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Fixing trade imbalances is only way to avoid eurozone implosion

From Prof Marcello de Cecco, Prof Paul de Grauwe, Dr André Grjebine and Dr Francesco Saraceno.

Sir, Western governments might have had an excuse in the 1930s: they did not know how to manage a Great Depression. Today's leaders, however, behave like cult followers who refuse to avail themselves of the treatment that will save their lives.

A successful strategy to resolve the eurozone crisis must reduce the debt of vulnerable states, rebalance external imbalances and distribute the burden of adjustment as fairly as possible. The agreement reached at the summit in Brussels on December 9 last year fails on all these criteria.

That agreement focused on tightening budget discipline and on fiscal "golden rules". This is based on the erroneous belief that the problems stem solely from the irresponsible fiscal behaviour of peripheral countries. Countries engulfed in recession are being told to reinforce austerity measures that have already triggered a vicious downward spiral of lower growth, lower fiscal receipts and increased debt. We have known since the time of Keynes the folly of such deflationary spirals.

The refusal of the European Central Bank to play a role as lender of last resort to governments removes a necessary firewall around countries vulnerable to speculation. It also increases the bill that will have to be paid to help troubled countries. Treaty provisions are a weak excuse for such dogmatism. What is the good of an insurance company that is unwilling to state that it will intervene when needed?

Emphasising public deficit and debt, while ignoring trade imbalances, puts the eurozone on the road to macroeconomic disaster. External imbalances led to high indebtedness, excessive borrowing and, finally, "sudden stops" in lending. Co-ordinated adjustment, which spreads the burden of adjustment on deficit and surplus countries, is the only way out. This would mean demand expansion in surplus countries, to match demand contraction in deficit ones, thus sustaining aggregate demand and growth for the eurozone, as a whole.

A chance to avoid the decade of economic stagnation entailed by current policies still exists. European leaders and institutions must abandon an orthodoxy that has already proved harmful and adopt pragmatic, evidence-based policies. If they do not do so, they will bear the responsibility for the implosion of the eurozone and, in the end, the failure of the whole European project.

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