openeurope

A Greek bailout:

Is it legally possible and what will it cost EU taxpayers?

A GREEK BAIL-OUT

Is it legally possible and what will it cost EU taxpayers?

February 2010

Open Europe
7 Tufton Street
London
SW1P 3QN

Tel: 0207 197 2333
Fax: 0207 197 2307
www.openeurope.org.uk

SUMMARY

As EU leaders are set to gather in Brussels to discuss the crisis facing the eurozone, Open Europe has published an overview of the ways in which Greece could be bailed out by the EU and what these solutions could cost European taxpayers.

Key findings:

- All of the options on offer carry significant costs for the eurozone and, in some cases, for the other non-eurozone members of the EU, such as the UK.

- The legality of a bailout under the EU Treaties is doubtful – of the ten options for a bailout that Open Europe looked at, only one is unambiguously legal under the Treaties, meaning that EU leaders are set to bend EU law if going ahead with a rescue package. This sets a worrying precedent.

- Open Europe also finds that a bailout of Greece could cost EU taxpayers up to €30 billion in a first instalment. Meanwhile, British taxpayers could be affected in six out of the ten alternatives currently being considered for a possible bailout of Greece.

- However, a one-off bailout would not address the enormous discrepancies in competiveness and productivity between different eurozone members, which continue to put the eurozone under strain.

- If these structural differences are to be overcome and the eurozone is to survive for the long term, ongoing fiscal transfers from the rich German-led bloc to the poorer bloc, consisting of countries such as Greece and Spain, might be the only feasible option. Calculations by Banque AIG in 2008 suggested that such annual transfers could be of the order of seven percent of German GDP – which dwarfs the amounts involved in a one-off rescue operation.

- There is very little popular support for a one-off bailout, much less for ongoing transfers. An Open Europe poll of German voters in 2009 found that 70 percent were opposed to using taxpayer funds to bailout countries in financial difficulties such as Ireland or Greece[1].

- Open Europe concludes that, taking all short term alternatives into account, EU leaders should either let Greece default, in order to avoid the 'moral hazard' scenario which could impose even higher costs down the road, while also avoiding policies for which there is no popular support; or go to the IMF, which has the necessary experience in coming to the rescue of individual countries. This would also avoid the huge complications involved in cross-border transfers of money and establishing central EU economic governance.

[1] See Open Europe press release: http://www.openeurope.org.uk/media-centre/pressrelease.aspx?pressreleaseid=117

- However, these short term measures will not address the structural lack of competitiveness that affects not only Greece, but also countries such as Spain and Portugal. The lack of a public mandate or support for establishing a formal system of fiscal transfer from poorer to richer eurozone countries will leave EMU with long term frailties that will be exposed again in future economic crises.

ALTERNATIVES FOR AN EU BAILOUT OF GREECE

OPTION	WHAT ARE THE COSTS?	WOULD IT AFFECT UK TAXPAYERS?	IS IT LEGAL?
1. Direct bailout	Unclear, but possibly up to €30 bn in first installment/moral hazard	Yes	Probably not
2. Early cohesion funds	€18.1 bn	Yes	Yes
3. Extending balance of payments facility	EU taxpayers liable/moral hazard	Yes	No
4. Common eurozone bonds	Punishing fiscally sound countries/moral hazard	No	Probably not
5. Setting up a European Monetary Fund	EU taxpayers liable	Yes	Probably not
6. Bilateral or multilateral loans	Place burden on a few member states/moral hazard	No	Probably not
7. Loans or investments by EIB	Risks transferred to EU taxpayers	Yes	Unclear
8. EU governments or EIB buy Greek bonds	Risks transferred to EU taxpayers	Yes	Unclear
9. 'Interest rate bailout' by ECB	Unsuitable interest rates for the 'German bloc' of eurozone countries that could cause inflation	No	No
10. Indirect bailout by ECB	Transfers costs of Greek borrowing to rest of eurozone and could cause inflation in the longer term	No	No

I. INTRODUCTION

EU leaders will on Thursday 11 February meet to discuss the bloc's economic strategy over the next decade. However, the talks will be overshadowed by the problems facing Greece and the rest of the eurozone.

As fears mount over the risk of Greece's economic difficulties spreading to the rest of the eurozone – in particular to countries such as Spain, Portugal and Ireland which face similar problems – rumours of a full-scale bailout of Greece are growing stronger.

A bailout would involve transfers of money – either in hand-outs or loans – from the bloc's richest member states to Greece or any of the other eurozone countries potentially in need of help. The transaction could involve only eurozone members or all EU member states, depending on the option chosen.

Greece's outstanding national debt now stands at an extraordinary €300 billion, which is equivalent to about 125 percent of the country's Gross National Product (GDP).[2] This ranks the country as one of the world's highest in terms of debt relative to GDP. The country's budget deficit is estimated at 12.7 percent of GDP – although the figure could well be higher due to Greece's problems with producing reliable statistics. Under the EU's Growth and Stability Pact, a country's deficit is not allowed to exceed three percent. Greece has vowed to cut its budget deficit to below this three percent level by 2012 – a task many analysts believe to be extremely difficult.

Meanwhile, the country's current account deficit is close to 15 percent. The challenges facing the Greek economy are therefore immense and a bailout could be imminent.

What will a bailout cost Europe's taxpayers?

It's virtually impossible to predict the exact amounts involved in a bailout of Greece, due to the number of factors involved. However, Greece will have to raise around €55 billion in 2010 in order to pay back maturing debt and keep up its current expenditure. Credit Suisse has estimated that Greece will have to raise around €30 billion by April/May (around €20 billion in maturing debt). If it fails to refinance this amount, the country would either default or would have to be bailed out.

Christel Aranda-Hassel, Director of European Economics at Credit Suisse has argued that,

> "Greece's acute problem is the need to raise financing to allow it to roll over maturing debt in April and May, while preserving sufficient cash to fund current expenditure. We estimate an additional funding need of at least €30bn by May. The concentration of maturing debt is unusual, but even if this immediate source of stress can be overcome, the funding profile for coming years remains demanding. The next three months will have a heavy bearing on the profile that

[2] As pointed our by Greece's Deputy Finance Minister Filippos Sahinidis on 9 December 2009, see http://www.rte.ie/business/2009/1210/greece.html

> is followed, but whatever happens, Greece and other peripheral euro area countries will still suffer from a chronic need to improve productivity, raise national savings and cut government borrowing."

An initial instalment by EMU/EU member states would therefore involve up to €30 billion – in order to guarantee that Greece will not default on its debts. Although it's extremely unlikely that Greece would default on all its loans – this gives an indication of the figures involved. Should a bailout mechanism be extended to a large economy such as Spain, the amounts involved would skyrocket.

But will a bailout be a one time event?

A one-off bailout would not address the urgent need for Greece – or any of the other countries subject to a possible bailout – to increase productivity and push through necessary and tough structural reforms to their labour markets and fiscal practices (in order to narrow the discrepancies within the eurozone). It's therefore unlikely that a one-off, IMF-style bailout would work. Particularly as a depreciation of the currency of the economy concerned has historically been a key part of such packages – but this element would not be possible for an EMU member.

Financial assistance from richer states to other struggling eurozone members in addition to Greece is likely to follow a first bailout. If these countries don't make the necessary trade adjustments, to address low productivity and other economic shortcomings, a one-off bailout is unlikely to steer the monetary union clear of the asymmetric shocks that we are currently witnessing. Instead, these countries could become the recipients of annual ongoing fiscal transfers in an attempt to artificially iron out discrepancies within the eurozone. Calculations by Banque AIG in 2008 suggested these transfers could be of the order of a staggering seven percent of German GDP every year.

Opening Pandora's Box

It is clear that a bailout would involve massive political and economic risks. To try to convince taxpayers in one country of the need for them to pay for the mistakes of a government in another country – which they cannot vote out of office – is a massively difficult task. For most people it is simply unreasonable and fundamentally undemocratic to make taxpayers liable in this way.

An Open Europe poll of German voters, in June 2009, found that 70 percent were opposed to using taxpayer funds to bail-out countries in financial difficulties such as Ireland or Greece.

In turn, the receiving country is likely to be forced to give up much of its control over its own economy as strict economic conditions are attached to the loans. Indeed, Greece is already experiencing unparalleled intervention from the European Commission in its economic policies. Such intrusion isn't easy to justify to voters at home either.

In addition, a bailout comes with huge economic risks, including what the FT's Martin Wolf has described as a "monstrous case of moral hazard".

For these reasons a whole range of observers have lined up to defend the ‘no bailout’ principle which is established in the EU Treaties. Former Chief Economist at the ECB, Otmar Issing, told the Frankfurter Allgemeine Zeitung that it would be a catastrophe to water down the 'no bailout' clause, arguing that it would spell an end to "the political stability of the monetary union". He said that, in order for financial discipline to prevail, every member state must be responsible for its own debt and deficits: "without this there would be no end", he said.[3]

Current ECB Chief Economist Jürgen Stark has said that "the ban preventing the EU and its member states from taking responsibility for the debts of partner countries is an important foundation needed for the currency union to function."[4] Karl Otto Pohl, former President of Germany's Bundesbank, said that if Germany decided to bail out other members of the eurozone it would open a Pandora's Box, adding "It would be like jumping in a swimming pool without water".[5]

The German Economics Minister Rainer Brüderle was reportedly applauded when he declared to German MPs last month that "there should not be a collective bailout for lopsided developments at national level."[6] Finland and Sweden have also clearly said that a direct bailout isn’t an option. “The EU cannot help, that’s part of our rules. They were established to let member states take care of themselves”, Finnish Finance Minister Matti Vanhanen has stated.[7]

[3] See FAZ, 20 February 2009 http://www.faz.net/s/Rub58241E4DF1B149538ABC24D0E82A6266/Doc~E40EB6E412FAD41CFAC5F8EC2CAE2867C~ATpl~Ecommon~Scontent.htm and http://openeuropeblog.blogspot.com/2009/02/not-all-germans-desire-union-of-debt.html
[4] Der Spiegel, 20 February 2009 http://www.spiegel.de/international/europe/0,1518,608985,00.html
[5] See http://www.openeurope.org.uk/media-centre/summary.aspx?id=792
[6] Quoted in http://www.independent.co.uk/news/business/news/greeces-debt-could-prove-fatal-to-eurozone-german-minister-warns-1882492.html
[7] Quoted in http://www.ftd.de/politik/europa/:defizit-und-schuldenkrise-eu-staatschefs-reden-griechenlands-problem-klein/50048477.html#utm_source=rss2&utm_medium=rss_feed&utm_campaign=/

II. 10 POTENTIAL WAYS TO BAILOUT GREECE

1. DIRECT BAIL-OUT

This would mean that the EU gives direct aid to Greece or another eurozone country in need of help through some sort of cash transfer. A month ago the German Government denied rumours of a possible bailout, with a spokeswoman of the German Finance Department saying that "financial help for Greece isn't being considered by the German government…both with regards to eurozone and bilateral support".[8]

However, this solution has been mentioned by the German Finance Ministry and German Chancellor Angela Merkel, both citing Article 122 of the EU Treaty (see below). According to recent reports, the German government has acknowledged that a bailout could now be unavoidable, with a direct cash transfer being one of the options considered.[9]

What will it cost?

It's virtually impossible to predict how much a direct bailout will cost European taxpayers, due to the number of factors involved. However, what's important to remember is that a direct bailout effectively involves cash hand-outs – not loans – meaning that none of the money would be recouped by governments or by taxpayers. It's also important to remember that a bailout is unlikely to be a one-off event. The ongoing redistribution of money required to compensate for fundamental divergences in competiveness between eurozone members might be far higher than the several billion euros involved in a first potential bailout of Greece.

Unsurprisingly, German taxpayers would be forced to shoulder the largest share of the burden. Germany would effectively pay for one quarter of the entire bailout, if the bailout was based on relative size of eurozone countries. Peter Bofinger, Member of the German Council of Economic Experts has said that a German bailout operation of other eurozone countries "could cost the taxpayer about €1.5 billion per year".[10]

Belgian Economics Professor Paul Degrauwe has estimated that in the event that Greece defaults on the full amount of its outstanding debt, a bailout by the other Eurozone governments would add about three percent to these governments' debt.[11] But he argues that this is "a small amount compared to the amounts added to save the banks during the financial crisis".

However, Italian Economics Professor Mario Nuti has warned that:

> "the bail-out of a country like Greece is affordable – but only up to a point: we should consider that 3% of an average 85% of GDP is a non-neglibible average

8Quoted on fr-online.de, see http://www.fr-online.de/in_und_ausland/wirtschaft/debatte_wirtschafts_und_finanzkrise/?em_cnt=2245826&
9 See for examples reports in the FTD, see http://www.ftd.de/politik/europa/:nothilfe-berlin-soll-griechenland-helfen/50067177.html#utm_source=rss&utm_medium=rss_feed&utm_campaign=/
10 As quoted in FTD, see http://www.ftd.de/politik/europa/:Hilfe-aus-Deutschland-Retter-aus-der-Euro-Not/477093.html
11 Cited in http://vox.cepr.org/index.php?q=node/4384

> 2.55% of their GDP on top of their already excessive deficit/GDP ratio (…) And an affordable bailout of a country like Greece could be followed or accompanied by the bailout of another country (…) or even an EU member outside the Eurozone."[12]

How much actual money this option would involve depends on Greece's liquidity crisis at the time but Credit Suisse's estimate of €30 billion should serve as an indication (although it's unlikely to be this full amount).

Will British taxpayers be affected?

Yes. If Article 122 is invoked (see below) then a majority vote would be taken involving all the EU's member states, meaning that the UK could be outvoted. Subsequently, all EU member states would have to contribute money towards a hand-out to the country in need of help. If Greece failed to raise €30 billion by April/May, then, based on the UK economy's size relative to other EU member states, Britain would be required to contribute at least €4 billion[13].

Is it legal?

Probably not. The legality of a direct bailout depends on how two seemingly contradictory articles in the EU Treaties are interpreted: one article allows for member states to provide financial assistance to another member state in case of an emergency beyond that country's control (Article 122). The other article explicitly prohibits member states from taking on the financial 'commitments' of a national government (i.e. assisting in closing a budget deficit) (Article 125).

Article 122 of the EU Treaty reads:

> *"Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. (Article 122.2 TFEU)'"*[14]

Whereas the 'no bailout' clause (Article 125) reads:

> *"The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project."*

12 http://dmarionuti.blogspot.com/2009/12/european-bail-outs-unaffordable-illegal.html
[13] According to Eurostat, UK share of EU GDP for third quarter 2009 was 13.52%; http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-08012010-BP/EN/2-08012010-BP-EN.PDF
14 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF

In a written answer to former MEP Kathy Sinnott, the Council of Ministers suggested that the 'no bailout' clause is superior to the article allowing for financial assistance to member states. On how article 122 can be used, it said:

> *"the Council recalls the terms of the Declaration on Article 100 of the Treaty establishing the European Community, which is attached to the Nice Treaty. According to this declaration, 'decisions regarding financial assistance, such as are provided for in Article 100 and are compatible with the 'no bail-out' rule laid down in Article 103..."*[15]

The Council therefore refers to a "Declaration on Article 100"[16] (that was attached to the Nice Treaty), which states that actions under article 100 must be *"compatible with the 'no bail-out' rule"* (our emphasis).[17]

But the Council's written answer also revealed that the EU's member states have never set out exactly what "exceptional occurrences" beyond the control of a member state might constitute, meaning that there's a legal ambiguity here and room for interpretation.

This, in turn, means that Greece's economic difficulties could be defined as an occurrence beyond the country's control (if linked to the global financial crisis), triggering Article 122. However, this would be a significant legal stretch. In an interview with Frankfurter Allgemeine Zeitung, German EU law professor Matthias Ruffert completely rejected the idea that the financial crisis could credibly be defined as "exceptional occurrences beyond [the Greek government's] control", saying: "state debt certainly cannot be counted among those." On whether "the financial crisis couldn't be seen as extraordinary and uncontrollable", he answered: "that wouldn't convince a judge. In other areas, jurisprudence strictly distinguishes between scientific and non scientific grounds in order to justify exceptions."[18]

2. EARLY RELEASE OF COHESION FUNDS TO GREECE

An early release of cohesion funds to Greece under the EU's structural funds or through the involvement of the European Investment Bank (EIB) has been mentioned as a way to bailout Greece.[19]

Greece is one the largest recipients of EU subsidies. The 2007-2013 EU budget allocated €20.2 billion in structural funds to Greece, with some €18.1 billion of this still to be paid out. The disbursement of the remainder of these funds could be fast-tracked to provide Greece with extra cash in case of a liquidity crisis. This has already been done

[15] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+CRE+20090507+ANN-01+DOC+XML+V0//EN&query=QUESTION&detail=H-2009-0237&language=EN
[16] See http://eur-lex.europa.eu/en/treaties/dat/12001C/htm/C_2001080EN.007001.html
[17] Also see here : http://openeuropeblog.blogspot.com/2010/01/to-bail-out-or-not-to-bail-out-that-is.html and http://www.europesworld.org/NewEnglish/Home/CommunityPosts/tabid/809/PostID/617/AnEUbailoutforIrelandNothankssaytheEUsbiggestcontributors.aspx
[18] Quoted in http://www.faz.net/s/Rub09A305833E12405A808EF01024D15375/Doc~EEDFC5F7196574891A4D3239F89606E19~ATpl~Ecommon~Scontent.html?rss_googlenews
[19] http://www.ftd.de/politik/europa/:nothilfe-berlin-soll-griechenland-helfen/50067177.html#utm_source=rss&utm_medium=rss_feed&utm_campaign=/

under the EU's economic stimulus package for central and eastern European members, to help them cope with the economic downturn.[20]

Fast-tracking the payment of the structural funds can be decided by the European Commission, so it would be by far the easiest option to execute.[21]

What will it cost?

In one sense this operation would be budget neutral as the funds are already allocated to the EU budget. But in another sense, there is a *de facto* cost to taxpayers for raising the funds in the first place. In addition, the early release of structural funds would effectively reward Greece's mismanagement of its economy, which in turn raises moral hazard concerns and sends the wrong signals to other countries. Greece also has a weak track record in absorbing the structural funds and allocating money to value-added projects, which begs the question of how effective the funds would be.

Will British taxpayers be affected?

Yes, in so far as Britain is one of the largest contributors to the EU budget, from which the fast-tracked structural funds are drawn.

3. EXTENDING THE EU'S BALANCE OF PAYMENTS CREDIT FACILTY

The EU has made available financial assistance to help non-eurozone countries that are experiencing balance-of-payments problems, through a fund which now amounts to €50 billion.[22] This fund could be made available to Greece.

Under this scheme, the Commission borrows money from the markets using EU-denominated bonds and then lends it to individual countries. Such balance-of-payment loans have already been extended to Hungary and Latvia.[23]

What will it cost?

The EU's bond prospectus to investors states that, "From an investor's point of view the bond is fully guaranteed by the EU budget and, ultimately, by the EU Member States." This effectively means that Europe's taxpayers are liable for the debts of the country which benefits from the credit facility – and would be forced to pay if the beneficiary defaults on its loans. As Times commentator and economist Anatole Kaletsky notes

---

20 http://www.guardian.co.uk/business/feedarticle/8920898

21 http://ec.europa.eu/regional_policy/policy/fonds/pdf/annexe-recto.pdf and http://www.eib.org/attachments/country/greece_2008_en.pdf

22 European Parliament resolution of 24 April 2009 on establishing a facility providing medium-term financial assistance for Member States' balances of payments, see http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2009-0327+0+DOC+XML+V0//EN

23 See press release f rom the European Commission, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/559&format=PDF&aged=0&language=EN&guiLanguage=en

> "[If] financial problems turn into a full-scale crisis, these guarantees and cross-subsidies between EU governments will increase to hundreds of billions in the months ahead and will certainly mutate into large-scale centralised EU borrowing, jointly guaranteed by all the taxpayers of the EU." [24]

Will British taxpayers be affected?

Yes. British taxpayers would be jointly liable with all other EU countries' taxpayers for the debts of the borrowing country.

Is it legal?

No. The current facility only allows for "medium-term financial assistance for Member States that have *not* adopted the euro" (our emphasis) and cannot be used for eurozone members.[25] For eurozone countries, the no bailout rule applies.

4. A COMMON EUROZONE BOND

The eurozone as a whole could issue common bonds, and create a similar facility to that available to non-eurozone members. Under this arrangement, Greece would obtain a share of the money raised, which would lower the country's borrowing costs. According to some estimates, common eurozone bonds could in a few years create a highly liquid bond market of some €4 trillion.[26]

However, when the idea was discussed in early 2009, several countries, including Germany, France and the Netherlands, opposed the idea.[27] European Commission President Jose Manuel Barroso has also rejected the idea, saying that "this would send the wrong message."[28] However, outgoing Economic Commissioner Joaquim Almunia has said that he's in favour of the scheme and incoming EMU Commissioner Olli Rehn has said he has an "open mind" about the issue.[29]

What will it cost?

Any common bond issue will have to raise a vast amount of money for it to help Greece. The country accounts for 2.5 percent of eurozone GDP and around six percent of borrowing, so it would stand to benefit relatively little if the proceeds of a bond sale were

---

[24] http://www.timesonline.co.uk/tol/comment/columnists/anatole_kaletsky/article6426565.ece

[25] See http://europa.eu/legislation_summaries/economic_and_monetary_affairs/institutional_and_economic_framework/l25005_en.htm

[26] Cited in http://www.londonstockexchange.com/exchange/prices-and-news/news/market-news/market-news-detail.html?announcementId=10358281

[27] Quoted in http://www.guardian.co.uk/business/feedarticle/8920898

[28] Quoted in http://www.lemonde.fr/europe/article/2009/12/15/l-ue-salue-le-plan-de-redressement-grec-et-exclut-toute-aide-financiere_1281115_3214.html

[29] Quoted in http://www.euractiv.com/en/euro/almunia-backs-eu-bonds-eurozone-bailout-plan/article-179937 and http://209.85.229.132/search?q=cache:0k0z_w33Q8gJ:www.euractiv.com/en/financial-services/eurobonds-gain-support-amid-greek-concerns/article-189347%3FRef%3DRSS+eurozone+bond+euractiv+schulz&cd=1&hl=en&ct=clnk&gl=uk

to be divided either by eurozone countries' share of borrowing, or by share of overall eurozone GDP.[30]

The German Finance Minister Wolfgang Schäuble has claimed that such a bond scheme would cost Germany around €3 billion a year.[31] As Germany currently enjoys the lowest compulsory rates in Europe, it would stand to lose the most from a common bond.[32] The Former Chief Economist at the ECB, Otmar Issing, wrote in an opinion piece that,

> "a common bond would be very costly for the more solid countries. (…) It would not cure the problems of its weakest members, but would instead prolong their reliance on budget deficits while encouraging them to hope for the de facto 'bail-out' that is waiting just around the corner. The biggest threat of all would come from the political repercussions of such a move."[33]

The ECB's Jürgen Stark noted that this instrument means that "responsible countries would be punished",[34] while ECB Governing Council member Ewald Nowotny has said that,

> "To issue euro zone bonds as something like a crisis instrument to allow less solid countries to raise cheaper debt at the expense of others, that's absolutely unrealistic and to be rejected."[35]

If adopted, Standard & Poor's said an EU bond would only receive an 'A' rating, due to Greece's low creditworthiness.[36]

Will British taxpayers be affected?

No. The bond would only involve eurozone countries.

Is it legal?

Probably not. A common eurozone bond effectively constitutes a credit facility to an individual eurozone member state which is prohibited by EU law (Article 123 – see below).

5. SETTING UP A EUROPEAN MONETARY FUND

[30] As pointed out in http://online.wsj.com/article/SB40001424052748703389004575033092784365492.html?mod=WSJ_Markets_section_Heard
[31] Quoted in http://www.eurointelligence.com/Article3.1018+M56e574ec1a8.0.html
[32] As noted in http://www.lemonde.fr/europe/article/2009/12/15/l-ue-salue-le-plan-de-redressement-grec-et-exclut-toute-aide-financiere_1281115_3214.html
[33] See http://www.europesworld.org/NewEnglish/Home_old/Article/tabid/191/ArticleType/articleview/ArticleID/21419/Default.aspx
[34] Quoted in http://english.capital.gr/News.asp?id=899137
[35] Quoted in http://www.xe.com/news/2010-02-08%2002:52:00.0/943529.htm?c=1&t=
[36] See also, http://openeuropeblog.blogspot.com/2009/02/not-all-germans-desire-union-of-debt.html and http://www.ftd.de/politik/europa/:hilfe-aus-deutschland-retter-aus-der-euro-not/477093.html

A similar institution to the IMF could be set-up especially for Europe. This 'European Monetary Fund' would operate under similar principles to the balance of payment credit facility, with IMF-style conditions attached to any loan. Thomas Mayer, the Chief Economist of Deutsche Bank, has proposed this solution, saying that "the advantage is that emergency plans won't be made in Washington but in Brussels". He lamented that during the financial crisis, "neither the ECB nor the Commission nor somebody in the EU could force Greece to do the necessary reforms in exchange for help."[37]

What will it cost?

As with the two previous alternatives, EU governments – and therefore EU taxpayers – would be liable if a country did not repay loans given by the Fund.

Will British taxpayers be affected?

Yes, if the UK takes part, British taxpayers would be partly liable for any loans given.

Is it legal?

As there's a ban on EU institutions from providing credit facilities to member states, this would also apply to this newly created 'EMF'. A Treaty change would therefore be needed in order for it to be legal.

6. BILATERAL OR MULTILATERAL LOANS TO GREECE

This would involve 'bridge loans' being extended to Greece from other eurozone governments. In return, the Greek government would probably have to accept strict conditions on its economic and fiscal policies.

Several observers see short-term bilateral loans as the most feasible solution should Greece fail to raise the necessary funds to pay back maturing debt and finance the country's existing expenditure. Such a loan carries the benefit of avoiding 'moral hazard' as it could come with clear IMF-style conditions.

However, European Commission President Barroso has denied rumours of "bilateral interventions", saying, "The best way to help Greece at this moment is to support its efforts to respect its commitments".[38] A spokeswoman for the German Finance Department directly dismissed the idea, saying: "the German Federal Government is not considering providing financial support for Greece in overcoming its difficult financial situation. This applies to alleged Eurozone support as well as bilateral help."[39]

---

[37] Quoted in http://www.unternehmer.de/top-okonom-fordert-europaischen-wahrungsfonds-wegen-griechenland-29649 and http://www.welt.de/die-welt/politik/article5938285/Der-Euro-Raum-kann-zerbrechen.html

[38] Quoted in http://www.ilsole24ore.com/art/SoleOnLine4/Mondo/2010/01/Grecia-sotto-attacco-Europa.shtml?uuid=2db1359c-0c35-11df-adf8-8d38f33e66af&DocRulesView=Libero&fromSearch

[39] Quoted in http://www.fr-online.de/in_und_ausland/wirtschaft/debatte_wirtschafts_und_finanzkrise/?em_cnt=2245826&

A variation of this could be to have KfW, the German government-owned development bank, or the *Caisse des dépôts et consignations*, a French governmental financial organisation extending credit to Greece.[40]

What will it cost?

This would place the burden of bailing out a country on a few major EU states, which could have massive financial implications for Germany for instance, costing billions to taxpayers.[41]

Will it affect British taxpayers?

Probably not, unless the UK government chooses to offer such a loan.

Is it legal?

Probably not. Article 123 of the EU Treaties states:

> *"Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.*"[42]

Based on this article, German EU law professor Ruffert has called these loans legally "impossible", saying that that "the ban on governments bailing out banks also extends to other governments. When a state gives a credit facility to another one, this is in breach of the EU Treaty".[43]

7. LOANS OR INVESTMENTS BY THE EIB

As suggested in a recent article in FT Deutschland, the EIB could receive a special mandate to directly lend to Greece, linking any rescue loans to strict economic conditions.[44] The EIB is a bank owned by EU member state governments and, as it has government backing, it raises money on the markets at good rates. It then lends money for various projects in the EU to promote growth and development. Under the EU's stimulus package, the EIB has already increased its lending to central and eastern European countries (lending €11.5 billion in 2009).

[40] Quoted in http://www.ftd.de/politik/europa/:nothilfe-berlin-soll-griechenland-helfen/50067177.html#utm_source=rss&utm_medium=rss_feed&utm_campaign=/
[41] Quoted in http://www.spiegel.de/international/europe/0,1518,608985,00.html
[42] See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF
[43] See http://openeuropeblog.blogspot.com/2010/01/another-twist.html
[44] As suggested in, http://www.ftd.de/politik/europa/:nothilfe-berlin-soll-griechenland-helfen/50067177.html

Nobel Prize Winner Joseph Stiglitz has suggested similar EIB action for Greece, stating that the Bank should undertake countercyclical investments in Greece, to offset the deflationary impacts of the budget cuts.[45]

What will it cost?

The risks involved in high-risk loans of this kind would effectively be borne by taxpayers across the EU.

Would British taxpayers be affected?

Yes, since the British taxpayer in effect part finances EIB loans.

Is this option legal?

Unclear, but as the EIB is an EU institution it would be strange if it is allowed to engage in activities that EU governments and other EU institutions are prohibited from engaging in (i.e. providing a credit facility for the purpose of closing a budget deficit).

8. EU GOVERNMENTS OR THE EIB BUY GREEK BONDS

Another option would be for EU governments or an EU institution, such as the EIB, to borrow money on the market and use it to buy Greek bonds, thereby helping the Greeks to raise funds[46]. Individual governments could also do the same thing.

What will it cost?

As in the previous option, the cost of making risky investments would be transferred to European taxpayers who in the end underwrite any loans to and from the EIB.

Will it affect British taxpayers?

Yes, since the British taxpayer in effect part finances EIB loans.

Is it legal?

Unclear, but in practice it constitutes a loan for a eurozone member, which is prohibited under EU law for both individual member states and EU institutions.

9. 'INTEREST RATE' BAILOUT BY THE ECB

Although highly unlikely, the ECB could in theory 'bailout' Greece. Tailoring EMU interest rates to Greece (keeping interest low) would in theory allow Greece to make necessary structural adjustments, while spurring the country's productivity.

[45] Quoted in http://www.guardian.co.uk/commentisfree/2010/jan/25/principled-europe-not-let-greece-bleed
[46] See http://www.bloomberg.com/apps/news?pid=20601068&refer=home&sid=an8EI62.Qlds and http://www.ftd.de/politik/europa/:nothilfe-berlin-soll-griechenland-helfen/50067177.html#utm_source=rss&utm_medium=rss_feed&utm_campaign=/ and http://openeuropeblog.blogspot.com/2009/02/not-all-germans-desire-union-of-debt.html

However, last December, ECB governing council member Ewald Nowotny said that the ECB won't bail out debt-stricken member states such as Greece, saying: "One has to be very clear: The ECB has no mandate or intention to take into account the situation of a specific country, especially not with regard to public finances."[47]

Such an interest rate policy would be unsuitable for the German bloc economies and could lead to higher inflation.

Is it legal?

This option would probably contradict the ECB's mission – prescribed in law – to maintain price stability.[48]

10. INDIRECT BAIL-OUT BY THE ECB

In reality the ECB is already engaged in bailing out Greece, because the ECB accepts Greek sub-prime bonds – which the markets would treat as "toxic" – as collateral for loans to Greek banks, which in turn finance the Greek government. It therefore transfers the risk of investing in unsafe bonds, issued by struggling EU governments, to the whole of Europe. Although the ECB has vowed to stop accepting 'junk' bonds from Greece and elsewhere (i.e. Spain, Ireland and Portugal), this practice could be allowed to continue and so provide a partial bailout on a running basis.

Is it legal?

No. It contradicts the ECB's own rules, but is nevertheless already taking place.

[47] Quoted in http://online.wsj.com/article/BT-CO-20091220-702837.html
[48] Cited in http://www.ecb.int/mopo/strategy/pricestab/html/index.en.html

III. ALTERNATIVES TO AN EU BAILOUT

1. LET THEM DEFAULT

The Greek crisis is a matter of direct concern to all EU countries and not just Eurozone countries because of their extensive holdings of Greek government debt. The UK and Ireland account for about 23 percent of the total outstanding Greek debt, followed by France at eleven percent and Italy at six percent. Germany, Austria and Switzerland hold about nine percent and the three Benelux countries another six percent.[49]

Karl Otto Pöhl, a former President of the Bundesbank predicted that the consequences of a Greek default would be "very expensive", saying that "the exchange rate would go down, 50 or 60 percent and then interest rates would go sky high because the markets would lose all confidence."[50]

However, others say that a default may not be that bad a solution. Peter Bofinger, a member of Germany's council of economic advisers, the government's independent economic think-tank, has said that the euro can withstand the bankruptcy of a small member state. He said financial aid from Brussels would be a dangerous precedent, as it would send a signal to Portugal and Spain that they can depend on EU aid.[51]

Economics Professor Charles Wyplosz compared it with New York City's troubles in the 1970s:

> "Letting member-state governments default could create havoc of untold proportions, as noted above. Or could it? When they wrote the no-bailout clause, the Maastricht Treaty Founding Fathers were clearly impressed by the New York City affair of the 1970s. The City informed the State of New York that it was about to declare bankruptcy and would do so unless bailed out. The State informed the Federal Government that it too would default unless bailed out, which could destroy Wall Street and the US financial system. The Federal Government responded to the State of New York "please default", a message that was then passed on to the Mayor. No one defaulted. And then, after the City had made substantial progress, the Federal Government provided a loan on which it subsequently made good profit. Even better, the City of New York has since become fiscally disciplined. The no-bailout clause is much better than the Stability and Growth Pact provided that it is enforced when it is needed."

He concludes:

> "this is the time. Let one of the profligate governments default. Much as it was necessary to let Lehman Brothers go down the pipe before bailing out the

[49] Cited in http://www.ft.com/cms/s/b7f8a9bc-0c74-11df-a941-00144feabdc0,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2Fb7f8a9bc-0c74-11df-a941-00144feabdc0.html&_i_referer=

[50] Quoted in http://news.sky.com/skynews/Home/Business/Karl-Otto-Pohl-Former-Bundesbank-Head-Says-Euro-Under-Threat/Article/200902415229838?f=rss

[51] Quoted in http://www.spiegel.de/wirtschaft/soziales/0,1518,675931,00.html

> remaining banks, it may be necessary to let a profligate government default and ask for IMF assistance before punching a hole in the no-bailout clause."[52]

2. GO TO THE IMF

There is a compelling argument that the IMF has much more experience than the EU in rescuing a country in financial difficulties and is therefore better placed to do the job.

Jean Pisani Ferry and Andre Sapir of the think-tank Bruegel have argued in favour of an IMF intervention, noting that,

> "even if the eurozone manages to get the necessary funds together there is no way the Europeans can provide the same standard conditionality and credible monitoring process…would eurozone countries stay in line amid rising anger in the streets of Athens? Would the eurozone be prepared to do the same for larger member states?" [53]

This option also carries the advantage of letting the IMF, rather than the EU itself, face up to the unpopularity amongst the electorate which inevitably follows in the footsteps of tough economic reforms. Going to the IMF was also one of the options put forward by the German Finance Ministry in 2009.[54]

However, despite this being the preferred solution for many observers, European leaders seem unlikely to go for this option, as conditions imposed by the IMF, for example on monetary policy, may compromise the ECB's independence.

Also, as the Economist commented: "Pride is at stake. To turn to the fund for aid would be a humiliation for Europe, never mind the Greeks."[55]

3. ATTRACT INSTITUTIONAL INVESTORS FROM OUTSIDE EUROPE

Greece can rely on a large number of non-EU institutional investors to raise money. But this is unlikely to hold in the long term. According to reports, Greece has encouraged China to buy up to €25 billion of its government bonds, something which China declined to do (although this has been denied by the Greek government).[56]

Yu Yongding, a former adviser to the Chinese central bank, said that China is unlikely to buy a significant share of Greek government debt because Greek securities are more risky than US Treasuries. He said, "It is unreasonable for an economist to support a diversification away from an unsafe asset class to a much more unsafe asset class."[57]

---

[52] Cited in http://voxeu.org/index.php?q=node/3110
[53] Writing in http://www.ft.com/cms/s/0/01554c86-0f69-11df-a450-00144feabdc0.html
[54] http://www.openeurope.org.uk/media-centre/pressrelease.aspx?pressreleaseid=117
[55] Cited in http://www.economist.com/world/europe/PrinterFriendly.cfm?story_id=15452594
[56] Cited in http://www.reuters.com/article/idUSSGE60Q01320100127
[57] Quoted by http://www.bloomberg.com/apps/news?pid=20601080&sid=a0qFe2Y.5GEI

4. WITHDRAWAL OF GERMANY AND SPLITTING UP INTO TWO ZONES

Michael G. Arghyrou and John Tsoukalas have proposed temporarily implementing a two-currency EMU, with both currencies run by the ECB. The core-EMU countries will continue to use the present currency, the 'strong' euro. The periphery countries on the other hand, will adopt, for a certain period of time, another currency: the 'weak' euro.[58]

Ambrose Evans-Pritchard, international economics editor of the Telegraph advocates a version of this solution. He notes,

> "this is the only break-up scenario that makes much sense. A German exit would allow Club Med to uphold contracts in euros and devalue with least havoc to internal debt markets. The German bloc would enjoy a windfall gain. The D-Mark II would be stronger. Borrowing costs would fall. The North-South gap in competitiveness could be bridged with less disruption for both sides."[59]

5. FISCAL FEDERALISM LIGHT

Former European Commission President Romano Prodi once admitted that any crisis affecting the EU could be exploited to radically speed up the pace of European economic integration. He said:

> "The euro will oblige us to introduce a new set of economic policy instruments. It is politically impossible now. But some day there will be a crisis and new instruments will be created."[60]

It seems this time has definitely come.

In what is presented as a long term solution rather than an immediate cure for Greece, the EU would coordinate – and partially run – national economic policy. In the framework of the new Europe 2020 economic strategy, which replaces the failed Lisbon strategy, there has been a lot of talk of EU sanctions for underperforming states.

Commission President Jose Manuel Barroso has already said he plans to interfere more in national economic policies, stating that "economic policy isn't a national, but a European matter. No modern economy is an island. When a member state doesn't make reforms, others suffer because of that." Wolfgang Schaeuble, German Finance Minister, has recommended setting up a complementary mechanism as part of the stability pact and the implementation of budget deficit measures, which would open for binding decisions on member states rather than mere recommendations. As Barroso has

---

[58] Writing in http://www.roubini.com/euro-monitor/258379/the_option_of_last_resort__a_two-currency_emu?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+EuropeanEconomonitor+%28European+EconoMonitor%29

[59] Writing in http://www.telegraph.co.uk/finance/comment/7119986/Should-Germany-bail-out-Club-Med-or-leave-the-euro-altogether.html

[60] Quoted by http://www.telegraph.co.uk/finance/comment/7119986/Should-Germany-bail-out-Club-Med-or-leave-the-euro-altogether.html

pointed out, such measures have become far more achievable under the Lisbon Treaty.[61]

At the moment, the Lisbon Treaty makes it possible for the Commission to issue recommendations for reforms to the structure of an individual country's pensions, healthcare services, labour markets and private commerce. These new EU powers, invoked under Article 121.4 of the Lisbon Treaty, have now for the first time been imposed on Greece[62]. EU President Herman Van Rompuy has also said he wants to use these powers to enforce the EU's new Europe 2020 economic strategy.[63]

6. OTHER

There are probably a range of other alternatives to an outright bailout. One solution would obviously be for member states to simply bring back their old currencies. Taking Portugal as an example, economists Charles Goodhart and Dimitrios Tsomocos, say that this could be done by the government passing "a decree that states that such escudo IOUs would be acceptable for all internal payments, except tax payments, between Portuguese residents, but not for any external payments between Portuguese residents and foreign residents."[64]

[61] Quoted by http://www.easybourse.com/bourse/actualite/presse-berlin-oppos-2-224-aide-financi-2-2-re-europ-2-enne-224-la-gr-2-2-ce-778984
[62] Cited in http://www.openeurope.org.uk/media-centre/summary.aspx?id=1030
[63] Cited in http://knack.rnews.be/belga/politiek/van-rompuy-rondt-europese-tournee-af-bij-leterme/site78-section3-article144589.html
[64] Cited in http://www.ft.com/cms/s/0/5ef30d32-0925-11df-ba88-00144feabdc0.html