European officials demand new cuts following Greek bailout request

Alex Lantier
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European officials signaled they will demand further austerity measures from Athens in exchange for a joint European Union (EU)-International Monetary Fund (IMF) bailout. Greek Prime Minister Giorgios Papandreou formally requested a bailout package on April 23. Under a previously agreed plan, the EU and IMF would combine to grant Athens roughly €45 billion in loans to stave off a Greek default on roughly €300 billion in government debt.

Papandreou formally requested the bailout package while on the remote Greek island of Kastellorizo, 2 kilometres from the Turkish coast in the Aegean Sea. The day before, he phoned the current EU president, Spanish Prime Minister José Luis Zapatero, and German Chancellor Angela Merkel. On Friday, Papandreou reportedly called Turkish Prime Minister Recep Tayyip Erdogan.

Kastellorizo was the center of Greek shipping in the nineteenth century, but now has only 500 residents. The US previously pressed Greece to consider giving the island to Turkey in order to improve Greco-Turkish relations. Papandreou's aides said he wanted to visit Kastellorizo before talks with Erdogan on May 14-15.

Greek newspapers reported Friday that Erdogan had offered financial assistance to Papandreou. Papandreou "kindly refused," according to these accounts. Turkish officials denied the story, saying that offers of financial assistance were "definitely not discussed."

After the bailout request was announced, 2,500 protestors marched in Athens and hundreds marched in Thessaloniki, clashing with police. They carried banners reading, "Capitalism must pay for the crisis" and "IMF go home."

Papandreou's government is in talks with the IMF, the European Central Bank (ECB) and the European Commission on further cuts to be implemented this year, as well as in 2011 and 2012. The prime minister is then slated to sign a "letter of intent" with the IMF, committing Greece to a multi-year austerity plan that the IMF would have to approve. A special coordinator for the EU-IMF programme will then be set up to monitor Greece's progress in carrying out cuts.

Greece has to refinance €8.5 billion in loans by May 19. With the interest rate Greece pays on new debts rising rapidly—closing last week at 10.23 percent for 2-year debt and 8.67 percent for 10-year debt—Papandreou and the financial markets are placing huge pressure on the Greek population to rapidly accept further cuts. An opinion poll in the Greek weekly *Proto Thema* found only 23 percent support for Papandreou's policy. Some 65 percent of those polled said Papandreou had misled the public over the state of the Greek economy.

Greece has already cut social spending by 10 percent, increased the retirement age by two years, and suppressed one month's wages in the public service.

Since these cuts reduce the size of the government's tax base, it is unclear whether Athens can raise enough revenue to avoid default. Vincent Chaigneau, foreign exchange and interest rate specialist at the bank Société Générale, said: "The €45 billion package would keep [Greece] going for at least 15 months and potentially they can avoid a restructuring [of debt and an eventual default]. But even with the liquidity mechanism triggered, there is still a question of whether they can avoid a death spiral."

The full cuts to be demanded of Greece will not be known before the end of talks with European and IMF officials. However, past experience suggests they will demand slashing cuts that will reduce the country to penury, setting it back decades.

A recent IMF bailout package for Latvia included pay cuts of 45 percent in the public sector and 5 to 30 percent in the private sector. Latvia's economy is continuing to shrink under the weight of these cuts.

European officials pressured Greece for further cuts after a G-20 financial summit in Washington, D.C., on April 24.

German Finance Minister Wolfgang Schäuble told *Bild am Sonntag*: "The fact that neither the EU nor the German government has taken a decision [to loan money to Greece] means that the response can be either positive or negative. Everything depends on whether Greece will pursue the strict policy of spending cuts it has begun to undertake. I was very clear with the Greek finance minister on this score." He said an "energetic restructuring programme" was the essential precondition to further German assistance to Greece.

In a TV interview, German Foreign Minister Guido Westerwelle said Germany would not write a "blank cheque to Greece."

Speaking to the *Journal du Dimanche*, French Economy Minister Christine Lagarde said France would pay out only €3.9 billion of a planned French contribution of €6.3 billion to the Greek bailout. She said the French government would be "firm" and "extremely attentive to results" before granting Greece the rest of the bailout package. She hoped France would make €150 million in profits from Greece by borrowing from bond markets at 1.5 percent and lending to Greece at 5 percent.

A further complication to European bailout plans for Greece is continuing opposition and procedural obstacles emerging in Germany to its slated contribution of €8.4 billion. Currently, the Merkel government plans to have the KfW state development bank put up the funds, a measure that would require parliamentary approval in order to guard against the possibility of losing money. Finance Minister Wolfgang Schäuble plans to use an expedited parliamentary procedure to pass the measure in 10 days.

A new law is expected to provide the Merkel government with better protection against challenges to the bailout in the constitutional court, such as that planned by economist and Euroskeptic Professor Joachim Starbatty. This is politically sensitive due to the unpopularity of bailouts with the German public and the upcoming May 9 election in North Rhine-Westphalia. This election could cost the government coalition control of the upper house of the German parliament.

There are reports that several of the Merkel government's coalition partners, including the Bavarian Christian Social Union (CSU) and the Free Democrats (FDP), might also file challenges to bailout plans. Several leading members of these parties have made statements since Papandreou's announcement attacking Greece.

CSU parliamentarian Hans-Peter Friedrich said, "Greece has not only a liquidity problem, but also a fundamental growth and structural problem." The need to regain competitiveness, possibly by reintroducing and devaluating a Greek national currency, should prompt Greek politicians to "seriously consider leaving the eurozone," he added.

Werner Langen, head of the Christian Democratic Union/Christian Social Union group in the European Parliament, said, "I am extremely skeptical as to whether the aid package conforms with European Union law and the German constitution. The real alternative is for Greece to leave the currency union and become competitive again via hard structural reforms."