Risks for rescuers in new lifeline to Greece

VENICE

Relief may only postpone default and widen E.U. rifts, economists warn

BY LIZ ALDERMAN

As European leaders move toward a second bailout for Greece, some economists are warning that a new rescue will simply kick the country's problems further down the road, and may not halt an eventual default that could strain the rest of the euro monetary union.

NEWS ANALYSIS

A year after providing an aid package of €110 billion, or $161 billion at current exchange rates, that has failed to help Greece mend its tattered finances, officials are considering whether to lend [illegible] country an additional €50 billion or [illegible] billion to give it more breathing room while it struggles with a deep economic downturn that has made it harder to avoid a restructuring of its debt.

Even if Greece is pulled from danger again, economists say, European leaders are faced with the prospect of providing more aid over the next several years if Greece cannot swiftly overhaul its economy and stoke the necessary growth to get it off a long-term lifeline.

"I don't see how Greece can eventually avoid some kind of default," said Martin N. Bailey, a senior fellow at the Brookings Institution and the former chairman of the U.S. president's Council of Economic Advisers.

"It's hard to see how you can avoid the need to finance this over the next 5 to 10 years," he said over the weekend at a conference held in Venice by the Council for the United States and Italy.

His sentiment was echoed widely among economists, politicians and analysts gathered here.

"We were too optimistic about the first bailout for Greece," said Fabrizio Saccomanni, the director general of the Italian central bank.

Slow economic growth has cut a bigger hole in the Greek budget, leading to a new scramble to find more money as the country remains shut out of financial markets and grapples with one of the largest debt burdens in the world. The government is trying to cut its deficit by €6.4 billion with more spending cuts and tax increases, and raise €50 billion by selling major national assets.

YANNIS BEHRAKIS/REUTERS

A demonstration Sunday outside the Greek Parliament to protest austerity programs. The government plans more spending cuts and tax increases and the sale of some national assets.

Without those pledges, the International Monetary Fund was wary of releasing a new portion of aid promised in its first loan a year ago, and European leaders were loath to come up with new financing for Greece.

Experts at the conference expected a number of potential international investors — many of whom stockpiled cash after the financial crisis — to look at what Greece is putting up for sale. But the country's ability to restore economic stability over time would be a major consideration for any deal.

That confidence may be hard to come by. The Greek fiscal crisis worsened after Moody's Investors Service warned last week that there was a 50 percent chance that the country would default or have to restructure its debts within the next five years.

European leaders want to avoid such an event at all costs. The European Central Bank has warned that a default or restructuring may lead to problems on the order of the collapse of Lehman Brothers, by sparking a panic about the ability of Ireland and Portugal — which have also received European bailouts — to repay their debts. The result, some say, could be a new contagion that engulfs other weak euro zone countries, a number of large European banks and even the E.C.B., which holds large amounts of Greek debt.

Some officials say such warnings are too dire.

"I don't see a crisis in the euro zone," Mr. Saccomanni said. "If anything, Europe's financial conditions are sounder than other economies, al-

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New lifeline for Greece poses fresh risks to E.U. rescuers

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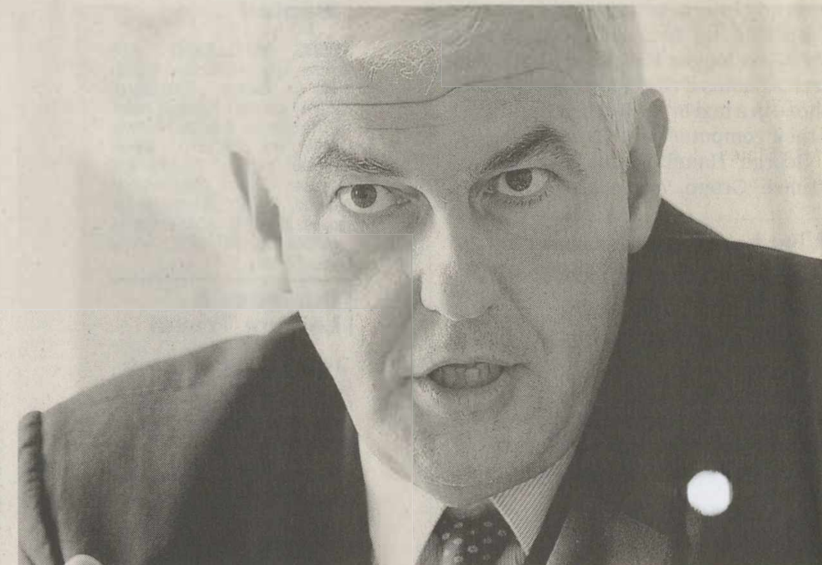
though there is a crisis in some euro zone countries.''

But most economists say they see any further trouble in Greece as both a political and economic flash point for the rest of the euro zone. As it is, the inability of heavily indebted countries to stoke their economies will probably broaden an economic divide between those nations and Germany.

The German economy has expanded so quickly that the E.C.B. raised interest rates in April to ward off the specter of inflation in the country, a move that analysts say will further dampen growth in Ireland, Portugal, Spain and other weakened economies.

''Europe is continuing to diverge,'' said Alessandro Profumo, a former chief executive of UniCredit, one of the largest banks in Italy, and a member of the board at Bocconi University in Milan. ''This cannot continue.''



PASCAL ROSSIGNOL/REUTERS (LEFT), GIUSEPPE ARESU/BLOOMBERG NEWS (RIGHT)

Anti-austerity demonstrators outside Parliament in Athens on Sunday. Alessandro Profumo, right, a former chief executive of UniCredit, said, ''Europe is continuing to diverge.''

That could leave the likes of Germany and France financing hefty new portions of aid for weaker countries for some time to come, a situation that would present fresh political challenges, economists said.

''What we can't afford is a transfer union'' in which taxpayers from strong countries continue to foot part of the bailout bill for weaker ones, said Roland Berger, the founder of Roland Berger Strategy Consultants and a former adviser to German national and state governments. ''The European population is simply not ready for it.''

Chancellor Angela Merkel of Germany, who exerts considerable sway in talks over assistance for Greece and other countries, will be hard pressed to explain to voters why Greece should receive more help, even though Germany has benefited greatly from being part of the monetary union. And in France, Mr. Berger said, economic concerns are among the issues that have helped bolster the campaign of a right-wing candidate, Marine Le Pen of the National Front.

A German official with knowledge of the Greek bailout discussions said the package would probably need to be increased by €50 billion to €60 billion. A report by Spiegel magazine, which implied that an additional €100 billion would be needed, was exaggerated, said the official, who requested anonymity because he was not authorized to speak publicly about the matter. A final decision will not be made until later this month, when the European Central Bank, the European Commission and the International Monetary Fund submit their report on the country's progress.

Europe's renewed troubles come as the United States faces a severe fiscal problem of its own, a development that alarms many Europeans. Last week, Moody's said it might downgrade the U.S. government's top-tier credit rating

''What we can't afford is a transfer union'' in which taxpayers of strong countries keep bailing out weaker ones.

if Congress failed to raise the nation's debt ceiling in coming weeks. The warning followed a similar one from Standard & Poor's in mid-April.

The United States is also trying to pare a huge deficit and debt load, a challenge that has grown amid renewed signs that the economy is not expanding as quickly as needed to create hundreds of thousands of new jobs.

''We have a serious debt problem in the United States, and we must do something about it,'' said Mr. Bailey of the Brookings Institution.

As in Europe, much of the American debate is focused on whether to continue to cut costs or help support the economy in the short term by avoiding austerity policies that could restrict a rapid return to growth, as has happened in Greece and Ireland.

''Countries consolidating are feeling the pain, and there's no question it will weigh on growth,'' Mr. Bailey said.

For that reason, he said, it would be unwise for the United States to try to reduce its budget deficit this year, even if ratings agencies and financial markets turn up the pressure.

Ever since the European debt crisis flared up, European policy makers have wondered aloud about when the day of reckoning might come for the United States. One question that started to circulate after the Moody's warning is whether the United States could eventually find itself in a similar situation to Europe, and even one day knock on the I.M.F.'s door for aid. While the United States is certainly no Greece, investor sentiment can shift quickly and without warning, as it did in Europe, they say.

''I don't think we'll see the U.S. go hat in hand to the I.M.F.,'' Mr. Bailey said.

But a senior I.M.F. official attending the meetings in Venice did not rule anything out. After all, no one could have imagined five years ago that three West European countries would seek bailouts.

''We have a major player in the global economy which is becoming like a traditional client of the I.M.F. in terms of fiscal policy,'' said the official, who requested anonymity because he was not authorized to speak publicly on the matter. ''If the ratings agencies continue on their course, maybe the United States will also apply for financial assistance'' at some point in the future.

Jack Ewing contributed reporting from Frankfurt.