

## **Emerging economies are key to the eurozone's survival**

*By: Jeffrey D. Sachs*

Last week's G20 meeting [marked the demise](#) of the eurozone's three-year effort to save itself. The monetary union will be saved, but not from the inside. Its survival will come at the hands of the International Monetary Fund and the emerging economies.

The meeting itself was an embarrassment for France on its own turf. Despite President Nicolas Sarkozy's call for a "New World – New Ideas" summit, the meeting was about the old world and old squabbles. With Germany, France, Greece, Italy, and other neighbours hardly on speaking terms, the rest of the G20 was astonished by the intra-European bickering.

The eurozone mess has exploded from a containable regional crisis in 2009 to a global crisis today. The simple truth is that Europe has been unable to clean up its own act. There are three reasons.

The first is that agreeing on how to share losses is always difficult, but nearly impossible in a world of 17 eurozone states, powerful banks, overlapping official European bodies, aggrieved public opinion, and dozens of political parties, with some of the smallest having the largest bargaining leverage. As game theory predicts, free riding by the True Finns, the Slovaks, the European Central Bank, creditor banks, and others has made it nearly impossible to reach a sensible agreement on anything. Without clear fundamentals and a credible lender of last resort, Europe's financial markets are buffeted by waves of self-fulfilling panic.

The second is the collapse of technical processes, not unrelated to the first syndrome. Europe hangs on the words of Chancellor Angela Merkel, which are sporadic and often doled out on the eve of eurozone summits. There is little technical preparation of highly technical issues. German coalition politics predominates. The Germans themselves speak with multiple voices, including political parties, Chancellery, finance ministry, Bundesbank, and Bundestag. Even France learns the latest German strategy in the Merkel-Sarkozy meetings that precede each summit.

The third has been the specific failures of the European Commission and the European Central Bank. There are many reasons for this, ranging from Jean-Claude Trichet's spent leadership, to the unworkability of the Lisbon Treaty, to the sidelining of Brussels by Germany and France. Mario [Draghi's arrival at the helm](#) of the ECB will be a partial tonic.

Europe's weaknesses were on full display at the meeting in Cannes. Mr Sarkozy did not hesitate to upbraid his Greek and Italian colleagues. Italy's premier Silvio Berlusconi displayed a further [retreat from reality](#). Ms Merkel, as usual, said very little. The US said even less. The decline of America's economic power was patent.

The rest of the G20 evinced a desire to help, but not to throw money directly into such a

scrum. No country declared an interest in investing in the European bailout fund. The message from China, Brazil, Russia, and other emerging economies was clear: external help would be channelled through the IMF, because it is global, technocratic, and detached from daily European politics. External help, in short, requires conditionality. The next weeks are crucial, and the IMF, ECB, and the commission have a last chance to respond before a eurozone meltdown. The new leadership of the IMF has by far the biggest responsibility, the first among equals in the design of a comprehensive programme. The European politicians, and the rest of the G20, would do well to encourage Greece to work with the IMF, EC, and ECB to resolve several critical and still outstanding issues. The IMF, on its part, must be especially wise to craft socially acceptable and economically realistic programs.

First, Greece needs its debt-service burden cut decisively and sustainably, whether by cutting the interest rate, the face value of the debt, or some combination. The debt reduction needs to cover both publicly held debt as well as privately held Greek government bonds. It should be deep enough to permit a gradual and credible reduction of the debt-gross domestic product ratio to manageable levels within a decade. A clear strategy must also address the problem of holdout creditors, such as vulture funds, that refuse to participate in a voluntary restructuring.

Greece's banks (and indeed many in Europe) also urgently need liquidity, because the withdrawal of deposits and credits from Greek banks is destroying the economy and with it the ability to collect taxes. Ensuring liquidity has to proceed even faster than recapitalisation. The ECB needs to swing into urgent action at long last. If the Germans continue to oppose this vital ECB function, the IMF should weigh in on the importance of the ECB's lender-of-last resort function.

As part of a credible adjustment, Europe needs an infusion of financial support from beyond the eurozone, channelled through the IMF. We are therefore at the end of an era, not only in Europe, but globally. The rising economic powers have financial surpluses, economic growth, and high stakes in global stability. They have the means to provide new bulwarks of the multilateral system. The traditional powers will have to make more room for them at the head table. That should happen in a cooperative and orderly manner rather than through crisis and collapse.

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