

Joseph E. Stiglitz writes: European Union leaders continue to play a game of brinkmanship with the Greek government. Greece has met its creditors' demands far more than halfway. Yet Germany and Greece's other creditors continue to demand that the country sign on to a program that has proven to be a failure, and that few economists ever thought could, would, or should be implemented.

The swing in Greece's fiscal position from a large primary deficit to a surplus was almost unprecedented, but the demand that the country achieve a primary surplus of 4.5% of GDP was unconscionable. Unfortunately, at the time that the "troika" – the European Commission, the European Central Bank, and the International Monetary Fund – first included this irresponsible demand in the international financial program for Greece, the country's authorities had no choice but to accede to it.

The folly of continuing to pursue this program is particularly acute now, given the 25% decline in GDP that Greece has endured since the beginning of the crisis. The troika badly misjudged the macroeconomic effects of the program that they imposed. According to their published forecasts, they believed that, by cutting wages and accepting other austerity measures, Greek exports would increase and the economy would quickly return to growth. They also believed that the first debt restructuring would lead to debt sustainability.

The troika's forecasts have been wrong, and repeatedly so. And not by a little, but by an enormous amount. Greece's voters were right to demand a change in course, and their government is right to refuse to sign on to a deeply flawed program.

Having said that, there is room for a deal: Greece has made clear its willingness to engage in continued reforms, and has welcomed Europe's help in implementing some of them. A dose of reality on the part of Greece's creditors – about what is achievable, and about the macroeconomic consequences of different fiscal and structural reforms – could provide the basis of an agreement that would be good not only for Greece, but for all of Europe.

Some in Europe, especially in Germany, seem nonchalant about a Greek exit from the eurozone. The market has, they claim, already "priced in" such a rupture. Some even suggest that it would be good for the monetary union.

I believe that such views significantly underestimate both the current and future risks involved. A similar degree of complacency was evident in the United States before the collapse of Lehman Brothers in September 2008. The fragility of America's banks had been known for a long time – at least since the bankruptcy of Bear Stearns the previous March. Yet, given the lack of transparency (owing in part to weak regulation), both markets and policymakers did not fully appreciate the linkages among financial institutions.

Indeed, the world's financial system is still feeling the aftershocks of the Lehman collapse. And banks remain non-transparent, and thus at risk. We still don't know the full

extent of linkages among financial institutions, including those arising from non-transparent derivatives and credit default swaps.

In Europe, we can already see some of the consequences of inadequate regulation and the flawed design of the eurozone itself. We know that the structure of the eurozone encourages divergence, not convergence: as capital and talented people leave crisis-hit economies, these countries become less able to repay their debts. As markets grasp that a vicious downward spiral is structurally embedded in the euro, the consequences for the next crisis become profound. And another crisis is inevitable: it is in the very nature of capitalism.

ECB President Mario Draghi's confidence trick, in the form of his declaration in 2012 that the monetary authorities would do "whatever it takes" to preserve the euro, has worked so far. But the knowledge that the euro is not a binding commitment among its members will make it far less likely to work the next time. Bond yields could spike, and no amount of reassurance by the ECB and Europe's leaders would suffice to bring them down from stratospheric levels, because the world now knows that they will not do "whatever it takes." As the example of Greece has shown, they will do only what short-sighted electoral politics demands.

The most important consequence, I fear, is the weakening of European solidarity. The euro was supposed to strengthen it. Instead, it has had the opposite effect.

It is not in the interest of Europe – or the world – to have a country on Europe's periphery alienated from its neighbors, especially now, when geopolitical instability is already so evident. The neighboring Middle East is in turmoil; the West is attempting to contain a newly aggressive Russia; and China, already the world's largest source of savings, the largest trading country, and the largest overall economy (in terms of purchasing power parity), is confronting the West with new economic and strategic realities. This is no time for European disunion.

Europe's leaders viewed themselves as visionaries when they created the euro. They thought they were looking beyond the short-term demands that usually preoccupy political leaders.

Unfortunately, their understanding of economics fell short of their ambition; and the politics of the moment did not permit the creation of the institutional framework that might have enabled the euro to work as intended. Although the single currency was supposed to bring unprecedented prosperity, it is difficult to detect a significant positive effect for the eurozone as a whole in the period before the crisis. In the period since, the adverse effects have been enormous.

The future of Europe and the euro now depends on whether the eurozone's political leaders can combine a modicum of economic understanding with a visionary sense of, and concern for, European solidarity. We are likely to begin finding out the answer to that existential question in the next few weeks.