

FLEMING ON FINANCE

Is the euro on the road to perdition?

By Stewart Fleming

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The eurozone stands at a critical juncture and could be very different after the Greek economic crisis is over.

“Ford to City: drop dead” was how, in October 1975, the New York Daily News summed up then US president Gerald Ford's threat to block a \$1 billion bail-out package for a near-bankrupt New York City.

A month later, New York's political leaders returned to Washington, DC to get the loans they needed – but only after submitting a credible plan to control the city's budget.

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No European politician is going to send the feckless Greeks quite so blunt a public message as Ford did to the Big Apple. But the Eurogroup – the finance ministers of the eurozone – on Monday night (15

February) correctly delivered to the [Greek government](#) a message that if financial support is needed, the terms will be humiliating and punitive.

[George Papandreou](#), Greece's prime minister, has been told that the eurozone is not going to be held to ransom by a country that accounts for a mere 3% of its gross domestic product. Some (already weakened) eurozone



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banks are holding more IOUs from Athens than is good for them, and there is indeed a risk of contagion to other frail eurozone debtor nations.

But, as Papandreou is being reminded, by far the biggest losers from a Greek default will be Greeks.

It is not the case, as Papandreou maintained last week, that Greece has become “a laboratory animal in the battle between Europe and the markets”.

Instead, what he is experiencing is further proof, if more were needed, of [Margaret Thatcher](#)'s famous adage that “you can't buck the market”, at least not for decades on end.

For a generation – this is far from the first time that Greece has flirted with financial disaster – its politicians (including Papandreou's father) and its central bankers have thumbed their noses at both the markets and EU officials. They have ignored calls to collect taxes from the rich, to reduce the size of a bloated civil service, and to stop subsidizing fuel and encouraging corruption. And they have ignored calls to reform a political system that encourages the middle-classes to rip off the state and lets bureaucrats and many middle-class people believe they have a right to retire before the age of 50.

Vulnerable borrowers

Greece is a test case. Unless it is handled wisely, speculators will see a bail-out of Athens as an invitation to move on to Portugal, Spain or (and those wallowing in schadenfreude in London should take note) the vulnerable borrowers ensconced in 10 and 11 Downing Street, London.

So the EU, not just the eurozone, has an interest in forcing Greece to put together a credible package to control its finances and to send a message to speculators (and to the other EU capitals) that a politically inspired fudge is not an option.

The Greek government needs plenty of heavily conditioned financial support to help it push through vital reforms. Without such finance, reform will fail. The



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alternative scenario is that people will take to the streets and block change, as overhasty efforts to slash decades of excess hit an already weakening economy, triggering a vicious circle of declining growth and burgeoning debt.

International investors, seeing such threats take shape, would refuse to roll over the state's already crippling debts, provoking a true liquidity crisis and, ultimately, default.

Indeed, it is hard to imagine the Greek government (or any other) credibly committing itself to the tough actions that are needed without an assurance that, if it does fulfil its side of the bargain, it will have reliable access to official funds to hold the markets at bay should economic conditions deteriorate further.

Swallowing hard, eurozone leaders will have to involve the [International Monetary Fund](#) (IMF) in the provision of such support. However, the precise scope of the IMF's oversight will have to be worked out (for example, who decides what to do and when if the Greek government fails to live up to its commitments?).

The eurozone is at a fork in the road. The issue is not whether the current crisis will quickly lead to the break-up of the eurozone. It is what sort of eurozone will be left when this crisis is over. Will it continue to be the hard currency, stability-focused, low-inflation area its founding fathers imagined? Or will it have set off on the road to perdition, a soft currency, distrusted by investors and citizens alike, a plaything for speculators around the world?

[Otmar Issing](#), the former chief economist of the [European Central Bank](#) who devised its monetary policy strategy and who remains a guardian of the single currency flame, warned on Tuesday (16 February) that “this is a decisive moment for economic and monetary union... a bail-out [of Greece] that broke the rules would make it impossible to deny aid to others”. This “last chance” for Greece, he said, also represents a “final test” for economic and monetary union.

Culture clash

Greece, too, is at a fork in the road. If reform is to happen, even with official financial support, it will require the Greek people to provide a positive answer to an existential question. The eurozone is a currency region built on the political culture of the German people – northern Europeans brought up to pay their taxes and believe that there is something called 'society', which is state-sponsored, which needs to be fostered and with which they have a mutually beneficial relationship.

The Greeks are not the same. Perhaps deep down they do not want to be part of the eurozone, even of the Union. Perhaps they really are incapable of making the deep cultural (and political) changes needed to maintain their membership. If that is so they should be helped to leave, but they should not be permitted to lay waste to a project that is vital to Europe's global role.