This article focuses on two aspects: first, as political surveillance of fiscal stability by the Stability and Growth Pact proved to be insufficient in the past to say the least, the question is whether this mechanism has been improved. Second, as Greece and other states depend on new packages of financial assistance various options are under discussion.

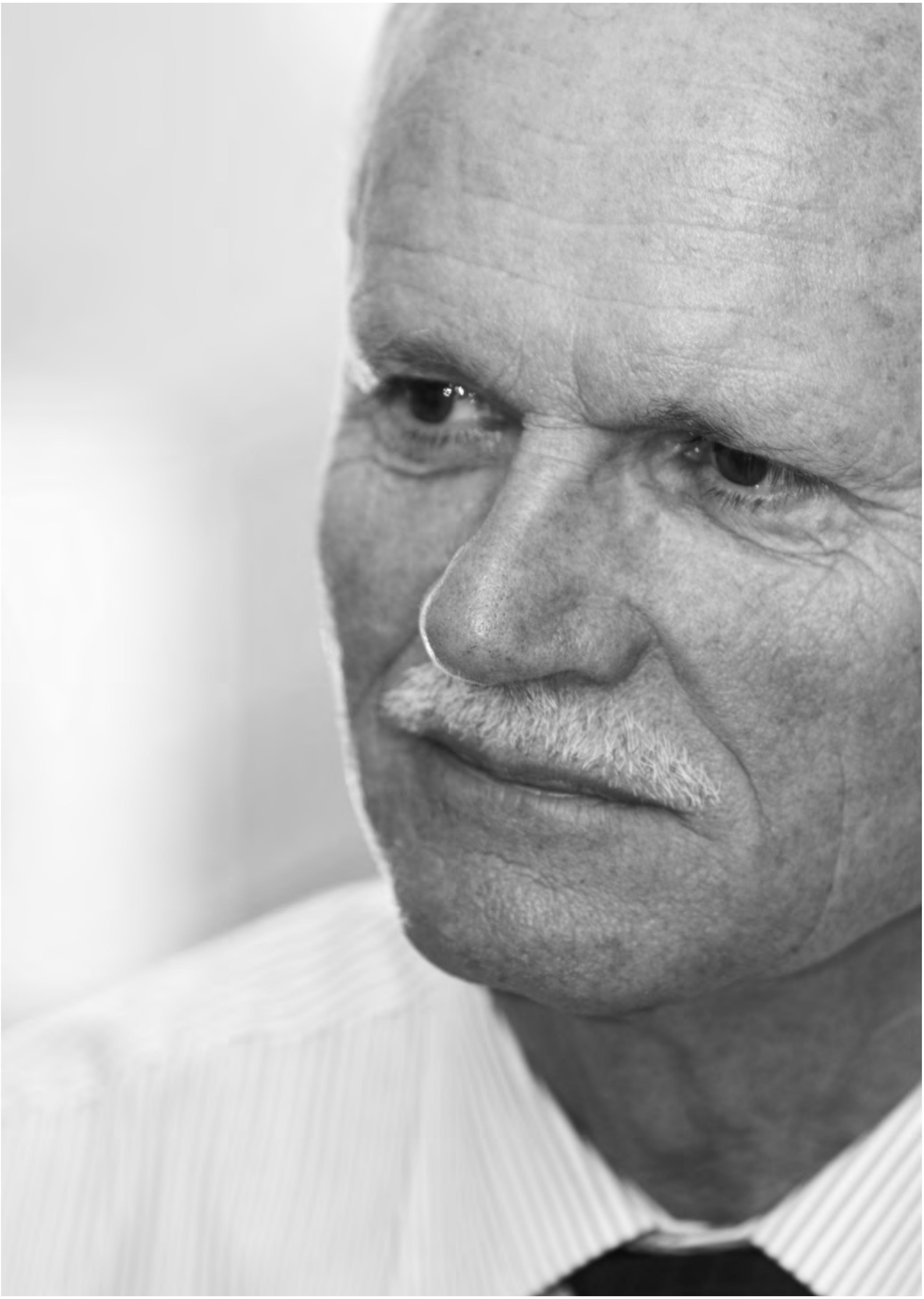
Turmoil in the Euro Zone:

No Lifeline without Major Risks

By Heinz-Jürgen Axt

Massive fiscal imbalances in Greece are considered to be the main problem of current turbulences in the euro zone. Other euro members are facing excessive deficits and debt too, yet the confidence of the financial markets towards heavily indebted countries will not return before the Greek problem is solved. This article focuses on two aspects: first, as political surveillance of fiscal stability by the Stability and Growth Pact has in the past proved insufficient, to say the least, the question is now whether this mechanism has been improved. Second, as Greece and other states are depending on new financial aid packages, various options are under discussion. Taking *economic* implications into account and acknowledging that all options are extremely risky, it comes as no surprise that authorities seem to be at their wits' end designing a long-term strategy.

When Greek bonds were downgraded to "junk" by rating agencies at the end of April 2010, the floodgates opened. Fears of contagion prompted investors to offload their Portuguese and Spanish bonds as well. On 10 May, euro zone governments, the EU and the International Monetary Fund (IMF) granted a financing package for Greece amounting to 110 billion and a further 750 billion euros for the euro zone as a whole. In both Greece



Heinz-Jürgen Axt. Foto: Max Greve

and Portugal, the problems were the result of debt and a lack of competitiveness. In Ireland and Spain, an overheated economy caused a real estate bubble to burst; their governments responded by guaranteeing bank debt. In November 2010, Ireland requested loans from the 750 billion euros European Financial Stability Facility (EFSF) set up to safeguard financial stability in Europe, with Portugal following suit in May 2011.

Financial assistance for indebted euro partners – what does the Maastricht Treaty say?

Under the Maastricht Treaty, every euro zone country must adhere to the principles of sound financial and budgetary management and cannot expect its partners to take on liability for its debts. This "no bail-out" clause is enshrined in Article 125 of the Treaty on the Functioning of the European Union (TFEU). Article 123 TFEU prohibits the European Central Bank from granting overdraft facilities to Member States. The Treaty requires the Commission to monitor the development of the budgetary situation in the Member States.

The fact that an agreement was reached in Maastricht to transfer monetary but not economic policy jurisdiction to supranational level was primarily due to the conflicting positions of France and Germany. Germany insisted that the ECB should be politically independent and maintain a commitment to price stability. France responded by demanding common economic governance. However, France's main concern was not to introduce supranational steering of economic policy, but to subject the ECB to the political influence of the governments of the euro zone countries. As these countries no longer had recourse to the tool of "external" devaluation of their national currencies in order to improve their competitiveness vis-à-vis trade partners, their only remaining option was to resort to "internal" devaluation through adequate wage and price flexibility.

In terms of compliance with the Treaties, however, the euro zone's granting of financial assistance is on thin ice, as is apparent from the provisions of the loan agreement with Greece. This refers to bilateral "pooled" loans from the euro zone countries, not to loans from the euro-area as a whole.[1] To avoid any conflict with the "no bail-out" clause, the legal basis for granting these bilateral loans and credits is Article 122 TFEU, which states that "in a spirit of solidarity", where a Member State is in difficulties caused by "natural disasters or exceptional occurrences" beyond its control, the Union may grant financial assistance to the Member State concerned. Referring to the Greek debt crisis in these terms is not convincing, as the European Commission itself confirmed in February 2010.[2]

A design flaw in the Maastricht Treaty?

With the benefit of hindsight, it is clear that at the time of the founding of monetary union, the risks were underestimated. When the Maastricht Treaty was concluded, the risk that the introduction of the euro could act like "sugar-coated poison" on less stability-conscious countries and prompt them to take on more debt was also underestimated. Greece is a good example: even though the international financial markets did not regard the country as particularly creditworthy, Greece had to offer 10.6 % yields on 10-year bonds in 1996, falling to just 4.6 % in 2008.[3] Investors relied on the fact that if problems arose, the euro zone would have no option but to bail Greece out, which mitigated their investment risk.

Macroeconomic divergences have had more of a negative impact in the euro zone than was assumed when the Maastricht Treaty was signed. The monitoring mechanisms built into the Maastricht Treaty rely on the euro zone countries supplying reliable macroeconomic data. If false data are reported to the European statistical agency Eurostat, however, as happened with Greece, the Stability Pact finds itself on increasingly shaky ground. The Commission's attempts to verify the statistics in Greece itself were thwarted by the euro zone countries, however.[4] The inaction lasted far too long, despite widespread concerns about compliance with the Maastricht criteria.[5] The sanctions envisaged in the Stability and Growth Pact are ineffective if euro zone countries collectively violate the debt ceilings. In 2009, only three of the 16 euro zone countries managed to keep their deficits within permissible limits.

Although Germany was keen to ensure, with the Stability and Growth Pact, that the euro zone countries adhered to sound budgetary management principles, Germany's own actions contributed to the softening of the Pact. In 2005, the Brussels European Council amended the Stability Pact and eased the criteria for defining what constitutes an "excessive deficit".[6] Finally, the rating agencies are also worthy of some criticism for failing to fulfil their responsibilities, particularly their considerable delay in warning of the risks posed by euro countries with a very high level of debt.[7]

The reform efforts to date

As existing instruments and procedures have not led to a satisfactory reduction of public debt and have failed to tackle macroeconomic imbalances, politicians are now focusing on reform. The Commission has therefore proposed drastic measures aimed at tightening up the Stability Pact. Under these proposals, the task of deciding on a deficit procedure would be transferred from the Council to the European Commission. The deficit procedure could then only be blocked by the Council on the basis of a "reverse majority rule", which means that Commission recommendations would be adopted unless a qualified majority of Member States in the Council votes against it, within 10 days.[8] Sanctions could also be triggered more automatically and at a much earlier stage than at present. In budgetary surveillance, a far more prominent role would be given to levels of debt as well as to the deficit. Annual growth of public expenditure should not exceed a prudent medium-term rate of growth of GDP.[9] President Herman Van Rompuy's economic governance task force signalled to the Commission where the limits lie, however: it accepted the Commission's recommendations on sanctions, with the Council to proceed on the basis of the reverse majority rule, but made it clear that responsibility for deciding on the crucial question of whether a deficit procedure should be opened at all must remain with the Council.[10] By way of justification, it argued that the Treaties require this to be a Council decision. The alternative – that this competence should pass from the Council to the Commission as part of a Treaty amendment that is due anyway – was rejected on the grounds that Member States wish to retain the right to make the final decision. President Van Rompuy's report was adopted by the European Council on 28–29 October 2010.[11]

By contrast, the German-French summit in October 2010 paved the way for agreement on establishing a permanent crisis mechanism. German Chancellor Angela Merkel was adamant that there should be no further recourse to Article 122 TFEU. Instead, following a Treaty amendment, a European Stability Mechanism (ESM) should be set up in the euro area as of 1 January 2013, with Article 125 ("no bail-outs") remaining in force unchanged and the Stability Mechanism being designed to safeguard the financial stability of "the euro area as a whole".[12] Attention also focused for the first time on case by case participation of private sector creditors in cases of excessive debt.

There is still a clash of opinions over the "preventive arm" of the Stability Pact, which entails closer coordination of economic policies under Article 121 TFEU. It is still unclear what is meant by France's call for "economic governance".[13] If such economic governance is supposed to entail supranational regulation of revenue and expenditure, it would lead to a loss of sovereignty which would be unacceptable to France itself. If it means coordinating wage trends, it would conflict with the right to free collective bargaining and the fragmentation of wage negotiations. If it is about limiting current account balances, it would be tantamount to an intervention in national budgetary sovereignty.[14]

In advance of the European Council on 4 February 2011, Chancellor Merkel unveiled a new six-point "Pact for Competitiveness" to be implemented nationally within 12 months: abolition of wage/salary indexation systems; mutual recognition agreement on education diplomas and vocational qualifications; the creation of a common assessment basis for corporate income tax; adjustment of the pension system to demographic development; obligation for all Member States to inscribe the debt alert mechanism into their respective constitutions; and establishment of a national crisis management regime for banks. In all these areas, the EU should follow the respective best practice. The programme defines quantifiable indicators for national economies' competitiveness (real labour costs, stability of public finance (public-sector wages) and investment in research, etc.).[15] New competences for Europe are ruled out.[16] The pact has little binding force and makes no provision for sanctions.[17]

There was some convergence of positions between Berlin and Paris: the Treaty amendment to introduce a permanent crisis mechanism, to which Germany attaches such importance, also gained the support of France. In exchange, Germany jettisoned its idea of withdrawing voting rights from transgressor Member States and dropped its support for automatic sanctions. The two countries also moved closer on the issue of maintaining the "no bail-out" clause, as well as on the participation of private sector creditors and the more prominent role given to levels of debt. With her competitiveness pact, the Chancellor has moved a step closer to the idea of economic governance advocated by France. The European Council meeting on 24–25 March 2011 agreed a package of reforms for monetary union, although the adoption of the legal instruments on the Stability Pact and the coordination of economic policy are still pending. The main priority, for the heads of state and government, was to impress the financial markets with a solid package of measures and put an end to speculative overheating.

To sum up: surveillance of fiscal stability will be strengthened by a reformed Stability and Growth Pact but a major problem will still exist in future. The decision will ultimately fall to the Council. If, as in the past, most of the euro members ignore deficit and debt limits, it will once again be a case of "sinners will sentence sinners". Although economic governance has been stressed repeatedly, it has become evident that real progress is hard to deliver. A loss of national sovereignty is unacceptable even to those who plead for this model. The same must be said with respect to the competitiveness pact. The intentions are clear, but sanctions are lacking.

Failed aspirations and critical questions on future options

As we can see, some progress was made with respect to future governance of the euro zone, but hope was dashed that Greece would be able to refinance its debt by private investors in 2013. That had been the intention when euro partners concluded the package for financial assistance in May 2010. In June 2011, it became apparent that alternative solutions were needed. A debate ensued as to what would be the best option for overcoming the Greek debt crisis and how to prevent the entire euro zone from being infected. There are five options under discussion: according to the first, Greece would leave the euro zone and return to the drachma as national currency. The second solution would be (hard) debt restructuring as it was done e.g. in the case of Russia in 2000, Argentina in 2005 or Ukraine in 2000, for example. "Soft" debt restructuring as the third option would rely on the reduction of interest rates and/or an extension of the terms of loans given to Greece. Common loans of the euro zone, so called "eurobonds", which would offer lower interest rates to heavily indebted countries, constitute the fourth alternative. Finally, the fifth option would be to assist countries like Greece with a fresh injection of money.

To provide a more systematic analysis of the opportunities and risks of the options mentioned, ten questions must be answered:

1. What will the *rating agencies*' reaction be to the alternatives? These agencies have been criticised heavily, as they had given positive credit ratings to institutions such as the Lehman bank, which led to the global financial crisis of 2008. Another criticism has already been mentioned: the agencies were too late in warning of Greece's financial problems. While it is clear that the agencies underestimate the critical debt situation of the US, they downgraded Portugal in July 2011, even though its government was following a stabilisation plan demanded by the euro zone and the IMF. At the same time, it is impossible to ignore the fact that investors rely on these rating agencies when deciding where to invest their money. It is a matter of fact that policy makers have to take the rating agencies' assessments into account when making decisions.

2. A second question concerns the reaction of the financial markets. Will they provide acceptable conditions with respect to interest rates and credit default swaps if one of the outlined options is chosen? As long as partners provide financial assistance to highly indebted states in the euro zone banks and other investors realise high profits. That is why politicians are demanding a substantial contribution from the private sector if new financial packages are to be granted to Greece and other candidates. That, however, has met with a critical reaction, as some rating agencies have declared that in such a situation they will downgrade debt states near to "default", as private investors have no chance of fully recouping their investment.

3. What are the consequences for domestic financial institutions? Will Greek banks, for example, have a chance to survive or will savers transfer their money abroad, leaving banks unable to provide credit to companies in Greece? In June 2011, Greek banks had given credit amounting to 45 billion euros to the states. Greek investment and pension funds were engaged with 29 billion euros.[18] The banks' core capital is estimated at 47 billion euros.

4. What are the consequences for creditor banks? Do they suffer substantial losses when borrowing states do not fulfil their obligations? To answer this question, it is important to know which banks are involved in Greece and with how much money. Two observations can be made here: first, the euro zone banks have reduced their involvement and second, the main creditors are in Germany and France. When estimating the risks for the banks, it is important to know what proportion of their total capital the credit given to Greece accounts for. Based on data from the Bank for International Settlements, the amount of credit given by banks to Greece is shown the figures in Table (1) (in billion US dollars)[19].

5. Each of the options must consider the consequences for the *stabilisation of the country* with excessive debt. Will revenue of the state budget increase and expenditure decrease so that the deficit will be reduced in a shorter and the debt in a longer time period? The financial assistance which was provided to Greece in May 2010 was dependent on strict conditions set by the euro zone and the IMF. As a consequence, Greece reduced its deficit, which was equivalent to 36.2 billion euros in 2009 by 14.2 billion euros in 2010. To give an impression of the Greek effort: if Germany intended to reduce its deficit by the same amount, it would have to save 143 billion euros. Recent experiences with Greece demonstrated once again that it is easier for governments to reduce expenditure by cutting wages and releasing employees than to increase revenues: from 2009 to 2010, expenditure in Greece was cut by 6.4 % whilst revenue increased only by 4.8 %.[20] A substantial reform to ensure that taxes are collected sufficiently from self-employed people is still a task pending for the Greek authorities.

6. As states try to avoid political cost, it is inevitable that the reduction of excessive deficits and the implementation of stabilisation programmes are put under *surveillance*. Here there are two alternatives: first, surveillance can be undertaken by *political* mechanisms. When the European Monetary Union (EMU) was created, the Maastricht Treaty

	Germany	France	Italy	Rest of Euro-Zone	United Kingdom	US
March 2010	23.1	27.0	3.3	22.9	3.6	5.4
End of 2010	22.7	15.0	2.3	7.7	3.4	1.5

(1) Value of credits given by banks to Greece in billion US dollars.

established the convergence criteria to construct an optimum currency area. Later, in 1997, the Stabilisation and Growth Pact was concluded to ensure that member states of the EMU would keep in line with the criteria. As explained above, the effectiveness of this political form of control had limited effects, since almost all states ignored the deficit and debt limits. Second, control can be provided by the *markets* in a very simple manner: markets can sanction states with excessive deficit and debt by demanding higher interest rates and credit default swaps. Under such conditions, governments face severe problems and are forced to follow a strict course of stabilisation in order to calm the markets and to obtain better credit conditions. This argument is only convincing, however, if the markets are perfectly intact and the rating agencies are sending out the correct signals (see above).

7. If the stabilisation programmes of heavily indebted countries concentrate exclusively on reducing expenditure and increasing revenue, they will fail to address a major problem: these states must strengthen *economic growth* and improve *competitiveness*. The more an economy grows, the smaller the debt as a percentage of GDP and the easier access to fresh money will become. Under such circumstances, countries can grow their way out of deficit and debt.

8. As Greece is not the only country with an excessive deficit, there is a risk that other states in the euro zone such as Portugal, Ireland, or Spain could be infected. The options for solving Greece's problems must therefore set out to avoid contagion, which could occur if investors pull out of countries or raise interest rates significantly as they perceive the measures taken to rescue Greece to be too negative.

9. The financial cost of any rescue package cannot be neglected. Almost every country has been forced to consolidate public finances and to cut social expenditure. Under these circumstances, providing financial assistance to countries which have ignored the principles of sound housekeeping can prove sensitive. Do we have to tighten our belts to help other countries? This question arises immediately in a euro zone in which individual responsibility for each state's own budget is the guiding principle.

10. Finally, *political cost* may be incurred if dissatisfaction with rescue measures leads to growing nationalist tendencies and national animosity. Under such circumstances, anti-integrationist movements may even gain influence.

Alternative options and their risks

The first scenario, in which a country *leaves the euro zone*, must take into account that no country can be forced to do so, as no such provision is made in the Treaties of the European Union. The positive implications of such a (theoretical) scenario would be as follows (see Fig. 2): as far as prices are concerned, the country would become more competitive. This would have a positive impact on growth rates and ultimately lead to greater competitiveness. On the other hand the country's debt would still be signed in euros. With a devaluating national currency, the country would not be in a position to pay its dues. Under such circumstances, the partners in the euro zone could feel obliged to take over the debts. What would the foreseeable reaction of rating agencies be if a country like Greece were to step out of the euro zone? The agencies would assume that a state can no longer trust the "solidarity" of the euro zone and therefore warn against investing in Greece. Debt conditions would deteriorate. Even relatively well performing countries in the euro zone could be affected, as they have to pay higher interest rates because of the question mark over mutual assistance in the euro zone. Banks in countries leaving the euro zone would have no chance of survival, as clients would immediately deplete their accounts. Creditor banks on the other hand would face problems if their loan was not repaid. Whether a state follows a strict policy of consolidation is a critical question: if the government wishes to benefit from acceptable conditions on the financial markets it must stabilise its economy. But if policy makers gain some form of debt relief the will to follow a strict course of stabilisation could be weakened as governments try to avoid political cost. Only in the case of governments following the first route would the financial markets assume the surveillance role. Although competitiveness can be improved by devaluation, it must be anticipated that depression would dominate for a long time under such conditions. And contagion to other highly indebted countries would be probable.

The second option, *debt restructuring*, is the favourite amongst economists.[21] What makes this alternative attractive? One important argument is that private creditors benefit from the financial crisis of euro members as they realise high interest rates guaranteed by financial assistance of the euro zone. In the case of debt restructuring, not only the tax payers but also creditors would have to assume some of the cost of financial assistance for the heavily indebted states. For creditors, debt restructuring implies that they have to charge off at least part of their credit. In such a case, rating agencies would immediately declare a "default", and consequently a country like Greece would no longer have access to the financial markets. Banks in Greece would go bankrupt under the ensuing exodus of capital. That is why partners from the euro zone might think about financial assistance for these banks. As economists argue, it would be less expensive to save Greek banks than to offer a guarantee for 70 % of Greece's debt.[22] To what extent

	rating agencies	markets	domestic banks	creditor banks	consolidation	surveillance	growth	contagion	costs
leaving the euro-zone	?	?	■	?	?		■	■	■
debt restructuring	■	■	■	?			?	■	■
soft restructuring	?	?	■	?	■	■	?	?	?
euro bonds	■	■			■	■	?		■
fresh money	?	?			■	■	?		■

positive □ unclear ? negative ■

(2) Alternative options and their implications.

creditor banks would face severe problems depends on the level of their financial investment in the country in question. If the capital invested in Greece amounted to a significant share of the banks' capital resources, a collapse could be the consequence, and state aid could once again be called for.[23] Under such conditions, the control over stabilisation programmes would be executed mainly by markets. Without a convincing programme of consolidation, the financial markets would be closed for states after debt restructuring. A longer period of depression would be unavoidable and could only be shortened by drastic reforms. Contagion would become an issue on account of the reaction of rating agencies and financial markets, which mistrust other heavily indebted states and anticipate debt restructuring here also.

Whilst economists prefer "hard" restructuring, many prominent policy makers are in favour of "*soft restructuring*".[24] The model of the Vienna Initiative is often referred to, when in 2009 states from Central and Eastern Europe had to repay loans and the credit period was extended. Another alternative would be to reduce interest rates. Both forms are interpreted as a "contribution from the private sector"[25] – but with fewer negative effects for banks and investors. To some extent the euro partners were already following soft restructuring when they extended the credit period for Greece from 3 to 7 ½ years and reduced the interest rate by 1 percentage point on 17 June 2011. If soft restructuring were pursued to meet the fiscal problems in Greece and other euro states, the rating agencies' reaction would be of major importance. The Fitch agency has already sent out negative signals when it declared that it would devaluate the affected country to the pre-stage of "default" if the Vienna Initiative were chosen as an option. Therefore the crucial question is: will rating agencies reach negative conclusions and will financial markets follow their assessment? If so, soft restructuring would turn into hard restructuring. If not, soft restructuring would have advantages, especially since the risk of contagion to other heavily indebted states would be reduced. By the same token, if restructuring were soft, this could become very critical for domestic banks, as they hold large parts of their states' debt. If creditor banks agree to soft restructuring it is highly likely that they will demand some sort of "deal" in return: extended credit periods only if state guarantees for the security of the loans are provided. The pressure for tough consolidation programmes would be weaker than in the case of hard restructuring. The surveillance of such programmes would be political, with all the weaknesses mentioned above. Whether growth and competitiveness can be improved depends on the course followed by the government of the indebted state. The amount of pressure they are under is limited as long as the perception prevails that getting fresh money is no problem.

The interest rates demanded from countries in the euro zone differ significantly. Germany, for example, was only required to pay around 3 % on a ten year loan in July 2011, whereas markets demanded more than 16 % from Greece, more than 12 % from Ireland and Portugal and nearly 6 % from Spain.[26] This situation led to the idea of whether it would be favourable for countries enjoying an excellent rating to take out loans under favourable conditions and transfer these loans to countries in the euro zone from which markets demand higher interest rates. That is the basic idea behind "*euro bonds*".[27] What are the opportunities and risks associated with this alternative? One risk would be the perspective that rating agencies might downgrade the donor states as investments here are assessed to be more risky. Financial markets could follow suit and demand higher interest rates if they feel insecure when euro bonds are transferred to countries with poorer credit standing. Negative effects could harm donor states, but not the banks. Neither domestic nor creditor banks would have reason to assess their investments in heavily indebted states as insecure. Under such conditions, the pressure to follow a strict course of stabilisation and consolidation would be weakened. The lever with which markets exercise control over these programmes would be abolished. Improvement of growth and competitiveness would depend entirely on the course adopted by governments. The positive aspect, however, is that contagion to other massively indebted states would be restricted. Nevertheless, contagion would be a problem for countries with a positive rating.

The last option is "*fresh money*" for those countries which have no chance of re-financing their debt on acceptable terms through the financial markets. When euro partners decided in May 2010 to provide financial assistance amounting to 110 billion euros to Greece, the expectation was that Greece would be able to return to the markets no later than 2013. As this perspective has become improbable, a second financial package is in sight. In such a case the rating agencies' response would be more or less neutral. They would not see any reason to downgrade or upgrade a country like Greece. The same should be anticipated of the market reaction. Interest rates would be kept on nearly the same – high – level. Prospects for domestic as well as creditor banks should be positive, as they need not fear any sort of haircut. It is not very likely for a government to follow a strict course of consolidation if it can avoid it. As control is undertaken exclusively by political mechanisms, bad experiences with the Stability and Growth Pact again raise their head. The chances of improving growth and competitiveness depend on the decisions taken by a government which is once again enjoying financial assistance. Assessments with respect to contagion are ambivalent: as far as the markets are concerned, there are no convincing reasons for increasing interest rates for other highly indebted countries. Meanwhile, these countries have good reason to request an extension of financial assistance for themselves too. A permanent "transfer union" would be unavoidable.

Having discussed the various options, there is now the question of their price in financial terms. It is evident that such a calculation must be tentative and approximate. Asked to calculate the costs for Germany, two scholars concluded that in the case of Greece the financial burden could range from 19.2 to 56.1 billion euros. The lesser amount would apply if privatisation in Greece progressed and the country served its debt in 2015. The higher amount would be the consequence of Greece failing to pay off its debt and debt restructuring taking place.[28] As mentioned above, the political costs must also be taken into account. In the case of Greece and other highly indebted countries, it may only be a question of time before people throw governments out of office and political instability sets in. At the same time, people in the "donor countries" become increasingly critical about financial assistance to highly indebted countries. Governments come under pressure, animosities rise and lead to nationalist and anti-integration movements.

Conclusions

One conclusion is that any country sliding into excessive debt, violating the criteria set by the Maastricht Treaty and ignoring the "no bail-out" rule surrenders itself to the international financial markets and encourages speculation. If governments are too big to be allowed to fail, and if an implosion of the entire euro zone seems imminent, reasonably well-managed euro states can be blackmailed and fresh money made available even if reforms in the indebted countries are found wanting. This explains why the political opposition in Greece is currently showing no willingness to unite in a national consensus to overcome the crisis and accept the political costs.

A second conclusion is that all the options discussed above have severe negative implications. There is no silver bullet out of the crisis in sight. A final question therefore needs to be answered: which option is favourable to whom? *Banks in Greece* and other heavily indebted countries must fear almost any attempt to solve the crisis. Only fresh money and euro bonds do not endanger their future existence. In all other cases, they will survive only if state aid is guaranteed from the euro zone. The same holds true with respect to *creditor banks*. For them, however, the extent to which they are engaged in the crisis states is significant. As we have seen, private banks have reduced their commitment and devalued their credit to Greece to the fallen market prices.[29] Nevertheless, the more stable countries in the euro zone should bear in mind the banks' request for rescue measures.

As far as *Greece and other troubled states* are concerned, the option of fresh money is their most favourable prospect: refinancing their debt would be secured, their own banks would not come under pressure, and control over the stabilisation programme would be political, leaving some room for manoeuvre. The pressure from the markets would be limited. It is important to note that prospects for growth and competitiveness are critical, if not negative, in all options. Only where governments are in a position to implement substantial reforms even against massive protest are the prospects more positive. Governments choosing to follow a policy of strict fiscal consolidation is most probable if they are under pressure from the markets (and not from negotiable political conditions). That is the case when debt restructuring takes place.

Contagion to other euro members from the Greek drama is a core concern of policy makers in the euro zone. From this perspective, two alternatives – Greece leaving the euro zone and hard debt restructuring – are the most dangerous cases of all. Economists perceive it to be helpful that markets define the rules of the game. For politicians, this carries with it negative implications of contagion. For them, fresh money, euro bonds and soft restructuring run a lower risk of infecting other countries. Nevertheless, one question still remains: will the rating agencies and financial markets perceive soft restructuring as coming close to default or not? If the answer is yes, politicians will find it difficult to be in favour of this option.

The last question relates to the least negative option for the countries footing the bill. As far as the *financial cost* is concerned, all the options receive a negative evaluation. States which have kept in line with the criteria of the EM have to pay for those which have ignored the rules. Cost is not only a sensitive issue in monetary terms. The *political cost* should not be underestimated. The Prime Minister of Slovakia refused to contribute to the financial assistance for Greece, arguing that Slovakia has undertaken severe reforms while Greece has not. When elections took place in Finland in April 2011, the True Finns party, with a populist and also anti-European programme, was the main winner. Surveys show that the majority of Germans would prefer the Deutschmark to the Euro. If one of the fresh money, euro bonds or soft restructuring options were chosen, creditor countries would have to be aware that the control over measures for consolidation would be rather weak. Debt restructuring could prove sensitive for the countries' own banks – depending, however, on the amount of credit in relation to the banks' core capital. The fact that policy makers in the euro zone are currently intending to set up a new rescue package for Greece (and eventually for other states) results from the fact that their primary concern is contagion. They want to prevent the Greek crisis from infecting Portugal, Ireland, Spain and even Italy or Belgium. And this is the achilles' heel of any attempt to stabilise the euro zone: as long as contagion cannot be excluded, money will be on hand even if stabilisation programmes fail to show positive results.

Zusammenfassung

Die Turbulenzen in der Eurozone weiten sich aus. Dabei stellt sich die massive Verschuldung Griechenlands als das Hauptproblem dar. Zwar sind auch andere Staaten übermäßig verschuldet, aber erst wenn das griechische Problem gelöst ist, wird das Vertrauen der Finanzmärkte zurückkehren. Der vorliegende Artikel geht auf zwei Fragen ein: Erstens, ist der Stabilitäts- und Wachstumspakt mittlerweile in einer Weise geschärft worden, dass wirksam eine übermäßige Verschuldung unterbunden werden kann? Zweitens, da Griechenland und andere Staaten aller Voraussicht nach ein weiteres Rettungspaket benötigen, stellt sich die Frage welche Variante die am wenigsten riskante darstellt. Es zeigt sich, dass alle Optionen erhebliche Risiken mit sich bringen. Es bleibt die Lehre: Wer sich übermäßig verschuldet, die Regeln der Europäischen Währungsunion missachtet und den Haftungsausschluss gemäß Maastricht-Vertrag ignoriert, der liefert sich den internationalen Finanzmärkten aus und ermutigt die Spekulation. Wenn Staaten zu groß sind, um sie mit ihren Schuldenproblemen allein zu lassen, und wenn eine Implosion der Euro zone droht, dann werden halbwegs solide wirtschaftende Euro-Staaten erpressbar und gibt es frisches Geld auch dann, wenn Reformen in den Schuldenstaaten unzulänglich sind.

Notes

1) For details, see the loan agreement, published by the BILD-Zeitung on 23.5.2010 (http://www.bild.de/BILD/politik/wirtschaft/2010/05/24/griechenland-hilfe-deutschland-milliarden-euro/schwarz-auf-weiss-die-dokumente.html, accessed on 10.2.2011).
2) Cf. Commission of the European Communities: Report from the Commission. Greece. Report prepared in accordance with Article 104(3) of the Treaty, SEC(2009) 197 final, Brussels, 18.2.2009, p. 4 (http://ec.europa.eu/economy_finance/sgp/pdf/30_edps/104-03/2009-02-18_el_104-3_en.pdf, accessed on 10.02.2011).
3) cf. Frankfurter Allgemeine Zeitung, 12.3.2010, 15.
4) For a detailed discussion, see Heinz-Jürgen Axt: Griechenlands Schuldenkrise: Gefahr für den Euro? Das Dilemma von vertragskonformen oder politisch opportunen Lösungen, Duisburg 9.3.2010 (http://www.uni-due.de/imperia/md/content/politik/axt/gr_euro_axt_sog_20100307__1_.pdf, accessed on 29.8.2010).
5) cf. Heinz-Jürgen Axt, Griechenland: Bewegung in der Außenpolitik und Stillstand in der Sozial- und Wirtschaftspolitik (FES-Analyse), FES Library, Bonn, February 2002.
6) For evidence, see Heinz-Jürgen Axt: Griechenlands Schuldenkrise…, loc. cit.
7) cf. Ansgar Belke/Hans-Peter Burghof: Jedes Land für sich selbst, in: Financial Times Deutschland, 27.9.2010 (http://www.ftd.de/politik/konjunktur/:eu-schuldenkrise-jedes-land-fuer-sich-selbst/50175118.html, accessed on 11.2.2011).
8) The arrangements proposed by the Commission would imply that deficit procedures could be initiated more quickly and easily.
9) Cf. European Commission: Proposal for a Regulation of the European Parliament and of the Council on the effective enforcement of budgetary surveillance in the euro area, COM(2010) 524 final, Brussels, 29.9.2010 (http://ec.europa.eu/economy_finance/articles/eu_economic_situation/pdf/com2010_524de.pdf, accessed on 11.2.2011).
10) Cf. Strengthening Economic Governance in the EU. Report of the Task Force to the European Council, Brussels, 21.10.2010 (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/117236.pdf, accessed on 11.2.2011).
11) Cf. Conclusions of the European Council (28-29 October 2010) (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/de/ec/117499.pdf, accessed on 11.2.1011).
12) On 16-17 December 2010, the European Council agreed to add the following paragraph to Article 136 of the Treaty on the Functioning of the European Union: "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality." (Conclusions of the European Council (16-17 December 2010) http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/de/ec/118604.pdf, accessed on 22.3.2010). The amendment takes place under the simplified revision procedure provided for in Article 48(6) of the Treaty on European Union (TEU), which allows the European Council, acting by unanimity after consulting the European Parliament, the Commission and, in certain cases, the European Central Bank, to adopt a decision amending all or part of the provisions of Part Three of the Treaty on the Functioning of the European Union (TFEU). Such a decision may not increase the competences conferred on the Union in the Treaties and its entry into force is conditional upon its subsequent approval by the Member States in accordance with their respective constitutional requirements.
13) Cf. Pascal Kauffmann/Henrik Uterwede: Deutschland, Frankreich und die Eurokrise: Auf der Suche nach der verlorenen Konvergenz (http://www.dfi.de/de/pdf/Verlorene-Konvergenz.pdf, accessed on 12.2.2011).

14) Cf. Sebastian Dullien: Ungleichgewichte im Euro-Raum, FES, WISO-Diskurs, Bonn 2010.
15) Cf. Pakt für Wettbewerbsfähigkeit (http://www.euractiv.de/fileadmin/images/Pakt_Wettbewerbsfaehigkeit.pdf, accessed on 12.2.2011).
16) Cf. Auf dem Weg zur europäischen Wirtschaftsregierung (http://www.bundesregierung.de/Content/DE/Artikel/2011/02/2011-02-04-eu-rat.html, accessed on 12.2.2011).
17) Cf. Conclusions of the Heads of State or Government of the Euro Area of 11 March 2011 (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/119809.pdf, accessed on 22.3.2011).
18) Cf. Frankfurter Allgemeine Zeitung, 9.6.2011, 17.
19) Cf. Frankfurter Allgemeine Zeitung, 7.6.2011, 19.
20) See Hellenic Republic Ministry of Finance, Greek Parliament Adopts 2011 Budget, 23.12.2010 (http://www.minfin.gr/content-api/f/binaryChannel/minfin/datastore/40/fc/77/40fc77471e04b9efeeca007b9890dbc66939a80e/application/pdf/HEPP_NEWSLETTER_issue7.pdf, accessed 12.7.2011).
21) In Germany 190 professors of economic science supported a debt restructuring. See "Stellungnahme zur EU-Schuldenkrise" (http://www.wiso.uni-hamburg.de/lucke/?p=581, accessed 12.7.2011).
22) Cf. Roland Vaubel, Brady-Bonds – politisch attraktiv, ökonomisch falsch, in: Frankfurter Allgemeine Zeitung, 13.7.2011, 10.
23) Risks for French banks are assumed to be higher than for German institutes. Cf. Frankfurter Allgemeine Zeitung, 16.6.2011, 13.
24) One of them is the German Minister of Finance Wolfgang Schäuble who has met with opposition from most of his colleagues and the European Central Bank.
25) The German Bundestag declared on 10 June 2011 a substantive contribution of the private sector as a precondition for any new financial assistance for Greece.
26) Cf. Frankfurter Allgemeine Zeitung, 12.7.2011, 23.
27) In July 2011, members of the "Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung" made the proposal that the EFSF could barter ailing Greek loans for loans of the EFSF. That way the Facility would gain a permanent guarantee and the proposal resemble the model of euro bonds. This became evident when one member of the "Sachverständigenrat" advocated a European treasury. Cf. Peter Bofinger interviewed by Tageszeitung, 18./19. 6.2011 (http://www.economics.uni-wuerzburg.de/fileadmin/12010100/sonstiges/Bofinger-taz-18.6.11.pdf, accessed 18.7.2011).
28) See Ansgar Belke and Christian Dreger as quoted in Frankfurter Allgemeine Sonntagszeitung, 22.5.2011, 37.
29) As the detailed analysis of the Frankfurter Allgemeine Zeitung (18.7.2011, 11) has made clear, the investment of German banks in Greece is limited. Risks with respect to Portugal, Spain and Italy are assessed to be more critical.

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