Views

EDITORIAL OPINION

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PALESTINIAN STATEHOOD

The only way to avert a United Nations vote on Palestinian membership is to offer a better solution.

A U.N. vote on Palestinian membership would be ruinous. Yet with little time left before the General Assembly meets, the United States, Israel and Europe have shown insufficient ur-

An impeccable disaster

European leaders are unwilling to acknowledge the nature of the threat to the euro, let alone deal with it.

Paul Krugman

On Thursday Jean-Claude Trichet, the president of the European Central Bank, lost his sang-froid. In response to a question about whether the E.C.B. is becoming a ''bad bank'' thanks to its purchases of troubled nations' debt, Mr. Trichet, his voice rising, insisted that his institution has performed ''impeccably, impeccably!'' as a guardian of price stability.

Indeed it has. And that's why the euro is now at risk of collapse.

Financial turmoil in Europe is no longer a problem of small, peripheral economies like Greece. What's under way right now is a full-scale market run on the much larger economies of Spain and Italy. At this point countries in crisis account for about a third of the euro area's G.D.P., so the common European currency itself is under existential threat.

And all indications are that European leaders are unwilling even to acknowledge the nature of that threat, let alone deal with it effectively.

I've complained a lot about the ''fiscalization'' of economic discourse here in America, the way in which a premature focus on budget deficits turned Washington's attention away from the ongoing jobs disaster. But we're not unique in that respect, and in fact the Europeans have been much, much worse.

Listen to many European leaders — especially, but by no means only, the Germans — and you'd think that their continent's troubles are a simple morality tale of debt and punishment: Governments borrowed too much, now they're paying the price, and fiscal austerity is the only answer.

Yet this story applies, if at all, to Greece and nobody else. Spain in particular had a budget surplus and low debt before the 2008 financial crisis; its fiscal record, one might say, was impeccable. And while it was hit hard by the collapse of its housing boom, it's still a relatively low-debt country, and it's hard to make the case that the underlying fiscal condition of Spain's government is worse than that of, say, Britain's government.

So why is Spain — along with Italy, which has higher debt but smaller deficits — in so much trouble? The answer is that these countries are facing something very much like a bank run, except that the run is on their governments rather than, or more accurately as well as, their financial institutions.

Here's how such a run works: Investors, for whatever reason, fear that a country will default on its debt. This makes them unwilling to buy the country's bonds, or at least not unless offered a very high interest rate. And the fact that the country must roll its debt over at high interest rates worsens its fiscal prospects, making default more likely, so that the crisis of confidence becomes a self-fulfilling prophecy. And as it does, it becomes a banking crisis as well, since a country's banks are normally heavily invested in government debt.

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Now, a country with its own currency, like Britain, can short-circuit this process: if necessary, the Bank of England can step in to buy government debt with newly created money. This might lead to inflation (although even that is doubtful when the economy is depressed), but inflation poses a much smaller threat to investors than outright default. Spain and Italy, however, have adopted the euro and no longer have their own currencies. As a result, the threat of a self-fulfilling crisis is very real — and interest rates on Spanish and Italian debt are more than twice the rate on British debt.

Which brings us back to the impeccable E.C.B.

What Mr. Trichet and his colleagues should be doing right now is buying up Spanish and Italian debt — that is, doing what these countries would be doing for themselves if they still had their own currencies. In fact, the E.C.B. started doing just that a few weeks ago, and produced a temporary respite for those nations. But the E.C.B. immediately found itself under severe pressure from the moralizers, who hate the idea of letting countries off the hook for their alleged fiscal sins. And the perception that the moralizers will block any further rescue actions has set off a renewed market panic.

Adding to the problem is the E.C.B.'s obsession with maintaining its ''impeccable'' record on price stability: at a time when Europe desperately needs a strong recovery, and modest inflation would actually be helpful, the bank has instead been tightening money, trying to head off inflation risks that exist only in its imagination.

And now it's all coming to a head. We're not talking about a crisis that will unfold over a year or two; this thing could come apart in a matter of days. And if it does, the whole world will suffer.

So will the E.C.B. do what needs to be done — lend freely and cut rates? Or will European leaders remain too focused on punishing debtors to save themselves? The whole world is watching.