

German hotheads are close to destroying the euro

By: Jeffrey D. Sachs

German tabloids and much of European public opinion seem fixated on Greece as an object of scorn. The fact that the Greek government is [pushing through the toughest of austerity measures](#) in the face of mass demonstrations seems to be of no import. Yet this aggressive attitude is now putting the euro in imminent peril.

Despite chancellor Angela Merkel's call for calm, shortsighted German politicians opine that Germany could actually benefit if Greece is forced into default, or even out of the euro. Nothing could be further from the truth. Germany now risks the destruction of its own and Europe's prosperity if it continues to ignore the interdependence of all of Europe's economies.

It is to her credit, therefore, that Ms Merkel this week [pushed back against her hotheaded colleagues](#). Even so, Germany's macroeconomic thinking remains blinkered. Greece is making a bold transformation, from a large primary budget deficit in 2009 to a primary surplus in 2012. The task is considerable. Yes, there has been modest slippage this year, but this reflects the steep recession now hitting the Greek economy.

The critics also seem wilfully to overlook that a European-wide financial panic has swept the credit lines and deposits from Greece's banking system, and with them the ability of the banks to lend. The economy is thus buckling under an intense credit squeeze, only stoked by the recent talk of default.

Worse, German and European leaders have responded to this downward spiral only with demands for fresh austerity. Greece obliged once again last weekend, with more tightening. But we must now understand Greece is at the precipice of social instability. Further cuts will push it over the edge – ending the adjustment programme, and intensifying the financial squeeze and the drumbeat of those trying to push Greece out of the eurozone. It is utterly naive to believe that the downward spiral would stop there. Italy, Spain, Portugal, Ireland, and even France could quite possibly be next, with the risk of bank runs pulling the entire edifice of monetary co-operation into rubble.

If ever there were a time for European leadership, it is now. Perhaps we must just hold our breath until [Mario Draghi](#) replaces [Jean-Claude Trichet](#), a spent force, at the helm of the European Central Bank. At least [Jürgen Stark's resignation from the ECB](#), though viewed negatively by the markets, now offers an opportunity for more realistic thinking in that institution.

The steps needed to avoid the abyss are clear. Greece needs working capital, backed by the ECB and the European Investment Bank, to prevent a panic-induced implosion. Not only must the ECB do its part but Greece and its partners must implement the deal agreed in July, under which the European financial stability facility will finance part of Greece's needs, while private-sector holders of Greek bonds will exchange them for 30-year notes. Delivering this deal, however, also demands a more proactive approach from Germany, not least to calm anxious markets. Ms Merkel will have her hands full keeping her colleagues quiet and persuading the German people to support the eurozone. But, in

addition to this, she must push others in Europe to ratify the planned EFSF expansion, while encouraging both Brussels and the International Monetary Fund to develop realistic financing targets for 2012 – even if that means a few billion more euros for Greece in the face of the steep recession. It will also help if she encourages the ECB to behave like a central bank, not a commercial bank, by exercising its lender of last resort functions in the midst of a financial panic.

The deal agreed in July can give Greece the breathing space it needs, locking in low real interest rates and providing the financing to recapitalize the Greek banks. Of course, implementing it will not be easy, especially given that it must be approved by Europe's national parliaments. Yet its leaders should now be working overtime to make this happen, not berating the Greeks for modest slippages. Greece, its creditors and the ECB need to show utmost responsibility, macroeconomic judgment and maturity. Greece is doing so, and the rest of Europe must as well. If they do not, the consequences for Europe and the global economy will be dreadful. This is an extremely dangerous moment. Europe must play for the long term.

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