A bail-out for Greece is just the beginning

By Martin Wolf

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Desperate times; desperate measures. After months of costly delay, the eurozone has come up with an enormous package of support for Greece. By bringing in the International Monetary Fund, at Germany's behest, it has obtained some additional resources and a better programme. But is it going to work? Alas, I have huge doubts.

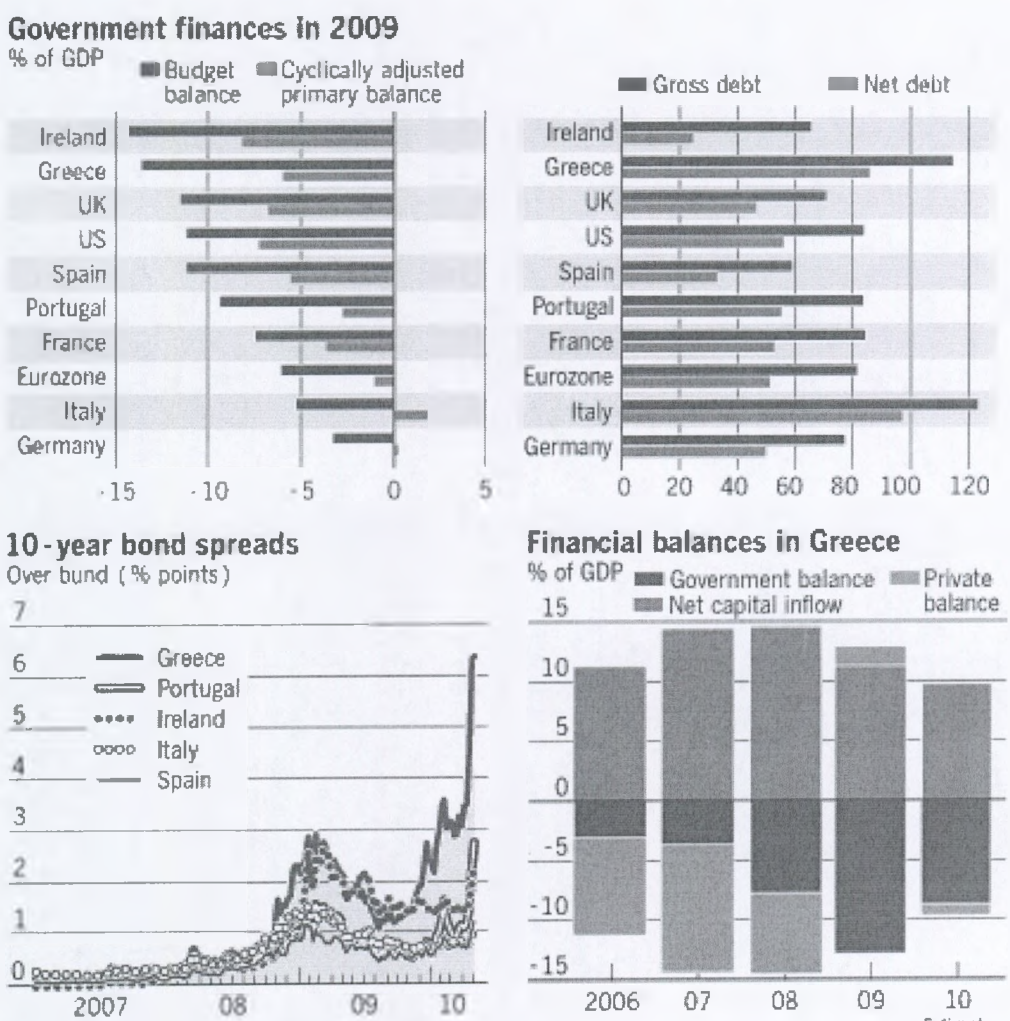
So what is the programme? In outline, it is a package of €110bn ($143bn) (equivalent to slightly more than a third of Greece's outstanding debt), €30bn of which will come from the IMF (far more than normally permitted) and the rest from the eurozone. This would be enough to take Greece out of the market, if necessary, for more than two years. In return, Greece has promised a fiscal consolidation of 11 per cent of gross domestic product over three years, on top of the measures taken earlier, with the aim of reaching a 3 per cent deficit by 2014, down from 13.6 per cent in 2009.

Government spending measures are to yield savings of 5¼ per cent of GDP over three years: pensions and wages will be reduced, and then frozen for three years, with payment of seasonal bonuses abolished. Tax measures are to yield 4 per cent of GDP. Even so, public debt is forecast to peak at 150 per cent of GDP.

In important respects, the programme is far less unrealistic than its intra-European predecessor. Gone is the fantasy that there would be a mild economic contraction this year, followed by a return to steady growth. The new programme apparently envisages a cumulative decline in GDP of about 8 per cent, though such forecasts are, of course, highly uncertain. Similarly, the old plan was founded on the assumption that Greece could slash its budget deficit to less than 3 per cent of GDP by the end of 2012. The new plan sets 2014 as the target year.

Two other features of what has been decided are noteworthy: first, there is to be no debt restructuring; and, second, the European Central Bank will suspend the minimum credit rating required for the Greek government-backed assets used in its liquidity operations, thereby offering a lifeline to vulnerable Greek banks.

So does this programme look sensible, either for Greece or the eurozone? Yes and no in both cases.



Sources: Thomson Reuters Datastream; Citigroup; IMF

Let us start with Greece. It has now lost access to the markets (see chart). Thus, the alternative to agreeing to this package (whether or not it can be implemented) would be default. The country would then no longer pay debt interest, but it would have to close its primary fiscal deficit (the deficit before interest payments), of 9-10 per cent of GDP, at once. This would be a far more brutal tightening than Greece has now agreed. Moreover, with default, the banking system would collapse. Greece is right to promise the moon, to gain the time to eliminate its primary deficit more smoothly.

Yet it is hard to believe that Greece can avoid debt restructuring. First, assume, for the moment, that all goes to plan. Assume, too, that Greece's average interest on long-term debt turns out to be as low as 5 per cent. The country must then run a primary surplus of 4.5 per cent of GDP, with revenue equal to 7.5 per cent of GDP devoted to interest payments. Will the Greek public bear that burden year after weary year? Second, even the IMF's new forecasts look optimistic to me. Given the huge fiscal retrenchment now planned and the absence of exchange rate or monetary policy offsets, Greece is likely to find itself in a prolonged slump. Would structural reform do the trick? Not unless it delivers a huge fall in nominal unit labour costs, since Greece will need a prolonged surge in net exports to offset the fiscal tightening. The alternative would be a huge expansion in the financial deficit of the Greek private sector. That seems inconceivable. Moreover, if nominal wages did fall, the debt burden would become worse than forecast. Willem Buiter, now chief economist at Citigroup, notes, in a fascinating new paper, that other high-income countries, notably Canada (1994-98), Sweden (1993-98) and New Zealand (1990-94), have succeeded with fiscal consolidation. But initial conditions were much more favourable in these cases. Greece is being asked to do what Latin America did in the 1980s. That led to a lost decade, the beneficiaries being foreign creditors. Moreover, as creditors are now paid to escape, who will replace them? This package will surely fail to return Greece to the market, on manageable terms, in a few years. More money will be needed if debt restructuring is unwisely ruled out.

For other eurozone members, the programme prevents an immediate shock to fragile financial systems: it is overtly a rescue of Greece, but covertly a bail-out of banks. But it is far from clear that it will help other members now in the line of fire. Investors could well conclude that the scale of the package required for tiny Greece and the overwhelming difficulty of agreeing and ratifying it, particularly in Germany, suggest that further such packages are going to be elusive. Other eurozone members might well end up on their own. None is in as bad a condition as Greece and none has shown the same malfeasance. But several have unsustainable fiscal deficits and rapidly rising debt ratios (see chart). In this, their situation does not differ from that of the UK and US. But they lack the same policy options.

This story, in short, is not over.

For the eurozone, two lessons are clear: first, it has a choice – either it allows sovereign defaults, however messy, or it creates a true fiscal union, with strong discipline and funds sufficient to cushion adjustment in crushed economies – Mr Buiter recommends a European Monetary Fund of €2,000bn; and, second, adjustment in the eurozone is not going to work without offsetting adjustments in core countries. If the eurozone is willing to live with close to stagnant overall demand, it will become an arena for beggar-my-neighbour competitive disinflation, with growing reliance on world markets as a vent for surplus. Few are going to like this outcome.

The crises now unfolding confirm the wisdom of those who saw the euro as a highly risky venture. These shocks are not that surprising. On the contrary, they could have been expected. The fear that yoking together such diverse countries would increase tension, rather than reduce it, also appears vindicated: look at the surge of anti-European sentiment inside Germany. Yet, now that the eurozone has been created, it must work. The attempted rescue of Greece is just the beginning of the story. Much more still needs to be done, in responding to the immediate crisis and in reforming the eurozone itself, in the not too distant future.

Comments

Supporting Greece is not rational, but it is explained by prospect theory

Prospect theory states that we are risk averse towards positive risks, but risk takers towards negative risks. We tend to cling on to a hope of maintaining the earlier status quo, even when we know that the probability of maintaining it is small and the price of that gamble is high.

Applied to the decision to support Greece: the citizens of EU countries are likely to agree with the political decision to bail Greece out for the slim hope of maintaining the value of euro. Meanwhile, the rational money bets on a sinking euro and spreading of the Greek flu. Salvation through bailout will turn out to be just a mirage. Believing in it will make matters worse for the average EU citizen.

EU countries should let Greece be, without any plan to bail it out. That would induce the Greek state to privatize a lot of state property to pay for its debts, plus straighten its domestic policy issues. And it would push the Spanish, Italian, Portuguese, Irish and French governments do the same. IMF will never be as efficient in finding the assets for liquidation.

Meanwhile, all national governments within the Euro zone could give loans to the banks owning Greek obligations, but only against shares of those banks. That temporary nationalizing of the banks would allow a political control on the bonuses offered to individual bankers.

As long as the public buys the claim -- touted by politicians and financial industry players -- that you have to support Greece in order to maintain a steady euro, the public has to pay for its own ignorance.
Report lothian9 | May 9 6:13pm | Permalink
| Options
It's difficult to determine if Wolf's essay is basically a prayer that things proceed better than he anticipates or is it an instance of throwing up one's hands in surrender to out-of-control events and a dismal future.
Report pallavi25_99 | May 9 12:13pm | Permalink
| Options
Amazing it took a decade post the Euro formation for Greece to go under. Greece is small and hence can afford a bailout, next is Spain and Italy. Will we have to wait another decade for the same? Would be interesting to see how Germany bails out of the next one.
Report Luis H Arroyo | May 7 8:49pm | Permalink
| Options
From FT sources: the euro has fallen to 1.26$; the 10 year German bund is at 2.75%; the Greek bond, at 14.5% this morning... All the markets in the world have tumbled. The OIS is becoming to signal a new inter banking crisis of confidence. Monday could be the beginning of the catastrophe: perhaps too late to the ECB could take the right decision. The recent press conference of Mr. Trichet has not been very effective to spread confidence… If this week end there is not a positive sign, I´m afraid next Monday will be a black Monday.
Report William Morris | May 6 12:56pm | Permalink
| Options
As Mr Wolf notes, default would result in the immediate closure of the deficit. Brutal as this is, it has a distinct advantages. The cuts in expenditure would no longer be seen as 'optional', a matter of negotiation with the EU/IMF. They would be explicit and real. They would not be imposed from abroad.

The government could then issue IOUs instead of Euros (what else is a paper currency other than an IOU) and these could hence be traded internally as a parallel currency (call them drachmas if you like). A local rate of exchange between IUOs and Euros would then develop, reflecting the real local economic monetary conditions.

Then renegotiate outstanding bonds at the new rate of exchange. Problem solved (for Greece anyway).
Report Eleftherios Leontaridis | May 6 10:55am | Permalink
| Options

@ Chris London

There is indeed a high probability that under whatever scenario, Greece may not be able to afford its debt. This has already been articulated by many commentators and is also the view of Martin Wolf in this article as I can see.

The motivation of my commentary was not to suggest which is the right, or even the preferable way forward - rather to take a look at what is actually happening and gauge the likely next steps. We could agree that this is not the same thing?

We could also agree that on every evidence from the governments' actions and perceived intentions, the Eurozone is for the moment trying to fight it out using every trick in the book? This might prove to be a huge mistake, but for the time being it seems to be the chosen path.

What I tried to say is that, given debt cross-holdings and combining the push for French and German banks to keep rolling over existing debt (presumably their own exposure) with the ECB's move to accept bonds with low market ratings, the door opens for the ECB to be the ultimate holder of the toxic sovereign bonds.

I also argued that, short of eurozone break-up, that might be a way to cover Portugal, Spain, etc. because I agree with you that further IMF-EU packages would be very difficult to arrange. In fact, if that road is taken, much of the Greek package might not have to be used either.

Again, I am not advocating this or any other scenario - just pointing out that, on present course that the eurozone governments are taking, this scenario could well come into play. We will soon hear what Trichet says today but if the ECB continues not to rule out eventual quantitative easing, then we should expect it to happen either directly or by stealth
Report gareth davies | May 6 10:21am | Permalink
| Options
@winterpeg

"The problem with option 2 is that Spain and Portugal will quickly follow suit, thus converting the Euro into a mere German-French currency."

Bound together as originally envisaged when the EEC was originally concieved. Bound together in a deadly embrace? I doubt it. The Germans will want the Deutschmark back and why not? Let the people decide.
Report Chris London | May 6 10:03am | Permalink
| Options
Eleftherios Leontaridis - There is one problem with your theory and that is the appetite and ability for both of these nations to take on such debt. The Germans are already pushing back against the bailout while France has itself an issue as it has to refinance itself in the next couple of years.

With these factors in mind and with the distinct possibility that more of the so called PIIGS will be turning to the EU and IMF for help your suggestion does not hold water. For Greece itself will struggle to pay for it's debts even if they manage to keep to their austerity package that they have committed to. Their economy is and was never strong enough to support the level of spending while supporting their debts. So if they could not afford it before why will they be now able to do so with an even greater debt. Especially when their economy is shrinking by around 3% this year and the forecast for the future is not looking too good either.

There are are a number of big decisions to be made however the EU as usual keeps on putting them off. These delays have worsened the situation and taken the Euro to the brink. It may be too late to save both the currency and all of the members. What has been touted as a possible solution is the expulsion of those members who are not able to meet the membership criteria. An action I support as I feel that is the only action that would save the Euro and in fact would probably make it a stronger currency.

The best quote I have seen on this subject is "beware of Greeks wanting loans".
Report Eleftherios Leontaridis | May 6 7:58am | Permalink
| Options

One aspect that Martin Wolf left out of this comprehensive analysis is the drive for German (and now also French) banks to keep Greek credit lines open. This looks like gaining traction, after Schauble's initial call. If they do, then more than a third of Greek debt can be rolled over outside the aid package, and this would make the numbers add up. See also
http://online.wsj....hpp_LEFTTopStories

Why would they do it? To protect themselves, and at comparatively low risk since they can deposit those bonds at the ECB after its suspension of minimum rating criteria. And I don't think anyone would doubt that when these options open on the initiative of governments, an implicit guarantee can be considered as a backstop. So, if "toxic" Greek bonds slowly find their way to the ECB, might that constitute a gradual and orderly debt restructuring by stealth?

The most worrying factor in the unfolding crisis is what happens to other economies. Portugal already faces borrowing costs that made the Greek government ask for the creation of an EU aid mechanism last January. See a very informative graph that appeared at the NYT showing debt cross-holdings among vulnerable economies and their biggest creditors, notably France and Germany. There is clearly a sizeable chunk of debt that's internal to the Eurozone, although the numbers are a bit odd (the Greek debt for example is higher than depicted).
http://www.vizworl.../europes-web-debt/

The managed rollover of debt cross-holdings within the Eurozone and particularly with France and Germany might be the only way to support these economies and preventing dominoes from falling. After all, as @Bond noted below, the ECB has the nuclear option of buying sovereign debt in a long-derided but possibly unavoidable move for quantitative easing. The fact that this option is already being denied in public statements means that it is being seriously considered as a last resort.
Report Argonaute | May 6 7:17am | Permalink
| Options
Greece's case is no different from that of Enron or Worldcom. Both corporations lied, cooked the books and their executives enriched themselves in the process. The difference between the two corporations and Greece is that in their case those responsible are doing time in prison but so far nobody, but nobody has asked who is responsible for the mess in Greece. Are we about to watch how some Greek politician crooks will get off the hook rescued by their fellow European crooks? If this is the case, pray for the end of the euro, the European Union, or the bankruptcy of Greece and its exit from the EU. The same people (party) who lied and cooked the books are in government now, for God's sake has anybody noticed it? Finance and economics set apart, I think the markets have! The EU president and his colleagues can say what they want about rating agencies, market forces are dynamics stronger than politics. How much more proof do the Europeans need, to realise that the politico-economic elite governing them has become an oppressive regime that is fleecing its voters under the noble banner of "Democracy". The Greek Communist Party (KKE) has displayed on one of the world's most sacred shrine, the Acropolis, the very birthplace of Democracy, a banner calling for the "Peoples of Europe Rise Up". As much as anyone can disagree with their ideology for once in my lifetime I must agree with them.
Report Daniel Kruppa | May 6 4:05am | Permalink
| Options
IMO this is a manufactured crisis in order to expand the power of the political establishment in Europe.
Report John27 | May 6 3:34am | Permalink
| Options
Fine analysis. Many questions and uncertainties. Overall, I think Greece and some other Mediterranean countries suffer from lack of revenues from the tourism industry during this recession. This might be a short term problem. EU needs to provide the necessary 'bail-out', which can be done in intelligent fashion, with clear contracts and responsibilities. Bottom line: the money will be paid back sooner or latter, with interest.
Bail-out or a better term is rescue or support package, is necessary, and needs to be structured long term, such that Greece can pay back. If other countries need money, EU can provide and demand fiscal discipline. This might be the road out of recession, and consolidation of the euro zone. I think this is going to work, but it requires good decissions and sacrifices.
Report Michael Pomerleano | May 6 2:32am | Permalink
| Options
Martin, it is a superb exposition of the issues. The imperative of the intervention is evident. Nevertheless, there are several issues that I would like to highlight. First, the markets could not be

fooled. Therefore, we ended once again in a situation in which the reckless lending by private sector banks in France and Germany is being bail-out by the taxpayers in Greece, and probably by the time the story ends, the entire EU. Second, The IMF, like in the Asia crisis, stepped in and asserted 'preferred creditor status', that is, the loans it provides are always senior to those of any other creditor. This situation creates a distortion in the alignment of interests of the creditors. However as Willem Buiter points out in a recent piece, the IMF assertion of 'preferred creditor status' has no legal standing and means no more than 'the creditor status preferred by the IMF'. The bailout would have been far more credible and reassuring if there was an alignment of interest of creditors being treated pari passu, as opposed to "debtor in possession" financing. Therefore, in my opinion, the package will fail, while the middle class taxpayers in Greece will be burdened for generations with unpredictable consequences. I share Buiter's view that it would have been far more desirable to proceed with a transparent, decisive and credible restructuring package that bail-in the banks at this stage and acts as a deterrent to future folly.
Report agpathma | May 6 12:28am | Permalink
| Options
I do quite agree with Mr Martin the great columnist.I also belive that the euro is a huge cost as it has it's own stuctural problems.The Noble prize winner Robert A Mundell's finding was that labour and capital should be able to move from abundant to scarce to sustain the equlibrium.But the main barriers among the 16 countries will stop getting the much needed equlibrium.Rich German and France or the northern Europe is trying to hold on to the Euro to compete against the Dollar.But everybody knows that the Dollar was created in the early 20th century and so far has sustain wars recessions a depression.What else it needs to test to say that it is thevtrue reserve currency.Just imagine US is a mastermind in one way. That is a nation out of almost all the races in the world.Mr Morgan did not form the federal system without a struggle to pass ghrough the congress in 1913.Dollar will regain it's value. But the US will not be a main engine to drive the consumption.Solution will be in the hands of China to revalue their currency.Then the world economy will stabalise.
Report ANDRAZ GRAHEK | May 6 12:04am | Permalink
| Options
Great article as always.

I'm more suprised that everybody is bemoaning the fact that Greece has no exchange rate mechanism to rebalance and on the other side disregarding how euro is absorbing the greek situation already and depreciating. One could actually argue that especially Germany as a major export powerhouse asymetrically profits because a small euro member got overextended on the debt balance and ended on the brink of default.

Greece is more a syndrom for the debt levels created by the fiscal/economic realities. Leverage intensifies volatility and people have been sticking their head in the sand about this. Volatility is the mother of risk and we should expect higher risk premiums going forward. It will be a painfull process to ackgnowledge this. This is especially true for the US Treasury debt refinancing needs. Look at the comming months for refinancing needs and hold your hat, for Greece will be nothing more than a breeze indicating a perfect storm - complaceny combined with ignoance.
Report Nishanth Balaji | May 5 11:23pm | Permalink
| Options
"Yet, now that the eurozone has been created, it must work."

Why? Why do you think it is impossible for the EuroZone to disintegrate? It could happen.

As an aside, I don't think Turkey will be clamouring to join the EuroZone any more. Penny wise and Euro foolish!
Report Hector Nevares | May 5 9:56pm | Permalink
| Options
The eurozone was a great experiment and like all experiments it had a possibility of failure. You suggest that it must work. I believe that most of the member states will not be willing to bear the cost.
Report Bond | May 5 9:40pm | Permalink
| Options
Hold on a sec, didnt the Fed fatten up its balance sheet to € 3 trn, x 2 or x 3, buying all that array of financial innovative products that had been triple AAA rated to save the global financial system from collapsing, just a year ago? Surely German spirited ECB would have reticences to monetize Government deficits stemming from unaccountable and profliglant counterparties, but wonder how that

reluctance could ease if systemic threats are considered to test the € viability.
There is no doubt fiscal national autonmy in the € area has been proven a myth- tell the Greeks!, but that doesnt mean harsh political commitment can overcome long lasting economic shortfalls- tell the Greeks too.
Markets directionally for the past fornight look to me very unaligned and uncorrelated with a probability weighted row of real economic developments affecting solvency- as opposed to liquidity.
While fiscal engagement mechanisms could be designed and probably will for ex-ante crisis implementation- so long sovereignty! the EC tone up suggests more immidiate drastic measures like Sov direct debt acqyisition could and probably should be considered.
Report James Frazer | May 5 9:38pm | Permalink
| Options
Mr Wolf-

Another excellent column. How is this for a solution?: Germany, not Greece, should leave the Eurozone. This would provide the devaluation that Greece and other debtor nations need both to pay their euro debt and to regain export competitiveness. (Germany might perhaps rejoin later.) In the meantime France (that other notorious hard money country) and other Eurozone members could work out an ongoing current accounts adjustment mechanism. For this, perhaps all member states could adopt legislation implementing automatic VAT increases or decreases based on their current account and-or fiscal balances. (The trigger might be a pure formula or Brussels might have a role.) Such automatic VAT increases would not only improve a deficit state's fiscal position but, more important, they would suppress consumption and thereby improve the country's current account position (as well as providing a domestic political incentive not to overspend in the first place.) Perhaps as important, automatic VAT decreases would encourage consumption in surplus states (a remedy which Germany would no doubt veto, providing another reason why it might be better to have them out of the Eurozone for at least a while). Best regards.

-James Frazer
Report Tom | May 5 9:23pm | Permalink
| Options
This column ties in with Martin's other recent column on the dangers of prolonged large current account deficits. I think what we are seeing in Greece is the first step in what is going to be a long, painful withdrawal by global capital markets from their longstanding support for developed-world current account deficits. This support has been driven largely by the accumulation by developing governments of developed-world currencies and bonds, a practice which makes decreasing economic sense, especially as developed countries face huge unfunded liabilities due to graying populations. One of the main effects of this long-standing support has been to inflate wages and other incomes and thus erode competitiveness in the developed world, while lulling people into thinking that developed economies were growing healthily, as wage inflation is statistically indistinguishable from real GDP growth. I'm afraid the sweet story about how the West could offshore its production without an ensuing collapse in wealth was just that.

My feeling is that, as this continues to play out, the stronger, mostly northern European countries will decide they need to save themselves and decline from further bailouts. That is, the next Eurozone country to be cut off from lending support by private capital markets will be allowed to default and its banking system allowed to collapse. The rest of Europe will try to contain contagion by repeatedly bailing out its banks, but anyway, at least several governments will succumb to default. Competitiveness will be the key criterion.

But I see neither fiscal union nor the end of the Euro in the cards. I see stronger rules to restrict borrowing (which for many won't be available anyway), and at most a few exits from the Eurozone by small peripheral members, such as Greece, Portugal and Ireland.

The bigger issue is the US, which by the way ran about a 13.5% total deficit last fiscal year, counting debt service. The Fed's tentative suspension of quantitative easing also has much to do with all this risk-off repositioning. As the biggest boat in a stormy sea, the US is still the obvious safe-haven - if it sinks, who won't? But the demands that US borrowing puts on the global financial system are grandiose and the potential for a minor pullback to quickly escalate into a panic is scary.
Report Marica Frangakis Ioannou | May 5 8:57pm | Permalink
| Options

The bail out has bought Greece time. The question is for what?? A long and deep recession will exacerbate the current situation and give rise to social unrest. Leaving the eurozone would buy some extra time and possibly help it set out its own survival plan. However the problems Greece is facing would not go away, neither would those of the eurozone. So the solution to my mind is only one, for the EU to make some radical changes. No currency can stand on a long term if it is not backed by a proper monetary policy embedded in a comprehensive economic policy framework. To the extent that this message actually gets through, the Greek crisis will not have been for nothing!!
Report justin mandly | May 5 8:55pm | Permalink
| Options
Welcome the empire. The United States of Euro
Report lothian9 | May 5 8:38pm | Permalink
| Options
It's looking more & more the Euro was a mistake, no?
Report Winterpeg | May 5 8:35pm | Permalink
| Options
Dear Mr. Wolf:
Very good article. Now I am wondering if in reality Greek authorities have two options:
1. A very tough combination of higher taxes and less spending that would lead to a long recession and high unemployment (Latvia), or
2. Declaring default, letting their banks collapse, exiting the Euro and force deposit holders to convert Euros back to Dracmas, thus achieving fiscal balance by lowering salaries and internal expenses while capturing higher-valued Euros. That is exactly what Argentina did in 2002 and to this date they are out of the capital markets (I think not for much longer) while the economy there grew on average 6% since 2003. Not bad for a country who shaved-off 60% of its debt.
The problem with option 2 is that Spain and Portugal will quickly follow suit, thus converting the Euro into a mere German-French currency.
Report raffreid | May 5 8:15pm | Permalink
| Options
kudeta, moral hazard is what I thought of also. As an American, I look at Greece and see the future of our once great Republic. I guess it's a good thing we are being nice to the Chinese.
Report Martin Wolf | May 5 8:11pm | Permalink
| Options
@ Hercules, yes. Fools who lent to Greece surely deserve what's coming to them. It will be a long time before anybody treats all eurozone debt as equivalent again. This must be a very good thing, in the long run.
Report Martin Wolf | May 5 8:09pm | Permalink
| Options
@ Jaded 123, Yes. Even Homer nods. Willem Buiter is a wonderful man, but he has a blind spot on European integration and the euro.
Report Kudeta | May 5 7:12pm | Permalink
| Options
This program of support for Greece seems to me to contain enormous moral hazard. Explicitly or implicitly, the loans from the IMF and the Eurocountries are subordinated to those held by the speculators without the latter having taken any haircut at all - shades of AIG.
These same speculators are now trying to get promises of similar treatment for their exposure to the other PIIGS by crying 'contagion' in the canyons of finance. If they succeed, then there will be few controls on the recklessness of the deficit nations or of the speculators, both groups then being insulated from responsibility for their actions.
Report Hercules | May 5 7:07pm | Permalink
| Options
We do not want the money we will NOT accept the EU IMF "assistance".We do want to be saved.Give this assistance directly to the US and German Banks.We will go to restructuring our debts.
Report Argonaute | May 5 6:52pm | Permalink
| Options
Greece won't be able to make it without restructuring of its debt, in fact the whole of the EU won't make it and the money lend to Greece will go wasted. The problem in Greece is cultural, nobody has ever been able to change cultural shortcomings of any nation overnight without a revolution and that is exactly what will happen now. I predict a chaotic situation both administratively and socially. I hope for the Greeks that some kind of a European consortium will take over the entire or at least key sectors of the Greek administration. We have seen this happening in recent years with specific projects such as

the Athens airport and Athens underground (metro) where German led consortiums still hold the reins. If this happens on a national level it will be an unprecedented event. However, since this will be happening within the European Union and particularly within the eurozone it can only bolster chances of a success and it may also toll the beginning of a political union among European nations. This is the last chance Europeans have otherwise somebody will be writing the obituary, not only for Greece but for the entire EU much earlier than anyone can imagine.
Report Simba97 | May 5 6:20pm | Permalink
| Options
When the original 13 states of the USA were formed, they were not happy about the concept of having a federal government with power to tax all the states. They wanted to keep state sovereignty and state militias. The federal government was forced on them out of necessity. It is not inconceivable to imagine that such a situation would occur in the EU.
While there are tough times ahead in the EU, the drop in the Euro is also helping them, and if the Euro drops all the way to parity with the dollar it might be enough to sove their economic downturn. Poltics trumps finances, and the Franco-German alliance is pretty strong - I would be skeptical of those who call for a collapse of the EU.
Report kettler | May 5 5:54pm | Permalink
| Options
Europe, as much as it's proponents may wish the think, is not a replica of the U.S. and never will be. Unlike the U.S. its component parts are not states but sovereign nations and Europeans are citizens of those mutlitude of sovereign nation not one U.S. Europe has experimented with unification before all to end in ruin and so it will again. Better to end this agony rather than to dig a deeper hole from which no one will be able to escape without excruciating pain and potential world wide turmoil!
Report Dr. Hu | May 5 5:36pm | Permalink
| Options
Looks as if that deep recession bullet we thought we'd dodged wasn't the only one in the clip. One labeled "toxic derivatives" lurks in the chamber along with "radical imbalances," but "soverign debt" speeds our way, seemingly on target, and others--"stgnation," "deflation" and "excess capacity" have already hit home, leaving the global economy one badly wounded beast.

As you point out, using taxpayer dollars to bail out German and French banks only buys the Greeks a bit of breathing space against the over-whelming odds that a radical austerity program can squeeze, tax and export its way back to fiscal health. (meanwhile "moral hazard" concerns sit on the shelf).

With a falling euro and austerity-contracted demand spreading across the Club Med nations (and others), how can Obama's America export its way out of its enormous trade and fiscal deficits? What about China, Japan and Korea's export-dependent economies? Just where will that elusive demand come from?

Richard Duncan ("The Dollar Crisis" and "The Corruption of Capitalism") got the analysis right, but I wish his solution--the US should use its great borrowing ability to fund green and clean energy technologies for export--falls way short of what the world needs.

Meanwhile the Greeks are in the streets just saying "No!" to radical austerity, and the blood is flowing. Yet the same productive forces that so recently promised easy affluence, now sit idled by our failure to get the financial piece right. Time for Plan B.
Report Jez | May 5 5:31pm | Permalink
| Options
Has anyone noticed how a bad debtor always comes up with excuses as to why it's not his fault and that others are in some way responsible. In my view this is precisiely the reaction of the European Institutions with their complaints and threats about the rating agencies, derivative markets and investors. I say lend them nothing ever again. Let them suffer for their profligacy and teach them all a lesson in humility.
Report Jaded123 | May 5 5:21pm | Permalink
| Options
Could this be the same Prof Buiter who was strongly advocating as recently as 2008 that the UK join the Eurozone as soon as technically possible?
http://www.nber.org/~wbuiter/ifeuro.pdf
Report NTT | May 5 5:05pm | Permalink
| Options

There has never been such a thing as a free lunch and it will never be, at least not until we have capitalism. Greeks have to understand that they have to work, because when they took the loans they didn't complain and now they start to protest when the government is trying to reduce expenditure. It is true that the only reason why they bailout Greece is because private banks need their money back + interest. And probably most of you can calculate the interest on 300bn euros. ECB has to print more money and there we go, the euro depreciates. A lot more interesting things are to come.
Report Martin Wolf | May 5 4:50pm | Permalink
| Options
@Desmond Lachmann, I intend to discuss this issue next week. I have, of course, frequently noted that the UK is greatly helped by not being in the eurozone. And, of course, I have long been a sceptic about the workability of this arrangement (though, to my shame, I briefly wobbled on UK membership in the late 1990s, before correcting myself).
Report Mike | May 5 4:00pm | Permalink
| Options
It is a great pity that the financial sector has become so large.

So many people are interested in what happens to the Euro and Greece just from the point of view of spectating the market in order to hopefully profit from opportune deals with others.

What about the lawless banks, operating under the flawed regime of regulation free capitalism that assisted off balance sheet financing for Greece at the intent of short term mega $$, duly spent one imagines on fast cars and immorality.

In the rabbles' desire for an exciting show, what a pity if we forget two things.
(a) go after the sin and folly that got us to this point
(b) make an effort to change the rules
Instead of just being excited spectators.

People died in Greece today for goodness sake!!
Report gareth davies | May 5 3:57pm | Permalink
| Options
The first three martyrs on the alter of the Euro fiasco
Report Desmond Lachman | May 5 3:41pm | Permalink
| Options
Martin Wolf most usefully reminds us that Greece faces truly daunting fiscal challenges whether or not it chooses to restructure its sovereign debt. If Greece chooses to eschew debt restructuring, as it is now doing under its IMF program, Greece will need 11 percentage points of GDP budget adjustment over the next three years. If instead, Greece chooses to restructure its debt, it will need a more immediate 9 percentage point of GDP budget deficit reduction effort in order to eliminate its primary budget deficit.

Recent experience with major fiscal adjustments under a fixed exchange rate would suggest that the deepest and longest of recessions lies ahead for Greece should it decide to remain within the Euro. Most recent examples, include Ireland and Latvia, where despite very much lesser fiscal retrenchment than is now being proposed for Greece, real GDP has declined by over 10 percent and over 20 percent, respectively, over the past two years.

By contrast, as Martin himself acknowledges Canada, Sweden, and New Zealand all succeeded with fiscal consolidation in the 1990s. However, what he does not note is that they all did so in the context of floating exchange rate regimes. Sweden offers a particularly encouraging example. In the early 1990s, Sweden managed a budget deficit reduction effort on the scale of that now being proposed for Greece without suffering a particularly deep or long recession. It managed to do so by allowing its currency to depreciate by 30 percent, which had the effect of producing an impressive export boom as an offset to the fiscal tightening.

Against the backdrop of these very different experiences, one has to wonder why Martin confines Greece to the debt restructuring option without exploring the additional option of exiting the Euro. One would have thought that exiting from the Euro would at least give Greece a chance of being spared multiple years of high unemployment and depression. It would do so by allowing Greece to regain competitiveness and to boost its external sector without having to tolerate many years of painful price and wage deflation.

Report GOKUL GHIA | May 5 3:09pm | Permalink
| Options
The macro cosequences are that monetary union without fiscal union for the Eurozone is impossible. And fiscal union, obviously, implies political union. This is a conclusion which Europe's leaders have denied, either through economic illiteracy or, possibly worse, a disregard for the constituents they claim to represent. Incidentally, does Nick Clegg really still want to take the UK into the Eurozone?!!
Report Martin Wolf | May 5 2:46pm | Permalink
| Options
@Eleftherios Leontaridis has made the correct response to @Wim Roffell. As I noted, Greece will need a primary surplus of at least 4.5 per cent of GDP, to meet the eurozone's deficit criteria. The question is only how quickly it is forced to eliminate the deficit. Without this package, it would have had to be instantaneous.
Report Larry | May 5 2:11pm | Permalink
| Options
There was an article in the WSJ a couple of weeks ago suggesting that both the pre euro and anti euro agreed at the beginning it would not survive in its current state. The anti euro figured this was a reason for not going ahead, the pro figured the resultant crises would be the trigger to force further integration. What is becoming increasingly worrying is the speed with which politicians are able to redirect public funds to objectors, and the complexity of the underlying structures. Politicians need crises, but every crisis appears to redirect more and more tax payer funds to unelected and unaccountable public bodies, run by ex-politicians.
Report petercat | May 5 2:02pm | Permalink
| Options
I'm not an economist. Just a "common-sensed " citizen who lives in a faraway latinamerican country. I judge that Greece and many other european countries shouldnt have never entered the Eurozone. Spain, Italy, Serbia, Bosnia and many other small countries the like, will soon be in "knee-deep waters" and screaming for help. Sweden, England and the like were far more wise and chose to stay with their own currencies. What's next??? Nothing but more trouble and not all of them can nor will be saved.
Report Flangini | May 5 1:52pm | Permalink
| Options
excellent analysis
Report Francis X Meaney | May 5 1:51pm | Permalink
| Options
Why not treat the financial deal for Greece as a severance payment and ease it out of the eurozone to run itsown own monetary as well as fiscal policies?
Report Philhellin | May 5 1:44pm | Permalink
| Options
No one here expresses any concern for ordinary people. How can a government accept to shut down the economy so as to make savings and at the very same time talk of paying back the debt? I am not an economist but I know that if I cannot make ends meet I need to find more work to increase my earnings. How will the Greeks do it if the others are asking them to shrink their economy, and keep a currency that makes them uncompetitive by comparison with Turkey and other Meditteranean countries outside the Euro?

It seems natural that Greek people are unlikely to play ball. Don't expect these turkeys to vote for Xmas.

The more probable events will be Greece leaving the euro and if the military come back the EU will probably expel them from the Union as well.. With a weak drachma tourism and enterprise may start up again as well as immigration for those who can go out and send money back to their families. Sad but that's reality. Greece is going back 40 or 50 years.
Report joseph belbruno | May 5 1:37pm | Permalink
| Options
@ Wim Roffel - Hi Wim. Intelligent contribution. Europe is an ethnographer's dream! Could I point out that quite often 'regionalisms' in Europe, inside and outside (!) the EU are actually MADE POSSIBLE by the existence of the Union?

By this I mean that Belgians can squabble about Flanders and Wallonie and Spaniards about Catalunya and Castille, the Italians about the Lega Nord (you will not believe this, but even my Sicilian towns crave for 'autonomy'!),...and of course the Croats and Serbs and Slovenians....What I would like to know is: HOW MANY FRATRICIDAL (or 'sororicidal') WARS would we have in Europe were it not for the POLITICAL REALITY of the European U-N-I-O-N? Perhaps the ONLY place to be a proud Sicilian will be....in the European Union!

As I said below, those nostalgic memories of "national democracies" are nothing but an atavistic pathetic attachment to a reality that millions of Europeans (mostly young) travelling from Lisbon to Leipzig and Warsaw will happily scoff at!

TS Eliot (a Londoner) for you (don't have any Rilke poems with me):
"Wipe your mouth and laugh,...the worlds revolve around empty lots, where ancient women gather fuel".

(Hey, Angela Merkel had me in tears just now on KlassikRadio talking about "unsere Zukunft in Europa"!) Ciao.
Report Farhaz Miah | May 5 1:25pm | Permalink
| Options
An EMF would heighten the risk of moral hazard and subsequent irresponsibility on the part of EU members; nonetheless the empirics of the existence of moral hazard points to only anecdotal evidence and its problems can be overcome by unsavoury penal rates to be paid back in post-crisis times. The break up of the European Union is inevitable as Martin has highlighted due to a lack of fiscal and political union. The whole European project is in tatters now as it shows that macroeconomic autonomy overrides any concern of Euro-wide stability. The least worst scenario would be a temporary suspension of membership and debt restructuring. In the Long Run the IMF should become an impartial rating agency mitigating the conflicts of interest that exist at the moment.
Report Guy Weston | May 5 12:52pm | Permalink
| Options
S&P rating implies a 14% probability of a Greek default in next 10 years, according to the sovereign head on Ransquawk. This is surely too optimistic. Whilst I don't align with EU doom mongers mouthing 'end is nigh' proclaimations. Doesn't this scenario assume virtually no contagion risk to other PIIGS?
Report Robert McDowell | May 5 12:15pm | Permalink
| Options
Martin's essay is excellent.
Commentators who blame Greece for being irresponsibly spendthrift and to link the state of public finances of UK to Greece etc. are both right and wrong. Greece alongside Ireland were complemented for years of high economic growth, for contributing positively to EU and Euro Area growth much above their weight etc.
Greece, under the assumed protection of the single currency and EU membership was merely operating a credit-led growth policy based on banks growing their mortgage business fast and lending to property developers, similar to the USA, UK, Ireland and Spain. Greece did so perhaps too enthusiastically and ran the highest trade deficit in the OECD financed by selling securitised loans to foreign investors and borrowing from foreign banks plus diaspora and tourist receipts.
Greek banks also invested massively on growing bank networks in nearby emerging countries to the benefit of developing those countries.
The Central Bank of Greece tried to order the Greek banks to cut back on property exposure and lend more to productive industry and help reduce the trade deficit. But, as in UK, USA and elsewhere this is like asking addicts to volunteer for rehab. The advice was ignored when the same advice in Spain was responded to by the banks there, if somewhat late.
Arguably, the problems derive from Greece believing there is security is doing what much bigger countries were doing like USA and UK such discounting the risks of historically high trade deficits so long as these could be financed (the so-called "new paradigm for economic growth' overcoming boom & bust). It is hypocritical to blame Greece alone for its problems. When the Credit Crunch erupted it seemed for nearly 2 years that the fragility of Greece could remain below the radar of the bond markets. Greek bankers told each other that the Credit Crunch would probably by-pass them so long as Greece was counted among emerging countries when those were viewed positively. This was, of course, a massive self-delusion.
Credit-boom growth was hugely positive in transforming the living standards and quality of life in Greece, allowing it to catch-up fast, like Ireland, with EU per capita GDP average. Ireland operated an extreme credit-boom catch-up growth too with banks lending too much to mortgages and property, even more than UK banks that lent 70% of domestic loans to mortgages and property.

The differences were that Ireland ran the highest trade surplus in the EU while extremely paradoxically also the highest payments deficit, and the UK generated a large financial services external surplus to off-set its more trade deficit. Greece was hoping to emulate the UK by how its banks were investing in cross-border retail banking but failed abysmally to get its banks to support export industries, while its main competitive advantage, its huge shipping fleet increasingly operated in tax, borrowing and GDP terms off-shore.
Greece's enormous trade deficit is as much a long term failure caused by the choices of banks of who and what to lend to as by government, but also very much an outcome of false assurances from the EU and the models they followed of the USA, UK, Spain and Ireland.
Germany's position in the whole matter is self-serving and hypocritical too insofar as its trade surpluses require there to be countries running deficits. It's excessive lending to business borrowers instead of mortgage and consumer borrowers leaves its banks vulnerable to funding costs so that the worse the sovereign risk costs of deficit countries are the lower are the borrowing costs of its banks and corporates. Greece is a mere pawn in a bigger global game.
Report Eleftherios Leontaridis | May 5 11:15am | Permalink
| Options
@ Wim Roffel

Wolf's argument is that using the aid package Greece has more time to eliminate its primary fiscal deficit, whereas in the event of a default this would have to be done immediately as outside funding would be unavailable. He is not suggesting that the deficit will not have to be wiped out.

In fact, that is the only hope - the sooner the primary deficit is credibly reversed into a surplus, the better chances are that market confidence may be restored.
Report Chris London | May 5 10:40am | Permalink
| Options
Whilst not wanting to get ridiculed I would like to put forward the case that too many economists and finacail commentators are just standing on the side lines and giving commentary on the current game and what the players have done wrong. Is it not time for us as a group to now stand up and put our head above the parapet.

For my part I would like to put forward the case for global restructuring. The situation as I see it is that the majority of the developed world has over the last decade lived in an economic bubble caused by spiraling debt and government overspending. This is evident across the continents, Dubai to the UK have overspent and now find their over leveraged debt causing considerable concern at home and to the markets. The EU and the Euro is particularly vulnerable with the so called PIIGS bringing intense pressure on the currency and the union as a whole. Pumping money into Greece will not fundamentally change or eliminate the issues that they have. As one commentator said "lending Greece further funds is like throwing it into a black hole, you will never fill it and once it has gone in you will never see it again". If Greece is to be turned around it will take decades rather than years to carryout such a transformation. The same goes for the other PIIGS (Portugal, Ireland, Italy, Greece and Spain) all of whom are in various states of collapse. Their fate being held by the markets who are just circling and waiting they time.

What is needed is for the debt of these nations to be wiped off, however this is never going to happen as the nations who hold the notes on this debt want their money back and in fact want their pound of flesh as well. China for one has so much tied up in national debt and the US's debt in particular that it would be catastrophic for their economy if any nation was to default.

So like giving more drink to an alcoholic we keep lending to the nations who can't afford to pay back what they already owe. The cycle will only be broken when one nation cant fund its debt and defaults. Then like a house of cards it will all come tumbling down. The Euro is on the verge of this with Greece possibly being the catalyst, however there are others who are lined up to take over if Greece fails to deliver. Portugal and Spain are being touted but I feel Ireland is sneaking up on the rails and may just pop them to the loosing post.

What is needed is as previously stated a global restructuring, this will mean that nations will have to start to bring their finances under control and stop living off their overdraft (deficit) and thus increasing the size of their loan (debt). Unfortunately I can not see this happening as we are now living in a "want it all and want it now" society both at a national and personal basis. So the inevitable crash is on the

cards which will take us a generation to get over if not two. It may also result in a number of goverment / regime changes as the populous react to the austerity measures that will surely be introduced. I think Greece is a window into which we are able to see the future of many nations to greater or lesser affect.
Report vukovicg | May 5 10:39am | Permalink
| Options
EU was transformed from an economic union into a political project. As an economic union it was prosperous. As a political project it is almost certain to fail. Last 10 years demonstrate world wide abandonment of economic realism in favor of costly political projects and unrestrained government spending. China and several other emerging economies have maintained their focus on economic development. The results are crystal clear.
Report Mark Gay | May 5 10:34am | Permalink
| Options
There is a worrying circularity in this phase of the crisis, in which the banks are once again wailing doom and governments are responding by transferring huge sums from the taxpayer to the banks.

If so, this second wave of the crisis is not the last one. This is a second banking bailout, yet to be followed by the real sovereign debt crisis.

Why is there a crisis in Greece? Because banks have lost faith in Greece as an investment, new information about government finances rendering it uncreditworthy.

Yet is this really new information? After all, banks helped Greece and other countries secretly to borrow money in order to improve its debt-to-GDP ratio.

Now the EU and IMF bail out Greece and who receives the money: the same financial institutions who are wailing doom.

As to the euro's future, I don't agree with those who say "the euro is here to stay and we must adapt to the new reality". As one who followed the evolution and launch of the single currency, I can imagine its disassembly.

The Greek-cum-second banking crisis has shown that the euro lacks institutional foundations, depth and flexibility - these are guilders by a different name - and, so far, politicians have shown that they have not a clue how to address the problem.
Report coruscate | May 5 10:29am | Permalink
| Options
Any state using the common currency can undermine it by exercising its sovereign right to issue debt disproportionately to its domestic savings and existing maturities. If the debt issuance offices of user states were to be merged in the ECB, which would become the source and arbiter of quantum and maturity of the common currency debt issuance and its guarantor. It would hold treasury notes against advances to user countries which it could refuse in pursuance of its primary task of maintaining the value of the common currency.
Report Wim Roffel | May 5 10:20am | Permalink
| Options
Mr. Wolf, I have for years studied ethnic conflicts and the main reason for separatism is that people think they will be better off. So it is always the rich provinces who want to secede: the Basques and Catalans in Spain, Northern Italy, the Slovenes and Croats in Yugoslavia, etc. A nice example is also Quebec that became coy about secession when its relative economic position inside Canada deteriorated. So how can you hope that a fiscal union will solve Europe's inequality problems? The more you force people for to pay for others the stronger the dissolving forces in the EU will become.

I would like you to compare Greece with the Baltics. The Baltics have done what Greece now needs to do: economic adjustment with a fixed exchange rate. On the Balkans Croatia has done the same.

You write that the main advantage for the Greek is that don't have to close their
primary fiscal deficit. I disagree. The fact that the Greek do not close their primary fiscal deficit for a long time robs the present deal of its legitimacy.
Report Hans Suter | May 5 10:11am | Permalink
| Options

@flavio.hannas it's a bailout of banks that e.g. gave credit to Greece for buying 300 leopard tanks (to mention Greece's "bloated defense spending"). And so we have come full circle.
Report kokkinid | May 5 9:46am | Permalink
| Options
Being a physicist-biologist, this article agains cnfirms to me that economics is a highly non-exact science, and more so when it is applied in the case of Greece. The country has a 35-40% inofficial economy. If the government (under EU/IMF pressure) manages to get grip of at least a part of that, the figures/statistics for Greece will look a lot better. On top of that, this inofficial economy provides a shock absorber making the impact of austerity measures much more bearable to the population. So don't write off Greece yet.
Report Luis H arroyo | May 5 9:41am | Permalink
| Options
Mr. Wolf,
The present circumstances have proved without discussion that the euro is not an Optimal Monetary Area. On the other hand, the euro must be defended if we will not to fall in an abyss.
The EU Institution must prove its commitment with euro. Specially the Eupean central Bank, the only independent Institution .
What is the very risk today for the EU? The fall in a new financial crisis, followed by a big deflation. The ECB must decide in consequence. The last decision on Greek debt qualification is in the right direction, but much more is needed.
Report Eleftherios Leontaridis | May 5 9:34am | Permalink
| Options
Martin Wolf is right. The eurozone is a fact, and governments are determined to make it work. When commenting on actual and future events, it is necessary to accept reality rather than go through all the theoretical options.

The underlying assumption here is that there is political will to keep the eurozone intact and solvent. Of course there are reasonable doubts, but so far only the economic dimension is debated.

Any way you add them up, as Martin Wolf and others have done, the Greek numbers show that the 110 bn are not enough. But what is not picked up in the article and by most commentators, is that this was left intentionally open. The IMF-EU programme spans through 2014, whereas the financial resources committed thus far address borrowing requirements until 2012. The assumption is that until then, Greece might be able to return to markets. Right now this looks doubtful, but two years are an eternity and nobody can really know now how market conditions will play then - there are too many uncertainties.

I am curious why the financial assistance provisions stop at 2012. Then I am reminded of the fact that from 2013 onwards, a new EU budget is supposed to kick in. Not to mention that there are about 20 bn in the current budget that Greece has largely left untapped. Might there be some correlation? Just wondering.
Report gedudel | May 5 9:10am | Permalink
| Options
saying the eurozone must work is an "endsieg" type attitude. so what if it doesnt? endkampf for Bruxelles?
Report gareth davies | May 5 9:06am | Permalink
| Options
"Willem Buiter, now chief economist at Citigroup, notes, in a fascinating new paper, that other high-income countries, notably Canada (1994-98), Sweden (1993-98) and New Zealand (1990-94)"

What those countries, note countries, nations, have in common is that they are run by democratically elected governments, all pretty much exemplars of the species, in control of their currency and their finances.

Greece is a nation state under the jackboot of the European elite with their fantasy of Euroland that in common with the other unfortunates Spain, Ireland, Portugal were flooded with cheap cash by the ECB and hey guess what do you do with lottery money - you fritter it away.Now they are expected to pay the price to keep the demented Europhiles in power.

Martin says - "Yet, now that the eurozone has been created, it must work" - er..Why?

If it continues to destroy to democracy and freedom it should go as soon as possible.
Report joseph belbruno | May 5 9:05am | Permalink
| Options
@ Danny Barrs - you are precisely right, if I may! If you go to the second 'wolfexchange' you will find that the process of European Union, far from being a poor copy of some kind of MYTHICAL BLUEPRINT (whether based on 'optimal currency areas' or 'equilibrium') is first and foremost a POLITICO-ECONOMIC PROJECT that is sui generis (unique) and one whose deep and compelling historical, social, political and economic origins need to be understood and, yes, debated but NOT in the name of a REGRESSION to the statu quo ante.

Eurocritics and eurosceptics continually wave in front of us the LUDICROUS MIRAGE, THE CHIMAERA, the BOOGIE of a fanciful, mythical blissful prior state of democratic European nation-states and regional economies.

THIS IS A DELUSION! The reality instead was made of 'competitively devalued' currencies and hyperinflation, of particularisms and regionalisms and atavisms and nationalisms and FASCISMS that led us to TWO WORLD WARS - all the combined folly of people who still advocate a divided Europe EITHER to further their own ulterior purposes OR because they have NO IDEA of the all-important interests at stake both internally (social peace) and externally (geopolitical relevance) for ALL Europeans.

IF we want to see DEMOCRACY we must BUILD IT AT THE EUROPEAN LEVEL, AT THE HIGHEST LEVEL OF DEVELOPMENT.
ANYTHING ELSE is just delusion and illusion, it is the most efferate retrograde conservatism, it is a WILL-TO- POWERLESSNESS (Wille zur Ohnmacht) that we must banish because it will lead us straight back to the HORRORS OF OUR PAST!!

Again, please review if you wish the lengthy discussions in the second 'wolfexchange' forum.
Report petermanning | May 5 9:00am | Permalink
| Options
To me, the attitude of the German people over the next few years is key. If Portugal, Italy and Spain follow suit how will long will the German electorate's patience last, as they will largely be the ones providing the bail-outs, particularly as they have taken the medicine to get their own house in order. If the German people put ther collective foot down and say 'No' then bye-bye euro and possibly bye-bye EU.
Report RENE KIM | May 5 8:54am | Permalink
| Options
I do see the arguments but fail to see the logic of Martin's statement that now the Eurozone has been created it must work. Better turn around half way than to be lost at the wrong destination. There is a structural error in design. Car companies do a recall or discontinue a model, but most importantly they improve their designs.
Report joseph belbruno | May 5 8:41am | Permalink
| Options
The last few several readers have lamented that Martin Wolf takes the survival of the eurozone as an article of faith. They are very much mistaken. And once again, as I did below, I would invite them to look at the discussions in the SECOND 'wolfexchange' (on European Monetary Union) and increasingly in the third on 'capital flows' (still running) to look into the reasons for what is rather the result of exhaustive research and long reflection about the REAL POLITICO-ECONOMIC FORCES behind the European project.
Report RiskManager | May 5 8:24am | Permalink
| Options
In the financial crisis we saw how complex markets, financial instruments and risk management had allowed every player to "manage their risk" in their own portfolio but with the result that systemic risk was created whereby even though each player was "safe", the market as a whole was not. When the hidden reality dawned upon everyone we found we were a long way from where we should have been. Cash! A Black Swan event.

In the unfolding European sovereign debt crisis we can perhaps see how the Euro "managed" all the risks away thus allowing some countries to think they were "safe" when in fact they were not. Greece was allowed to spend freely without a market response in its debt costs.

Perhaps both were excercises in denial of the underlying reality?

The underlying of reality of Europe can, I suggest, be seen quite clearly at its core. Belgians cannot even get on with each other within their own country, but as their govt falls over a trivial linguistic tribal spat they can still lash out at a common enemy, burka wearing Islamic women.

As European elites have built ever more vainglorious structures, it is I think this foundation that always lets the project down.

Europe, a fine idea spoiled only by the nature of European peoples?
Report Ole Ness | May 5 8:14am | Permalink
| Options
Another great column, however the conclusion is disappointing: "Yet, now that the eurozone has been created, it must work," Wolfe concludes. Why? This is an article of faith, not an argument. This has indeed been one of the problems with the euro from the beginning. In stead of clear analysis of the underlying weaknesses, "eurobelievers" have made a leap of faith, just to ensure that ever closer union is realized. However, it is time that Europeans understand that Europa should follow a path of unity through diversity. Independent states competing with each other, including with independent currencies, and an end to the French dirigiste dream. For once Europeans should look to the future based on clear and independent analysis. Martin Wolfe could be a starter, but it is of course very comfortably to be a part of the Euro elite, and to talk about what is never to be, but bueatiful words.
Report Danny Barrs | May 5 8:03am | Permalink
| Options
As usual Martin Wolf's analysis is spot on as is his conclusion. But the sentiment expressed, however, is slightly bizarre. The decison to turn to the Euro was always the start of a process of greater economic unity and not an end in itself. To label it a "high risk" strategy is to accept that the current crisis would somehow have been "less risky" without the Euro (an extremely risky hypothesis given the loans made to Greece by European banks)...and that you can just have monetary unity without the rest...and to give in to pressure of those that desperately want the Euro to fail for idealogical reasons even if the whole of Europe were to suffer from that failure!
Report fngracal | May 5 8:01am | Permalink
| Options
I have always been a Euroceptic and, in my humble view, I believe that this could be the begining of the end of the Eurozone.
After all, Europe changes borders every 40 years and the the defunct USSR was in a much more advanced stage of consolidation and fell apart abruptly.
Report Keithmmcburney | May 5 7:51am | Permalink
| Options
Mr Wolf

1. Which nation states contribute directly to the IMF and by how much?

2. You wrote Greek debt is foecast to peak at 150% of GDP. Presumably this figue ecludes personal and private company debt - yes? What are these?

3. According to the recent BIS report (No 300) and their claimed conservative projections, UK national debt is set to rise:

3a. inexorably to 100% of GDP in the early years of the parliament we are about to vote for, due to the structural deficit being so high and compounding interest payments - yes/no, comments?

3b and thereafter, assuming tight fical and regulatory control from day 1 of the new parliament, and depending how public pensions, and by implication pay, and benefit costs for are managed to 300 - 500% of GDP. yes/no, comments?

3ci what components of UK national debt are off-book are off book and by how much?

3cii by amount and percentage from the start of FY 2010, how much are the present public sector pensions and age pensions and benefits, and other benifits and tax credits budgetted for? I understand these are not included in theperent UK national debt figures and projctions because they are considered to be funded by current spen. However the BIS figures incude them, i think - yes/no comments?

3ciii why are some PFI interest payments included in the UK national debt figures and not others? true/false and comments?

3civ What are the current levels of personal and private company debt in the UK?

3cv To what extent do the multi-nationals switch thir losses from nation to minimis tax outgoings? What was the effect in terms off exchequer loss in FY09/!0 estimated to be?

4. Where can these figures all be seen, especially in one place, and prefereably in as few as possible if not?

5. I wouldn't emigrate, but some might. Where would you advise them to go and for how long?

6. Which questios should i have asked and what are the anwsers?
9this might be the best place to start: :) or (
Report European | May 5 7:44am | Permalink
| Options
The Euro is before everything and above all a natural development of a political project rooted in post WWII Europe. The human and economic cost of wars, or even the need to maintain huge armies overwhelms any financial adjustment required from time to time. Let us not forget that "detail".

Neverthless, the lack of efficient demand which is forcing governments to apply for debts is a temporal solution, since only a huge shifting of income distribution would be able to maintain aggregate demand.
Report Confused European | May 5 7:42am | Permalink
| Options
Martin - please elaborate on the alternatives.

How would an undoing of the Euro work? What consequences?

Is there a chance of leaving the old core France, Germany and the Benelux as a Euro zone with others reverting to national currency?

Adam Pharaoh is right - pain has to be shared, including pension funds which like that type of sovereign paper.
Report Adam Pharaoh | May 5 6:58am | Permalink
| Options
Martin, could you please walk us through the "what if" scenario of Greece leaving the Euro Zone. It seems to me the inevitable end state solution, however politically unthinkable for many.

Of course, this represents another form of default, but it also seems to me the solution most likely to give the people of Greece a chance to avoid permanent deflation and/or unemployment.

Either way, banks take a severe haircut, a la sub-prime, but then at least their shareholders & bondholders suffer the consequences and not just the wage earners and savers in Greece.
Report vrendeler | May 5 6:55am | Permalink
| Options
Saying "the eurozone must work" will not make it work.
Report joseph belbruno | May 5 6:11am | Permalink
| Options
"Yet, now that the eurozone has been created, it must work".

Martin Wolf has been labelled a 'socialist', a closet 'Austrian-School' proponent....and even a 'communist'!!
NONE of all these. Mr. Wolf is an intellectual of the highest integrity (and I say this with great respect, of course). And the 'cause' of an intellectual is neither socialism nor communism or....whatever. The

cause of an honest intellectual is the pure and simple truth, or at least the indomitable quest for it.

TO UNDERSTAND the possible reasons behind the above statement, I would invite readers to plough through the first three 'wolfexchanges', and decide for themselves.

For the moment, let me just correct PURPOSELY or 'hortatorily' (is there a telos in this?) this fatidic statement: "Now that the eurozone has been created, it must....BE MADE (!) to work!"

'Wolfexchange' everyone!
Report Fiscal union baby! | May 5 5:30am | Permalink
| Options
Instead of writing all the time about the demise of the euro, you should reconcile with the idea that Europe is moving towards fiscal union! The vindication of neo-functionalism which argues that crises promote than hinder European integration.

Your staunch Euroscepticism (or better anti-EU sentiments) cannot let you see that. I admire that you mention it though...even though you obviously don't believe it.

Regarding the Greek data, we all know that all data on Greece are wrong as they are not properly collected. Also, the -8% growth is completely mickey-mouse for a country with 40% of unofficial economy. No way to calculate real growth/employment rates.

Regarding Germany, that's another point of your anti-EU agenda: Germans, Dutch, British, etc. were ALWAYS against giving out money to other countries. Europe always ignored that opposition with its parliaments!!

LONG LIVE EUROPE! LONG LIVE EUROPEAN SOLIDARITY! LONG LIVE THE EURO!!

P.S. Have you thought who will bail out two other bankrupt countries (US and UK)? China? Or Russia? Unless constant devaluation will solve the problem (that's the only option that Greece / EMU countries lack).
Report taylor.conant | May 5 4:50am | Permalink
| Options
Whoops! Didn't attach my link for some reason, here it is:

http://conant.econ...imacy-of-hope.html
Report taylor.conant | May 5 4:49am | Permalink
| Options
Does Martin Wolf believe in the primacy of hope over reality?

Follow the link to find out!
Report bigeschi | May 5 2:28am | Permalink
| Options
Greece should do a "friendly" restructure of its debt and leave the eurozone. With no access to the market it could finance it´s deficit with it´s own currency allowing moderate inflation buying some time to get it´s budget in order (it will have to get it order eventually). A more beneficial exchange rate could give it a chance to jumstart its economy and reverse the current account deficit. Nominal deflation has never, ever work in history and all major debt crisis have been resolved the same way through out centuries, restructuring and devaluation. The only people to benefit from this bail out are the creditors, which includes to a very significant extent european banks which are still vulnerable from the 2008 crisis. Also, the figures for Spain do not capture the inmense expansion of households debt through the las 20 years, and the fact that it has a huge amount of still unsold houses AND a 20% unemployment rate, wich put toghether are a perfect storm for its financial system (which by the way happens to be among the few competitive sectors in its economy). With the end of property bubble 2 of the drivers Spain has had for its modest grow (construction and banking) are gone for good. In the case of Portugal, well, it simply doesn´t grow and its debt burden is unsustainable. The simple truth is that the euro does not work for most of ths countries which, before and after the adoption of the single currency, have seen huge amounts of flow into their contries, driving asset prices up, and financing crhonicle current account deficits, which couple with the huge fiscal deficits they ve been running have proven a tad too much for the market to digest. Be it not for the fact that the world is absolutely flooded

with excess liquidity (it was before the crisis, and and the amount of liquidity after the crisis is just obsene) this would ve taken a turn for the worst a lot earlier. To some extent, this has also happened to eastern european contries, and to a great extent this is what is happenning to Brazil, which has grown an incredibly modest 3,2% in the las 7 years, despite the incredible amount of flow it has seen (thanks to having the higher real interest rate of any major economy). Inflation in Brazil has been contain below 5-6% for years now, and while grow has been vey slow by any standard (in the same 7 years, a post default argentina, which shares its agricultural exports and also benefited from the change in relative prices grew more than 7%, and china and india managed even more impressive growth figures). All in all, present crisis and future crisis do share the same root, and at least to my knowledge, the only way out of them through history has been the same (first, a failed attempt at nominal deflation, followed by a sharp output fall, social unrest and market sckeptisism, and finally the unavoidable debt restructure and competetive devaluation. I would say, get it done with it, and use the 110 billion euro to soften the impact this restructures (plural) will have, both for debtors and creditors.
Report billthayer | May 5 12:34am | Permalink
| Options
The problem is really pretty simple. The Greeks spend more than they bring in and have been doing so for years and hiding it. The problem is the total national debt has gone up, paying it is tougher and the Greeks are digging a deeper hole each year until they zero out that budge. The Eurozone has been very nice to give the Greeks a year or so to try to solve their problems. It also gives the rest of the world time to gets its house in order before the coming Euroquake (a lack of confidence in the Euro when Portugal follows Greece to the bailout window).

The solution to the Greek problem is not easy (pay cuts, tax increases etc.). Let me offer another approach as well: Work more. Now the Greek politicians have agreed to give up the idea of working 12 months and getting paid for 14 as well as retiring at age 53. How about changing that cushy 6 week vacation each year. My calculations indicate that increasing the work year from 46 weeks to 50 could yield 8.7% more output (50/46 = 1.087), and the Greeks could certainly use that sort of productivity increase.
Report US Pessimist | May 5 12:33am | Permalink
| Options
What a mess.

The smoke is clearing and the emperor has no clothes.

I do not believe this contagion can be stopped without restructuring and debasing of the currency by printing a whole lot of money. It's the cowardly thing to do and therefore it will be done. Spain, Portugal, Italy will most likely domino as they collapse under the weight of their debt. What we have here is a serial collapse of Argentinas.

I keep pyramiding these short positions on the bonds, banks and euro. So be it.

As Livermore said, I feel I'm right and I've got to sit tight. This is getting interesting from a trading perspective as it is tragic from the human. I feel sorry for the people who will suffer badly, and the social unrest has only just begun.
Report Don the libertDem | May 4 11:18pm | Permalink
| Options
It was always clear that the richer countries were going to have to subsidize the poorer countries. It was simply a matter of the bill. Accepting that fact and dealing with it now would reduce the eventual amount of money that the rich countries will be forced to spend. The alternative is really messy with a bill even harder to calculate, both in terms of money and socially.
Report Martin Wolf | May 4 11:02pm | Permalink
| Options
@David Lehmann, the absence of exchange rate flexibility makes the adjustment problem for Greece even worse, of course.
Report Martin Wolf | May 4 11:01pm | Permalink
| Options
@flavio.hannas, that is what I tried to say.
@ David Lehmann, the similarity is that the pretence that the Latin Americans were solvent allowed the banks to avoid having to write off their loans until they had strengthened their capital. This imposed a massive cost on the people of these countries, since they were deprived of access to new capital as

long as the stock of debt was left in being. The same is going to happen to Greece. It would be far better to restructure the debt, which now looks unmanageable to me.
Report David Lehmann | May 4 10:34pm | Permalink
| Options
It would be good to have a systematic comparison with the Latin American debt crises. Except for Chile, those countries went through years of high inflation and devaluation, with resulting fall in real wages and employment, before finally bowing to the inevitable, or at least to the pressure of international capital and domestic elites. Maybe those years of inflation were part of the remedy, but t is not available to Greece. If Europe does not make a fiscal union it is condemned to a stagnant future with no direction and a paltry contribution to the wellbeing of the world.
Report flavio.hannas | May 4 10:23pm | Permalink
| Options
Is it a bailout of Greece? No!
Is it a bailout of Greece's people? Of course, not!
It is in fact a bailout of banks from Germany, France, Spain, etc., which have lent enormous amounts of money to the Greece government.
Money that really doesn't exist.
Report Huw Sayer | May 4 10:07pm | Permalink
| Options
Interested in Mr Buiter's EMF proposal - but perhaps it needs to be coupled with a punitive levy - as I proposed to the Economist on 13 February as follows:

"Since peer pressure has proved so ineffective at controlling profligate EU governments, perhaps the answer is an EU-wide state borrowing tax.

While individual countries would remain free to issue euro denominated sovereign debt they would have to pay a percentage of the money raised and a percentage of the related coupon to the ECB.

The more a country borrowed, the more money they would pay to the ECB. And the more they paid for their borrowing (the higher the yield demanded by the market), the more money they would pay to the ECB.

These two taxes would reinforce market signals, discourage countries from borrowing too much and strengthen the ECB."

Change ECB to EMF and you have a self-financed pan-EU bail-out fund.