Europe's Financial Crisis, in Plain English

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The flag of the European Union flies in front of the German Parliament building in Berlin.

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Much like our own recent housing crisis, the European financial mess is unfolding in a foreign language. It is the lingua franca of financial obscurity — "sovereign credit spreads" and other terms that most people don't need, or care, to know.

Deep thoughts this week:

1. Don't worry too much about Greece.

2. Instead, worry about Italy.

3. Portugal might do all right with the escudo.

4. Just as in '08, it's all about uncertainty.

Yet the bottom line is simple: Europe's problems are a lot like ours, only worse. Like Wall Street, Germany is where the money is. Italy, like California, has let bad governance squander great natural resources. Greece is like a much older version of Mississippi — forever poor and living a bit too much off its richer neighbors. Slovenia, Slovakia and Estonia are like the heartland states that learned the hard way how entwined so-called Main Street is with Wall Street. Now remember that these countries share neither a government nor a language. Nor a realistic bailout plan, either.

Lack of fluency in financialese shouldn't preclude anyone from understanding what is going on in Europe or what may yet happen. So we've answered some of the most pressing questions in a language everyone can comprehend. Though the word for "Lehman" in virtually any language is still "Lehman."

Q: Will the euro survive?

It's a dangerous question to ask out loud. Suppose a credible rumor spread throughout Greece that, rather than accept the harsh terms of another bailout package, the government was plotting to revert to the drachma. Fearing the devaluation of their savings, Greeks would move their money somewhere safer, like a German bank. The Greek banking system would then, in all likelihood, implode.

But Greece's economy is too small for an isolated collapse to cause any significant damage throughout the continent. (Even a collapse confined to Greece, Ireland and Portugal couldn't take down Europe.) So the concern about a run on the Greek banking system is largely about whether a panic might spread to Spain or — worse — Italy, which *could* topple Europe's financial system. Maybe that's why the treaty that created the euro doesn't say anything about a country's abandoning the currency. Or why European leaders scarcely mentioned the possibility (not in public, at least) until this fall, two years into the crisis.

Q: Why is it such a bad thing for a country to abandon the euro?

If a country did pull off a surprise euro exit — and get out before everybody could take their money out of the banks — there would still be a period of economic chaos. Exports and imports would shut down. Lending would collapse, which would send companies into bankruptcy. Ripple effects would be felt throughout Europe.

The problem is thorny enough that the British chief executive of Next, a European retailer, recently offered a £250,000 prize for the person who comes up with the best plan for countries to leave the euro without destroying the European economy. (Have a brilliant idea? Entries are due early next year.)

Q: Wait a minute: If leaving the eurozone would be so awful, why would anyone do it?

It's not all bad. Leaving the euro would allow a country to ignore demands from the leaders of other European countries. It could simply refuse to pay its debt.

After the short-run pain, weaker European countries could also see a long-term benefit. If Greece or Portugal went back to the drachma or the escudo, the cost of their exports would fall. Because it would be cheaper for foreign travelers to stay in their hotels and eat in their restaurants, their tourism industries would get a bump, too. The alternative is to spend the next decade as poor countries tied to a rich one's currency.

Q: Why exactly does Angela Merkel always look so woebegone?

For the euro to survive in the long run, Germany — the zone's biggest economy — will most likely need to vouch for the debt of struggling eurozone members. And it will become more expensive to borrow money if bond investors fear the country is becoming overextended.

The Germans are also wary of the widespread calls for the European Central Bank to buoy Spain and Italy by buying their bonds. If they know the E.C.B. will bail them out, what will be their incentive to act responsibly in the future? Worse, Germans argue, printing money to pay off government debt (which is what the E.C.B. would essentially be doing) is the first step to hyperinflation.

Q: What happens to the European Union if the euro crumbles?

It turns out that a bunch of vastly different countries, each with control over its own budget but all bound to a common currency, is not a sustainable economic model. And that leaves Europe with two main, and painful, options.

Option 1: Keep the euro, and make the eurozone even more integrated. While this doesn't necessarily require a full-blown United States of Europe, individual countries would probably have to give bureaucrats in Brussels or Frankfurt power over how much money they can spend. The E.C.B. might promise to do whatever is necessary to stop a panic, but poorer eurozone countries would very likely endure years of difficult economic adjustments, including falling wages.

Option 2: Greece and perhaps a few other struggling countries on the periphery leave the euro. A Greek exit alone might give the European dream a hard kick in the teeth, but it wouldn't necessarily be fatal. It might, in fact, even prod European leaders to act more boldly to defend the rest of the eurozone. But the departure of Italy — the zone's third-largest economy — would be a different story. Italy is what wonks call a systemically important country, which means that it is so big, and so intertwined with the rest of Europe, that it would take the whole eurozone down with it. Think massive disruptions to European trade, chaos in the financial system and a dose of political and social unrest.

Q: What does this mean for the U.S.?

Fortunately, exports to eurozone countries amount to only about 3 percent of America's overall economy. The bigger worry, though, is the financial system. U.S. banks say their exposure to Europe is manageable, but when you ask smart people what a financial disaster in Europe would mean for the U.S., their answer usually goes, "Blah, blah, blah, Lehman." To put a finer point on it: when Lehman Brothers went bankrupt in the fall of 2008, it initiated a global financial panic greater than almost anyone predicted, largely because of uncertainty. Nobody knew who owed what to whom. The global financial system froze, with disastrous consequences.

European banks currently hold an extraordinary amount of European debt. And while U.S. banks have been reporting more details about their exposure to European banks, there still is a tremendous sense of uncertainty about who is on the hook, and for what, exactly. If Europe's biggest banks go down, it could very well cause another Lehman-like crisis in the U.S. The good news: It's still an "if."

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