{ EUROZONE DEBT CRISIS }

JEREMY WARNER

The longer the crisis persists, the greater the damage, says Jeremy Warner

Like St John's biblical reference to the poor, the eurozone debt crisis seems destined to be always with us. Every time European policymakers think they've managed to get the fire under control, the flames come leaping back, seemingly with ever more intensity. Policy, it appears, does just enough to keep the entire place from burning down, but repeatedly falls short of the radical actions necessary to resolve matters once and for all. The longer the crisis persists, the greater the damage. Failure to act with sufficient resolve is only multiplying the costs of final settlement.

But let's for a moment rise above the present impasse and imagine the world as it might be a year from now. Even worse, a cynic might reply, and indeed there are good reasons for thinking that this might well be the case. Experience to date gives little reason to believe Europe can make fundamental progress in tackling its problems. Far from lancing the boil, a Greek exit is, at least in the short term, likely to make matters very much worse. In itself, Greece is neither here nor there at just 2% of eurozone output, but once the precedent of a eurozone exit has been set, the contagion will be hard to stop. Other, much larger economies, would soon find themselves in the same impossible position as Greece. Crippling capital flight would lead to intolerable political and economic tensions, eventually causing others to confront the 'in or out' question.

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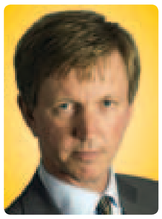
Personally, I'm a big believer in the merits of free-floating sovereign currencies, which provide a natural market mechanism for adjustments in competitiveness and external indebtedness. This is what Europe really needs to resolve a crisis, which is at root no more than a classic stand-off between creditor and debtor nations.

But to use one of George Soros's favourite expressions: once the omelette has been made, it cannot be unscrambled. The costs of returning Europe to its constituent parts, given the way it has become interlinked through trade, contract and finance, is unimaginable.

Looking forward a year, we can at least say with some certainty that Europe will be a very different place from the way it is today. It's possible that policymakers will by then have taken the nuclear option and ejected Greece, or at least made it impossible for Greece to stay in, risking a full-blown meltdown in the single currency.

But there is also a more benign possibility – that the alternative growth agenda trumpeted by France's François Hollande will have triumphed, allowing for a more accommodative European Central Bank, and a more conciliatory approach to deficit reduction in the countries worst affected by the debt crisis.

We do know that the present approach isn't working. Even Germany is starting to shift its message, saying it might allow a little wage inflation so as to prompt domestic demand and help resolve imbalances. For Britain, pretty much powerless to control the self-destruction on our doorstep, there is only one way to respond: prepare for the worst, but hope against hope for the best.



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