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Europe has resolved nothing over Greece

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Το deal Διέσωσε την Ευρωπαϊκή συνείδηση της Χώρας λόγω του σχίσματος που είχε δημιουργηθεί

Another knife-edge summit in Brussels, another late-night agreement, followed by self-congratulatory poses from European leaders: the "emergency funding agreement" for Greece sounded like a significant deal on Thursday night. But then you wake on Friday morning, examine the details and realise it was mostly smoke and mirrors. They had you fooled for a minute.

The aspect that puzzled me most was the announcement that a rescue would come in the form of a loan at market interest rates. This surely must imply that the market would not be willing to lend money to Greece at market interest rates. That is an absurd proposition.

In fact, it is hard to imagine even a hypothetical scenario in which the European Union would disburse the emergency aid. Greece would have to be cut off from the capital markets; in such a situation it is difficult to imagine that a loan from the EU – at prohibitively high interest rates – would solve any problems.

Judging from some of the comments from Greece, I suspect the big idea is to try to get by without help, using the promise of an emergency fund as a psychological support for the market. This is a dangerous confidence trick. It will backfire, perhaps not right away, but at some point. It was no surprise that Standard & Poor's, the rating agency, concluded that its rating of Greek government debt would be unaffected by the deal.

The Greek problem is not simply access to capital – which has not been a problem during its crisis so far – but the interest rates the country has to pay for its debt, which are too high given the likely trajectory of its economy. The Greek government recently announced an austerity package that aims to shave 4 percentage points off the deficit-to-gross domestic product ratio. This will result in a deep and probably long recession. When a country adopts an austerity package of such magnitude it needs some form of relief, simply to make it through the recession. This would normally come either through devaluation or from a low-interest loan, usually from the International Monetary Fund, or ideally both. Greece will have neither.

Under these circumstances there may come a point when the Greek government concludes that default is the financially superior option, especially since 70 per cent of Greek debt is held by foreigners. If they are smart, they will take the EU money and then default. In any case, default is still the true backstop, not the emergency loan. Bond market investors should be well aware of that.

The agreement, and the way it was struck, raises plenty of questions about the governance of the eurozone, and the readiness of its political leadership to support it in the long run. As the French economist Agnès Bénassy-Quéré has noted: the combination of no bail-out, no default and no debt monetisation is logically inconsistent. Hence a conditional resolution system is needed. A package of loans at market rates, in which 16 prime ministers or heads of state have a veto, is not going to resolve this fundamental conflict. The Greeks had better make sure they do not get cut off a week before the next German state elections.

The EU did not strike this particular deal because anybody believed it would constitute an ideal crisis resolution mechanism, but because it was an expedient compromise between two conflicting positions.

The priorities for Angela Merkel, German chancellor, were to ensure strict compliance with the "no bail-out" rule and a veto over the disbursement of emergency aid. Berlin does not want to pay a cent. The priority of the European Central Bank has been to reduce the role of the IMF. The reason is that this would give the IMF an undue influence over the economic policies of the eurozone, and might challenge independence of the ECB. The only logical way to accommodate both positions was to concoct an ingenious mechanism so restrictive that it is unlikely ever to be invoked.

This agreement does not solve the problems of Greece, or any other country in trouble. But it solves the problems of Ms Merkel and, at least partially, those of the ECB. At no point during the summit did EU leaders even contemplate the idea of trying to solve the double threat that hangs over the future of the eurozone – the lack of an effective resolution regime and the problem of the eurozone's internal imbalances.

In the meantime, we are still asking the same uncomfortable questions as we did last week. Is the Greek austerity plan realistic? Will Greece be able to pull through? What happens if Portugal gets into difficulty? What about Spain? What about Italy? Is there an agenda to deal with current account imbalances? Will Germany ever accept any responsibility for the cohesion of the eurozone, other than expecting others to converge with Germany? All the questions are still out there, unanswered.

I must admit that the late-night meetings, the dramatic announcement of an agreement, and the press conferences by European leaders are highly effective tools to impress the outside world. Ms Merkel in particular is a very persuasive politician. But the politics of smoke and mirrors cannot fool all the people all of the time. This will not end well.

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