek bonds. Now the European Central Bank even started buying Spanish and Italian bonds. It is not even clear, however, if it is legally allowed to do so.

Soros: Yes, but there is a well-established conviction that the central banks always do what is necessary to keep the system going and then afterwards you then take care of the legal aspects. In a crisis, you simply do not have time to think about such concerns for too long.

SPIEGEL: The United States is drowning in even more debt than Europeans. Its economic recovery has been painful. Are we going to see a double-dip recession in the US?

Soros: The indebtedness of the US is not all that high, but if a double-dip recession was in doubt a few weeks ago, it is less in doubt now, because financial markets have a very safe way of predicting the future. They cause it. And the markets have decided that America is going to see a recession, particularly after the recent downgrade of the US by the rating agency Standard & Poor's.

SPIEGEL: President Barack Obama has been fiercely criticized for his handling of the economy. You were one of his biggest supporters in 2008. Are you happy with his economic policy?

Soros: No, of course not. But the reality is that we have had 25 years of excesses building up in America -- a combustible mix of too much credit and too much leverage. You need a long time to reverse that.

SPIEGEL: Obama tried to stimulate growth with a gigantic stimulus program which increased the national debt further. Was that a mistake?

Soros: Obama embraced the ideas of John Maynard Keynes. Basically, the analysis of Keynes is still very relevant -- with one big difference between now and the 1930s. In the 1930s, governments had practically no debt and could therefore run deficits. Nowadays, all governments are heavily indebted, and that is a big change.

SPIEGEL: If Keynes were still alive, would he adjust his theory?

Soros: Definitely. He would say governments can still benefit from running fiscal deficits, but the new debt has to be invested in a way that will pay for itself. So the money spent would have to increase productivity.

SPIEGEL: The $800 billion stimulus program launched by Obama did not live up to that?

Soros: Obama's stimulus program was not big enough and it was not directed at improving infrastructure nor human capital. So it was not productive enough.

SPIEGEL: And any further stimulus is now basically a non-starter, because the conservative majority in Congress is hell-bent on preventing it.

Soros: That is what is pushing the world towards another recession, into a double dip.

SPIEGEL: The Republicans are doing that?

Soros: Yes, but Obama is also at fault. He yielded the agenda to the Republicans. He is talking their language. The president would have to show leadership to counter the Republican wave, and so far he has not done so.

SPIEGEL: Do you think the US deserved the recent downgrade by Standard & Poor's?

Soros: Probably not. This decision was the attempt by the rating agencies to reinvent themselves as anticipating rather than responding to changes that have occurred. So they are really basing that downgrade on the expectation that the political process will not provide the solution. Judging such political developments is a very new role for the rating agencies, though.

SPIEGEL: As an investor, do you listen to the rating agencies?

Soros: Well, I do not, but many other investors do.

SPIEGEL: The credit rating agencies are accused of exacerbating the crisis. Do you think the role of the rating agencies in the financial system needs to be scaled back?

Soros: I do not have an answer to that.

SPIEGEL: There are no alternatives.

Soros: Frankly. It is an unsolved problem in my mind

SPIEGEL: As an investor, would you still bet on the euro?

Soros: I certainly would not short the euro because China has an interest in having an alternative to the dollar. You can count on China to back the efforts of the European authorities to maintain the euro.

SPIEGEL: Is that the reason why the euro is still so strong compared to the dollar?

Soros: Yes. There is a mysterious buyer that keeps propping up the euro.

SPIEGEL: And it is not you.

Soros: It is not me (laughs).

SPIEGEL: In the end, will China be the only winner in this crisis?

Soros: China, of course, has been the great winner of globalization, and if globalization collapses, the Chinese will also be among the losers. So they have a strong interest in preserving the current global system. However, in some ways, they have been just as reluctant to accept it as the Germans. Germans have been hesitant to accept responsibility for Europe, and the Chinese have been hesitant to accept responsibility for the world. But they are both being pushed into it.

SPIEGEL: Mr. Soros, we thank you for this interview.

Interview conducted by Gregor Peter Schmitz and Thomas Schulz