European officials demand further cuts in Greece after bailout pledge

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The February 11 Franco-German pledge to bail out Greece threatened to unravel yesterday amid criticism from the Greek government, and as European Union (EU) officials demanded that Athens make further budget cuts. It is increasingly clear there was no real agreement on how to pay for a bailout, and the negotiations sought primarily to strengthen the pressure from financial markets on the working class to accept massive cuts in jobs and wages.

Greece is running a large budget deficit of 12.7 percent of its Gross Domestic Product (GDP). Amid fear that the government might not make deep budget cuts, investors have driven up interest rates on Greek government debt, increasing the risk of a debt default. The bailout pledge—negotiated by Papandreou with German, French, and EU officials—called for the 16 countries that use the euro to "take determined and co-ordinated action, if needed, to safeguard financial stability in the euro area as a whole."

Divisions soon emerged over the pledge, however, with the German government indicating that it might not lend money to Greece after all. A "senior EU diplomat" told the *Guardian*: "Germany is stepping totally on the brakes on financial assistance. On legal grounds, on constitutional grounds, and on principle." *La Croix* reported that French President Nicolas Sarkozy had failed to secure an agreement from German Chancellor Angela Merkel for direct loans by eurozone countries to Greece.

In short, the bailout plan was based on hopes that a vague announcement would calm fears in the debt markets. Before the negotiations, Papandreou himself said he was seeking "political and psychological support from Europe," and that Greece had not "asked for financial support."

However, there is little support, either political or financial, for a concerted bailout by the eurozone. This would depend on overcoming deep divisions between the major European powers: if Greece were bailed out by the entire eurozone, the cost would fall disproportionately on Germany, the region's largest economy—but the benefits would go primarily to other countries' banks.

According to Crédit Suisse figures, the UK and Ireland hold 23 percent of Greek government debt obligations, France 11 percent, while Germany, Switzerland, and Austria together hold only 9 percent. European banks collectively have made $252 billion in loans to the broader Greek economy. This includes $75 billion (€55 billion) loaned by France, $63 billion (€46 billion) by Switzerland, and $43 billion (€31 billion) by Germany.

Le Monde quoted a "senior French source" yesterday, who maintained: "If the Greeks sell government obligations and it does not work, we will buy them." However, *Le Monde* noted that "due to German reticence, nothing is ready yet."

Economic figures for the fourth quarter of 2009 showed extremely weak growth in Europe. The German economy was flat in the fourth quarter and fell 1.7 percent year-on-year. The eurozone economy grew by 0.1 percent, led by France whose 0.6 percent growth was powered by consumer spending and a large budget deficit (7.9 percent of GDP). Italy shrank by 0.2 percent, and the Spanish and Greek economies also shrank.

Yesterday, Greek Prime Minister George Papandreou turned on the recently-negotiated agreement, saying "the credibility of Europe and its willingness to stand up to international markets are at stake." He bitterly criticized the deal for turning Greece into "a laboratory animal in the battle between Europe and the markets." He warned that Thursday's negotiations sent "mixed messages about our country … that have created a psychology of looming collapse which could become self-fulfilling."

Papandreou blamed the European Commission for failing to detect or act upon the previous conservative Greek government's "criminal record" in falsifying economic statistics. He added: "This has undermined the responsibility of European institutions with international markets."

In the run-up to the conference, Papandreou proposed drastic cuts in government spending. They included cutting Greece's budget deficit by a massive 4 percent of GDP in 2010, increasing the public sector retirement age by two years to 63, freezing wages and cutting bonuses, while imposing a 10 percent increase in fuel prices. These cuts could cost tens of thousands of jobs in private firms that work for the government.

Nonetheless, leading European officials gave interviews yesterday demanding deeper cuts.

In an interview with *Der Spiegel*, European Central Bank (ECB) Chief Economist Jürgen Stark called for lower wages in Greece. He said: "Greece has lost its ability to compete on the basis of price. Its unit labor costs have risen tremendously. The government in Athens has recognized this. That too is something it will have to quickly come to grips with."

Though not explicitly repudiating the principle of a bailout of Greece, Stark refused to clearly endorse any mechanism for giving Athens money: "Solidarity is not a one-way street." He ruled out loans by other European governments to Greece—either in the form of direct payments or joint bond issues. He also said a bailout by the International Monetary Fund (IMF), headquartered in Washington and influenced by US policy, would be "inappropriate."

Stark maintained that a Greek bankruptcy "isn't a scenario, as far as I'm concerned," later repeating that Greece "must and will make it." He indicated that Germany—which runs lower budget deficits—was an "effective role model" for the entire eurozone.

Der Spiegel made unusual public criticisms of the English-speaking powers. It noted: "In the United States, the Fed is doing plenty of rescuing. It simply prints money and buys treasury bonds." Stark responded: "We cannot take that approach. And I am glad we are not permitted to do so. Our mission is price stability."

Asked about concerns raised in the financial press that Spain, Italy, and Portugal might also face a credit crunch, Stark said: "Great Britain has a budget deficit of the same magnitude as Greece. The US budget deficit is also more than 10 percent of GDP. All advanced economies are currently having problems. In fact, it is astonishing to see where most of the criticism of the euro is coming from at the moment."

Asked if he thought the "Anglo-American media" was behind attacks on the euro, Stark said: "much of what they are printing reads as if they were trying to deflect attention away from problems in their own backyard."

In an interview with Jean Quatremer of the French daily *Libération*, Luxembourg's Prime Minister Jean-Claude Juncker made clear that any eurozone bailout would serve to enforce financial markets' demands: "The Greek plan must appear credible. If the markets question the Greek government's course of action, further measures must be taken. The eurozone will only intervene once that has been done."

Asked by Quatremer if Germany was hostile to a bailout, Juncker responded: "Germany must deal with internal problems of justification that France does not have. This means that France has a more proactive approach than Germany." However, Juncker indicated Paris would align its policy on Berlin.

Le Monde noted the bailout pledge represented "a violation of promises by politicians to the German public when they gave up the Deutschemark [and joined the euro]. Edmund Stoiber, the Minister-President of Bavaria, had promised in the run-up to the euro in the late 1990s that 'a union based on financial transfers [between countries] is as unlikely as a famine in Bavaria.' Less than ten years after entering the monetary union, Greece is smashing all the rules to pieces."

A one-day general strike has been called in Greece, by the ADEDY public sector union and the GSEE private-sector union, for February 24 to protest Papandreou's cuts.

The ambiguity maintained on the terms of assistance to Greece amounts to a deliberate weapon to intimidate working-class opposition and help Papandreou push through his cuts.

The *Financial Times* wrote: "To avoid moral hazard, and to act as a warning to other fiscally profligate countries, everyone needs to believe that Greece might go down. It is a nuclear-style threat that would make Lehman's bankruptcy look like a firecracker. At the same time, the eurozone cannot countenance that possibility. If Greece lost access to the financial markets and, so, defaulted, yields on Italian, Spanish, and Portuguese bonds would soar. Borrowing costs would rise further, and the eurozone economy, whose recovery has already stalled, would slow even more."

At the same time, entertaining doubts on Greece's solvency is proving highly profitable for investors. Though the interest rate the Greek government pays on its debts has fallen since the Franco-German bailout announcement, it remains high—5.1 percent for a 2-year bond, and 6 percent for a 10-year bond—offering attractive returns.

Montsegur Finance fund manager Marine Michel told Reuters: "The fears over this country have been overdone. The Greek bond offers a far higher yield than many corporate bonds and is an interesting proposition."

The press has also begun an ominous debate on what forms of state repression might be needed to push through the gigantic cuts being planned in Greece, which as recently as 1974 was ruled by a military dictatorship.

Asked how much "public unrest" austerity measures might cause, *Financial Times* commentator John Paul Rathbone replied: "How much suffering can a population bear? Well, democracies very rarely do deflation, so that's not very promising. What Greece really needs to do to meet these budget cuts is to deflate the economy and for wage and other prices to fall to a level that makes Greece competitive once again. That's the underlying problem. … So it promises to be a very volatile situation."