

## Europe on the brink

*A debt crisis that began with Greece now endangers the entire eurozone and even the U.S. What caused this mess?*

### How bad is Europe's crisis?

It's so bad that it could drag down the global economy, and tip the U.S. back into recession. It might also mean the beginning of the end for the euro, the common currency of 17 countries and 330 million people. The debt crisis began in one corner of the continent—Greece—and has spread like an epidemic, threatening banks and investors and undermining the creditworthiness of other European countries. Bailed out last year by the EU to the tune of \$140 billion, Greece enacted tax increases and deep public-sector cuts, outraging much of its population. But the cuts didn't end the crisis, and in some respects backfired. Greece's unemployment rate has soared to 16 percent, and its economy is on track to shrink 6 percent this year. As a result, the country's government has falling revenues, and less money with which to pay off its debt, which stands at 160 percent of GDP and climbing. (In comparison, U.S. debt is 100 percent of GDP.) So in July, Greece went back to the EU for a second bailout, of \$157 billion. But the fed up EU now says it won't put up more money unless Greece makes more radical cuts to government spending.



*Outraged over austerity: Greek protesters in Athens*

### Why is that a problem for other EU countries?

Greece isn't the only country with a debt crisis and a foundering economy. Spain, Ireland, Portugal, and Italy all have similar, if less immediate, debt problems. Greece's meltdown came after it went on a spending spree and ran up tremendous debt after adopting the euro, and then found in the downturn that it couldn't repay its bonds. Ireland's problems largely stem from the collapse of a housing bubble and a huge government bailout of its banks. Spain was also hit hard by a housing bust, and Italy's anemic growth imperils its ability to service its \$2.6 trillion in public debt. All these faltering economies are now tied to Greece's fate: If the Greeks default, investors may lose faith that the other countries can clean up their own fiscal messes. The prospect of a Greek default is already raising the cost of borrowing for governments, effectively making their defaults more likely. That could mean more—and bigger—EU bailouts in the future, which the wealthier countries adamantly oppose.

### Who is to blame?

There is no single villain, but plenty of blame to go around. The Greeks dug themselves into a deep hole by creating a society of high public- and private-sector salaries, lavish benefits, early retirement, and rampant tax cheating and corruption. Some civil-

service workers got bonuses just for showing up on time. In entering the eurozone, Greece painted a rosy, and misleading, picture of its finances, and European leaders failed to look harder. In a sense, the blame goes back as far as the creation of the euro itself, in 1999. Eurozone countries agreed to share a single currency, which tied them together economically, but continued to set their own fiscal policies independently. They were not supposed to exceed certain debt levels, but the rules weren't enforceable. The euro's "original sin," says German economist Joachim Starbatty, is that

"the union was devised as a one-size-fits-all."

### How does this affect the U.S.?

The impact is both direct and indirect. U.S. banks and money market funds hold more than \$2 trillion worth of investments in European banks, many of which are burdened with a lot of sovereign debt that could go bad. If Greece and other nations default, banks here and in Europe—still shaken from the 2008 economic meltdown—could suffer major losses. Those losses would spook them sufficiently to cause them to stop lending, drying up global credit in an echo of what happened after the fall of Lehman Brothers, in 2008. The EU is also collectively America's biggest trading partner, so if more European countries tumble into recession, European spending on U.S. goods and services could plummet. "The biggest single risk to the United States today is that the European situation will spiral out of control," says former Treasury official Edwin M. Truman. "Europe is not going to save the U.S. economy, but it could be the straw that breaks it."

### Europe's culture clash

Spenders vs. savers, the corrupt vs. the clean, the lazy vs. the industrious: Those are just some of the old stereotypes hauled out to explain why southern European countries need bailouts—and why it falls to their northern European counterparts to do the bailing. "There is a view in Germany that Mediterraneans are lazy slobs who basically don't have the German work ethic," says German political commentator Alan Posener. But the southerners are no less dismissive of the humorless workaholics of sun-starved Germany. "I think the Germans are just jealous of us," says Greek journalist Melina Haritatu. On a darker note, Germany's calls for more Greek austerity have awakened bitterness among some Greeks that their fate is again in the hands of their World War II occupiers. Germans "killed and starved a million Greeks, and now there is a Siemens washing machine in my bathroom," said one Greek welfare worker. "At least it stops them from producing weapons."

### What happens next?

"There are only two answers to the euro crisis," says former British Chancellor of the Exchequer Norman Lamont. "Cough up or break up." The first option would involve giving Europe's bailout fund, created last year, more cash and greater flexibility to help countries and banks, an option that Germany has opposed. Otherwise, Greece, and possibly other countries, might simply exit the eurozone—causing a collapse of confidence in the euro, and producing what economist Barry Eichengreen calls "the mother of all financial crises." European leaders face some very painful choices, says Carl Weinberg, chief economist at High Frequency Economics. "Some days it feels as though the end of the world is knocking at the door."