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Resigned, Europe looks to curb shock from Greece

ATHENS

Athens seen as paralyzed and unlikely to carry out its economic promises

BY RACHEL DONADIO
AND NIKI KITSANTONIS

As Greece and its lenders prepare for another week of tense negotiations, European officials now say that the task is less to help the country through its troubles than to avoid the sort of uncontrolled default that many experts fear could threaten the global financial system.

Officials from the so-called troika of foreign lenders to Greece — the European Central Bank, European Union and International Monetary Fund — have come to believe that the country has neither the ability nor the will to carry out the broad economic changes it has promised in exchange for aid, people familiar with the talks say. As a result, they say, the institutions are even prepared to withhold the next installment of aid in March.

Adding to the anxieties, talks broke down Friday between Athens and private lenders over a plan to reduce Greece's debt by €130 billion, or $165 billion, a "voluntary" default that the troika has demanded before extending more aid. Those negotiations, aimed at persuading hedge funds and other private holders of Greek debt to accept large losses to make the country's debt load more manageable, will resume Wednesday amid rising concerns about the consequences of failure.

"There is an urgent need for agreement to inject an element of stability," Charles H. Dallara, managing director of the Institute of International Finance, which represents Greece's private creditors, told Reuters.

The markets have taken into account a voluntary default by Greece, most experts say. But financial experts fear the possibility of an "involuntary" default if the negotiators are unable to reach an agreement. That could unleash violent

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Faith slips in Athens' ability to avoid default

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market reactions that could conceivably produce another market cataclysm like the 2008 bankruptcy of the New York investment bank Lehman Brothers and throw the world into another recession.

Fanning those fears is a growing conviction among the Greek political establishment and the country's lenders that the old dynamic — with Greece pretending to make structural changes and its lenders pretending to save it from default — has become untenable, people close to the talks say.

As recently as November, Greece and its lenders were optimistic that the country's new prime minister, Lucas D. Papademos, a well-respected financial expert, would stabilize Greece's soaring debt and help nurse the country back to health. But since then, his interim government — stocked not with technocrats but with politicians gunning for national elections as soon as March — has been paralyzed. Although it passed the 2012 national budget, it has failed to put into effect most of the unpopular changes mandated by the loan agreement that the previous government made in 2010, when the country first admitted it was broke.

"The prime minister is a fine personality — he's educated, he's honest, he's the best you can get around. But no one is helping him," said George Kirtsos, the owner of a weekly newspaper, The Athens City Press. "Those that take the decisions at a national level believe that Greece will not make it."

There is considerable posturing in such negotiations, and the troika has threatened to withdraw aid in the past, only to approve the next loan installment. It may do so again despite its misgivings, because the alternative of an uncontrolled default is too risky. But it will do so only if negotiations with private bondholders can be completed successfully.

But amid a stream of gloomy news from Europe, including the downgrade Monday of the euro zone's bailout fund and of the debt of France and eight other countries Friday, the sense that default is inevitable is growing. "When you simply go over the bare figures I can't really imagine another scenario," said Michael Fuchs, a leading member of the Christian Democratic Union, Chancellor Angela Merkel's party, in the German Parliament.

The prime minister is "educated, he's honest, he's the best you can get around. But no one is helping him."

"Mathematics is mathematics, and one plus one has to equal two and not five," he said, describing how, even with a significant restructuring of its debt, the Greek government's deficit would still be too large and its economy not competitive enough to return the country to a sound footing. That sense can be self-reinforcing as well, making it even harder for Mr. Papademos to push through the changes Greece needs to surmount the crisis.

The seriousness of Greece's economic condition can hardly be overstated. After two years of tax increases and wage cuts, Greek civil servants have had their incomes shrink 40 percent, and private-sector workers have suffered as well. More than $75 billion has left the country as people have moved their savings abroad. About 68,000 businesses closed in 2010, and an additional 53,000 — out of 300,000 still active — are said to be close to bankruptcy, according to a report issued in the autumn by the Greek Co-Federation of Chambers of Commerce.

"It's an implosion — it's an endless sequence of implosions from bad to worse, to worse, to worse," said Yanis Varoufakis, an economics professor at the University of Athens and commentator on the Greek economy. "There's nothing to stop the Greek economy losing 60 percent of its G.D.P., given the path it is at."

Still, more than 70 percent of Greeks say they want to stay in the euro zone — and they continue to believe that Mr. Papademos is the right man for a tough job. Yet the prime minister faces stiff, if stealthy, resistance from politicians who calculate that it makes no sense to risk their careers backing major changes in the Greek economy that may ultimately fail to solve the problems.

There is ample evidence of Greece's political dysfunction. About a year ago, after missing earlier fiscal targets, Greece promised to sell state assets as a condition for receiving emergency loans. So far, though, it has sold only a small fraction of the properties because of domestic opposition and a reluctance to part with assets at fire-sale prices.

The country also pledged to lay off public-sector workers, overhaul tax collection and make its economy more competitive. But it has fallen short in those areas as well. A law passed last autumn called for cutting 30,000 public jobs by shifting workers into a labor reserve at much lower pay, but only 1,000 workers have been so assigned.

Adding to the sense of déjà vu, last week the Greek Parliament began debating a bill that would streamline some state entities and open the professional associations governing lawyers and truck drivers, among others — measures it passed in 2010 but never put into effect.

Greece's political troubles contrast with the performance in Italy, where another financial expert, Prime Minister Mario Monti, has succeeded in pushing through an ambitious austerity package. Crucially, Mr. Monti was able to appoint his own cabinet, all nonpoliticians, with new elections not due until 2013. Mr. Papademos's government, by contrast, is composed of members of three Greek political parties and a new election is expected in March or April.

The center-right New Democracy Party, which governed from 2004 to 2009, is expected to win that election, riding a wave of anti-austerity sentiment and discontent with the Socialists, who left power in November to make way for Mr. Papademos. The politicians are not making things easy for the prime minister. "Papademos wants to accelerate, and New Democracy applies the brakes," said Mr. Kirtsos, the newspaper owner.

Meanwhile, the third of the three parties, the rightist Popular Orthodox Rally, has said it will stop backing Mr. Papademos if the three parties cannot agree on economic policy.

Nicholas Kulish contributed reporting from Berlin, and Dimitris Bounias from Athens.