Greek crisis triggers fierce conflicts in Europe

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Rumours about the possible withdrawal of Greece from the euro, and a secret meeting of European finance ministers, have triggered fierce conflicts within the European Union.

Spiegel Online reported on Friday that Greece was considering leaving the euro zone and reintroducing the drachma as its national currency. Finance ministers from the largest euro countries met in Luxembourg with euro group chief Jean-Claude Juncker, European Central Bank (ECB) President Jean-Claude Trichet, and EU Commissioner Olli Rehn.

The news sparked turmoil on the financial markets. The euro fell considerably against the dollar. Jean-Claude Juncker at first denied there had been a meeting, even though he had issued the invitations. Greek Prime Minister Giorgos Papandreou denied there were plans to leave the euro, saying angrily, "Such scenarios border on the criminal." Other governments and the ECB also denied the existence of such exit plans. "No euro-zone member wants to abandon the euro," said ECB executive officer Erkki Liikanen.

Nevertheless, speculation about the possible consequences of a Greek withdrawal from the euro zone is mounting. Economists, politicians and journalists are avidly discussing the pros and cons of such a move.

The tone of discussions between the capital cities is becoming more and more heated. According to *Spiegel*, Berlin is accused of deliberately spreading confidential information. “In Germany, there are people who are deliberately spreading rumours and half truths”, said one critic cited by the *Süddeutsche Zeitung*. "They are either acting irresponsibly or pursuing their own agenda."

The newspaper cited another high-ranking representative of the euro countries saying that Berlin was throwing "Greece and the euro into the jaws of the speculators."

A year ago, the European Union and the International Monetary Fund agreed to a 110 billion-euro rescue package for Greece, demanding that the Greek government implement drastic austerity measures. It is now obvious that Greece—despite, or rather because of, this programme—is slipping deeper into debt.

The Papandreou government has pushed through drastic cuts in public spending; wages in the public sector have declined by 30 per cent. But the austerity measures have in turn unleashed a recession, which is eating up all the savings. According to the Ministry of Finance, in the first four months of this year government revenues were €15.1 billion, €1.3 billion less than the amount needed to meet the requirements of EU and the IMF.

Last year, economic output fell by 4.5 percent and total debt increased to 142 percent of gross domestic product (GDP). There have been 65,000 bankruptcies, and more than 200,000 people have lost their jobs. In Athens, one in five shops now stands empty. In the countryside, the situation is even worse.

All figures suggest that the recession has deepened. The number of building permits issued in January was 62 per cent lower than in the same month last year. The sale of new cars fell by half in the first four months compared to the same period last year.

The EU and IMF plan anticipated that Greece's borrowing needs until 2013 would be covered by the €110 billion bailout. Thereafter, it should be able to gradually raise funds on the capital market by issuing government bonds. But half of the rescue fund has already been used up and the remaining €55 billion will probably last only until the spring of 2012. At the same time, the financial markets refuse to lend to Greece. The rating agencies have downgraded the country so low that it must pay 25 per cent interest for two-year bonds—an unsustainable situation.

If nothing happens, Greece must declare state bankruptcy next spring. This would result in significant costs falling on other European governments.

The bailout means that a growing portion of Greek government debt is not held by private banks but by public institutions. In 2009, private creditors held 100 per cent of Greek public debt, whereas now 37 per cent is in the hands of the EU, IMF and ECB. "The burden has shifted massively from private to public hands", said Unicredit banker Andreas Rees.

The public share of the debt is expected to rise to 50 percent by 2013. Private investors will probably then only hold €180 billion of Greek debt, compared to just under €300 billion in 2009. The recovery programme for Greece has turned out to be a rescue programme for the private banks.

The threat of Greek state bankruptcy has led to fierce conflicts within the EU. Especially in Germany, there are increasing calls for debt rescheduling or for Greece to be expelled from the euro zone.

In several recent interviews, the head of the Ifo Institute Hans-

Werner Sinn called for Greece to return to the national currency. “Any attempt to stabilize Greece and keep it in the euro zone would be a bottomless pit. If Greece is left inside, it would destabilize the euro,” he said. The return to the drachma would enable Greece to devalue its currency and become competitive again.

Max Otte, professor of economics at the University of Applied Sciences in Worms, argues in a similar fashion. "Leaving the euro would help Greece to establish its competitiveness again through external devaluation. Over time, the country could rehabilitate itself without this being seen as the result of dictates from abroad," he wrote to finance daily *Handelsblatt*.

The finance expert of the Free Democratic Party (FDP) parliamentary group, Frank Schäffler, called for "positive support for Greece's withdrawal from the euro-zone, as it is clear the Greek bailout and savings measures are accelerating the crisis."

However, other experts warn of the explosive consequences of such a move: massive price increases for energy and other imports, a run on the Greek banks and a massive capital flight. And public and private debts would probably still be denominated in euros. "[Debt] servicing would become impossible and the Greek state would immediately become bankrupt", wrote Gustav Horn, director of the Institute for Macro Economics and Crisis Research (IMK).

This would also bankrupt the Greek banks and pension funds, which have loaned the Greek state €75 billion. The export sector would see little benefit from devaluation, as exports contribute only 7 percent of GDP in this industrially weak country.

In other words, the introduction of the drachma would result in state bankruptcy and massive inflation. It would decimate the living conditions of broad layers of the population, as happened under hyper-inflation in Germany in the 1923.

Government representatives warn that a Greek exit from the euro zone would pull Ireland, Portugal and Spain into a maelstrom, and bring about the end of the euro. "We don't want the euro area to explode for no reason", commented euro group leader Jean-Claude Junker.

Nonetheless, a small but influential minority in Germany is insisting that Greece be forced out of the euro zone. The call for Greek debt rescheduling finds broader support. Berlin does not openly advocate this step, however, fearing a violent reaction by the financial markets that could overwhelm Ireland, Portugal and Spain.

There are sharp conflicts regarding this issue with other countries, whose banks and governments have underwritten far higher loans to Greece. In contrast to previous rescue measures, which had merely extended credits to Greece, billions would be lost forever in the event of debt rescheduling.

The German banks have clearly come to the conclusion that they could deal with debt rescheduling in which Greece wrote off up to 50 percent of its debts. For France and other countries, such a restructuring would be far more difficult to bear. For the Greek population, it would be bound up with further cuts and attacks on living standards - as is the current rescue package.

According to *Spiegel Online*, a 50 percent debt write-off would cost the German banks, the federal government and Bundesbank (Federal Bank) a total of €27 billion. But only €9 billion would fall on private banks, of which the lion's share is held by Hypo Real Estate, which is state owned.

This amount is relatively high. But compared with the costs of German unification, which have amounted to well over one trillion euros in the past twenty years, it is quite modest. Germany's annual trade surplus of €200 billion is a multiple of that amount. In addition, the longer a debt rescheduling is postponed, the more expensive it becomes for Germany.

Some commentators have come to the conclusion that the essential problem in the Greek crisis is not financial but political. The pressure of the international financial crisis is bringing national interests increasingly to the fore in Europe.

Columnist Wolfgang Münchau writes in the *Financial Times*: "The core issue in the euro-zone crisis is not the overall size of the peripheral countries' sovereign debt. This is tiny relative to the monetary union's gross domestic product. The area's total debt-to-GDP ratio is lower than that of the UK, US or Japan. From a macroeconomic point of view, this is a storm in a teacup. The problem is that the euro zone is politically incapable of handling a crisis that is now contagious and has the potential to cause huge collateral damage.”

Former German Chancellor Helmut Schmidt argues along similar lines in *Die Zeit*. The alleged crisis of the euro was “much more a crisis of the ability to act of the EU as a whole,” he writes. "There is neither a common economic or finance policy, nor a common foreign and security policy (look at Libya!) nor a common energy policy."

According to recent agency reports, the EU is now preparing to increase the size of the rescue pact for Greece by €30 to 60 billion, linking this to further cuts targets for the Greek government. However, this will only postpone the problem and intensify the crisis rather than resolve it.