

Greece's debt crisis strains European unity

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When European leaders laid the foundations of the European Union with the 1957 Treaty of Rome, they spoke optimistically of an "ever-closer union," a "pooling" of resources and "concerted action" to bring the diverse nations together.

The problem is that the Europeans have never, to this day, been willing to accept the consequences of this assertion of unity. They wanted a single currency but refused a common fiscal policy that could keep the books balanced; they wanted a common flag but rejected a Europe-wide constitution; they desired the benefits of community but not its limitations or responsibilities.

This tapestry of European integration, woven so nobly by the post-World War II generation, has been fraying over the past decade. Last week you could hear it begin to rip at the seams as Germany and other financially strong nations struggled to decide whether to rescue Greece, their weakest and most profligate member.

The seriousness of the European crisis is illustrated by the fact that there are no good solutions to the Greek mess. The short-term fixes that investors are clamoring for would carry significant long-term costs. What's worse is that the institutions that could create a framework for long-term stability don't exist and aren't likely to be created now.

What makes sense, in theory, is to let the Greeks default on their debts, decouple from the European monetary union for long enough to restructure their economy, and then rejoin the union on a more honest and sustainable basis. As one hedge fund manager warns: "Investors had always regarded the euro as a de jure German deutsche mark; it is dawning on the world that it is becoming, de facto, a Greek drachma." The one-size euro obviously doesn't fit all members.

But a Greek default, in reality, could trigger a process of contagion and panic like what happened on Wall Street in 2008 after the collapse of Lehman Brothers. Every other weak economy in Europe would become suspect, and investors would shun the bonds of Spain, Portugal and Ireland. If bondholders were forced to take a "haircut," the result could be a run on big European banks that hold this toxic debt. A sovereign debt crisis could become a banking crisis.

European finance ministers were likely to approve a rescue package over the weekend, but the numbers are genuinely scary. The Greek bailout is expected to total about \$159 billion. According to financial analyst David Smick, if similar rescue packages were offered for Spain, Portugal and Ireland, the cost could be an additional \$660 billion. The total cost, in other words, could approach a trillion dollars if the Greek rescue sets a precedent.

The core problem is that the vision of one Europe hasn't been matched by institutions or rules that could maintain fiscal order. The Europeans instead find themselves caught in their own illusory structures. Brussels has a city full of E.U. offices busily issuing directives, but there's no common finance ministry. The European Central Bank in Frankfurt is toothless when a crisis hits: It can't issue debt on behalf of its member nations or conduct creative monetary operations as the Federal Reserve did during the 2008 financial crisis.

For years, analysts worried that the European project would be undone by East-West tensions. The first threat was the Soviet Union and its Eastern European allies; then came the struggle to absorb those Eastern Bloc nations into the European Union. But it turns out that the real fault line is North-South. The financially disciplined nations of northern Europe, such as Germany, resent the loose financial ways of the southerners, who have treated the euro as a credit card whose balance never needed to be paid.

The E.U. dream of an "ever wider, ever deeper" union has been a European form of "political correctness" in recent years, with Euro-skeptics attacked as retrograde nationalists and worse. But the warning signs of public unhappiness have been there, most clearly in France, the nation that championed the dream of one Europe: The French in 1992 barely ratified, by a scant 51 percent, the Maastricht Treaty, which established the common currency; and French voters in 2005 rejected outright the European constitution that had been the handiwork of their former president, Valery Giscard d'Estaing.

The European Union has been a defining achievement of the post-1945 generation. It reconciled ancient enemies, dismantled trade barriers, helped topple communism and created unimagined prosperity. But it didn't establish the one thing it implicitly promised -- a real union -- and now it is paying the price.

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