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Europe in a hole: Which way out?; Budget-trimming cure could have dangerous side effects, critics say

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Across Europe, from profligate Greece to newly strait-laced Ireland, governments are promising deep, painful cuts in public spending even as they face the likelihood of a new recession.

To protect the value of the euro, satisfy investors and appease Europe's economic taskmaster, Germany, the region's most heavily indebted countries believe they have no choice but to slim down. Reviving economic growth and reducing unemployment must wait until countries get their fiscal houses in better order, the thinking goes.

But some argue that Berlin is pressing too hard and that the region's new fixation on debt has created a ‘‘cult of austerity'' that could make it harder to recover from the slump. Drastic budget cuts, if implemented as promised, could set off deflation, send already high unemployment rates surging, bring governments down and even create popular opposition to the euro, critics say.

The pressure ‘‘will impose terrible strains on the government and society'' for years to come, said **Jean-Paul Fitoussi**, professor of economics at the Institut d'Études Politiques in Paris. ‘‘It's self-defeating, because if you have austerity and deflation in Greece, Portugal and Spain, then the European economy will not recover, firms will fail and jeopardize the banks.''

Opposition to austerity is spoken softly in official circles, as political leaders fret that markets will punish countries that show weak resolve to lower debt. But Germany, which has insisted on steep cuts in public spending in the most indebted countries, is facing criticism for harping about the dangers of debt without doing more to support growth, mainly by buying more from its neighbors.

The French finance minister, Christine Lagarde, warned Berlin that it must increase its domestic demand to help partners in trouble. Could Germany, with its high savings and big trade surplus, ‘‘do a little something?'' she asked in an interview with The Financial Times. ‘‘It takes two to tango. It can't just be about enforcing deficit principles.''

The debate is partly about economics — what steps European countries need to take to tackle their demons of high debt and slow growth. But it is also about leadership, as the European Union struggles to define its mission during the deepest economic crisis in its history.

The Germans insist the problem is debt. Addressing it means radical and immediate cuts in public spending, using the pressure from markets to impose changes that are politically difficult but crucial to long-term health.

France has a different, softer approach, akin to the U.S. perspective. Public spending must expand in times of economic crisis to bolster employment and growth, which will gradually cut the deficit through increased tax receipts. Many European countries need to streamline their public sectors, France argues, but not as shock therapy.

German rigor has worked well for Germany, which has kept wages down, overhauled its social-welfare system and remained one of the world's top exporting countries. Psychologically, Germans are obsessed with inflation and saving. But Germany consequently has a big trade surplus with its euro-zone partners. And that imbalance makes it harder for less competitive countries to grow out of their own problems.

The Germans note that Spain, Portugal, Greece and Italy did not play by the rules of monetary union, drafted largely by Germany.

‘‘Wages rose very fast, productivity stayed low and governments went on a spending spree, and that makes Germans angry, because they did the opposite,'' said Thomas Klau of the European Council on

Foreign Relations.

The Germans are preaching harsh budget cuts, tax increases, changes to pension systems, a later retirement age and a quick return to government deficits closer to the euro-zone requirement of a maximum of 3 percent of gross domestic product, a far cry from Greece's 12.7 percent for this year.

On the other side are worries that this sounds similar to the austerity mantra that helped prolong the Great Depression of the 1930s. Mr. Fitoussi said that it risked throwing the Mediterranean countries into deflation, which would create huge political and social pressures and short-circuit Europe's economic recovery. Forecasts already predict recession for the most of the southern rim for at least another year or two.

The United States has also taken the tack of accumulating new debt to stimulate growth and worrying later about reducing deficits. The U.S. budget deficit this year will be 11.2 percent of gross domestic product, nearly the level of Greece. But Washington can better afford it. Not only does it control the dollar, which remains the world's reserve currency, but gross U.S. debt is only half that of Greece when measured against gross domestic product.

France, hit less hard by the crisis, is trying to find a median — with moderate stimulus, no tax increases, support for small and midsize businesses, and a deficit growing to 8.2 percent of gross domestic product, even as unemployment has climbed back over 10 percent.

To an extent, smaller economies like Greece have to bow to the demands of the market. Iceland with its bank disasters and Ireland with its real estate and bank bubbles, have also buckled down to cut budgets considerably in the face of plunging tax receipts.

Chancellor Angela Merkel of Germany is edging toward an International Monetary Fund-led solution to the Greek budget crisis as she navigates between European Union leaders who say the Union should take charge and a German public unwilling to foot the bill, Bloomberg News reported from Berlin.

As Ms. Merkel prepares for a summit meeting of E.U. leaders on March 25 and 26, she has already made clear that no decision on aid will be taken in Brussels.

Prime Minister George A. Papandreou of Greece set a one-week deadline Thursday for the Union to come up with a financial aid mechanism, saying he might turn to the I.M.F. to overcome the debt crisis if E.U. leaders failed to agree on a lending facility at the meeting.

The International Monetary Fund repeated Thursday that Greece had not asked it for financial assistance, according to Reuters.

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