

European financial leaders postpone a new bailout for Greece

Stefan Steinberg**18 May 2011**

The two-day summit of European finance ministers in Brussels failed to arrive at a consensus yesterday on how to deal with the main issue they faced: the crisis of the Greek economy, which is increasingly spiralling out of control.

On Monday the finance ministers agreed on terms for their €78 billion loan to Portugal in exchange for punishing cuts in social spending and a program of far-reaching privatizations. They also agreed to the nomination of Italian banker Mario Draghi, a former employee of Goldman Sachs, as the next head of the European Central Bank.

Talks broke down, however, on Tuesday on how to stem the haemorrhaging of the Greek economy. Conflicts also emerged on an item not officially included on the agenda, but which dominated discussions behind the scenes at the summit—the need to replace the head of the International Monetary Fund, Dominique Strauss-Kahn, now held without bail in a New York City jail on sexual assault charges.

In May 2010, Greece was the first European country to receive a bailout from the European Union (EU) and the International Monetary Fund (IMF). The aim of the €110 billion bailout was to protect the assets of European banks and finance houses, which had invested heavily in the Greek economy. The bailout guaranteed Greece credit at punitively high interest rates for a number of years. In return, demands were placed on Greece to massively cut back its public spending and reduce its burden of debts.

One year on, the crisis of the Greek economy has worsened considerably. After a series of austerity budgets imposed by the government, the country's indebtedness has increased dramatically, as the EU-IMF austerity program has condemned the country to a prolonged recession.

Unable to arrive at an agreement at the Brussels meeting, Eurozone finance leaders put off any final

decision until the next scheduled EU meeting in June. The only proposal put forward by the assembled finance ministers was to further social cuts in Greece – in particular through the privatisation of key services such as power and telecommunications, which still remain largely in the hands of the state.

The complete privatisation of these companies represents a windfall for the private companies that bid to buy them up. They will be able to dictate prices to all consumers of these essential services.

Commenting on the failure of European leaders to come to terms over Greece, the German magazine *Der Spiegel* lamented: “If the medicine isn't working, increase the dose. That...is the treatment plan being pursued by the saviours of the euro in Brussels. A new austerity and loan program would not only increase Greece's debt and curb the economy even further. It would also stigmatize Greece as Europe's stepchild for decades to come, dependent on the goodwill of the lender nations, governed by the inspectors of the European Commission, the European Central Bank and the International Monetary Fund, a prospect London's *Financial Times* describes as a ‘political nightmare.’”

The main fault line inside the Eurozone lies between Germany on the one side and a majority of countries, together with the European Central Bank, on the other. Germany has been pushing recently for some sort of restructuring of Greek debt.

This option would involve significant losses for European banks, notably the biggest investors in Greek debt: the French banks and the ECB. The latter has bought up large amounts of Greek government bonds since the start of the European debt crisis. Recently a leading member of the European Central Bank, Lorenzo Bini Smaghi, warned that any restructuring of Greek debt would lead to a “true economic meltdown” in Europe.

German banks have less exposure to Greek debt. The

main German investor in Greek debt is Hypo Real Estate (HRE), which was nationalized by the German government after the 2008 financial crisis. This means losses incurred by HRE in connection with a restructuring of Greek debt would ultimately be paid by the taxpayers, not the banks.

The majority of EU countries, led by France and supported by the ECB, are demanding a solution that would involve Germany – as the continent's biggest economy – paying more to shore up the ailing Greek economy.

German Chancellor Angela Merkel is under increasing pressure from those, including a significant number of deputies in her own coalition, who are vehemently opposed to further financial aid and argue that the Greek economy be allowed to go to the wall.

Only last weekend, one-third of the delegates at a party conference of the free market Free Democratic Party—a member of the ruling German coalition—declared their opposition to further German funding for Greece. Having already provoked the fall of the Finnish, Irish and Portuguese governments, the European debt crisis threatens to turn into a crisis for the German government as well.

Controversial discussions also took place over a possible replacement for the Eurozone summit's missing guest, IMF leader Dominique Strauss-Kahn. Strauss-Kahn was due to take part in the meeting but was replaced at the last minute by two IMF subordinates after his arrest in New York on charges of sexually assaulting a chambermaid.

Both Germany and the European Commission immediately issued statements declaring that any replacement for Strauss-Kahn should come from Europe. Traditionally, in the post-war period, the IMF has been headed by a European with an American functioning as his deputy. In exchange, the post of chief of the World Bank has invariably been filled by an American.

Now this decades-long agreement is threatened by the sudden incarceration of Strauss-Kahn. European leaders are concerned that a non-European candidate—unfamiliar with or even hostile to the European banking sector—could disrupt or derail the continuous negotiations necessary to keep the eurozone from collapsing or breaking apart.

Expressing the worries of a number of European leaders, German Chancellor Angela Merkel told reporters: “We know that in the medium term, developing countries have a right to the post of IMF chief and the post of World Bank chief. I think that in the current situation,

when we have a lot of discussions about the euro, that Europe has good candidates to offer”.

Merkel's comments, echoed by EU Commission chief Jose Manuel Barroso and Belgian Finance Minister Didier Reynders, were an attempt to stake out territory at a time when European handling of the euro crisis has come under increasing criticism from abroad.

At a meeting held in Washington last month, American, Chinese and Canadian finance officials all expressed their increasing irritation with the inability of European leaders to contain the euro crisis and pacify the markets.

According to one EU diplomat, “The US, Canada and Beijing told the EU: You've got to get this done to stop the speculation.”

While united in their determination to secure a European replacement for Strauss-Kahn, there is little consensus among European nations on a potential candidate.

Figures already being raised as potential candidates for the post are French Finance Minister Christine Lagarde, Turkish Finance Minister Kemal Dervis, former German Finance Minister Peer Steinbrück, and even former UK Prime Minister Gordon Brown

Over the past decade, Germany and France have jockeyed for leading positions in European and international financial bodies. Based on their increasingly divergent approaches to the euro crisis, it is difficult to see how they could arrive at an agreement on a candidate.

Gordon Brown is not regarded as a serious candidate – Britain is not a member of the eurozone and his nomination is opposed by the current British premier, David Cameron, while the Turkish candidate is regarded as a representative of newly emerging economies. Despite repeated attempts by its government, Turkey has been repeatedly refused membership in the European Union.

At a time when Europe is coming under increasing pressure from both America and China, the sudden dispatch of the head of the IMF has only served to intensify antagonisms between the continent's major powers.



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