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Questions about Debt-financing in the Eurozone

Margit Rácz

As of June 2011, it is now certain that the 110 billion Euro rescue package provided to Greece last year will not be sufficient for financing the Greek debt. This is above all true because financing from the market is out of the question, even in the future. Therefore, Greece will only be able to cover all of its expired debt with external support.

Up till now, two further members of the Eurozone have applied for financial assistance; the packages for Ireland and Portugal remain under 110 billion Euros. In neither of these cases do experts imagine these countries will be unable to finance their debts from the market in the near future. Based on the experience of these three countries, the first question concerns the key differences between the Greek debt and the debt of the other two countries.

Since the beginning of the 90's, Greek debt has exceeded 100% of GDP. This is the case neither in Ireland nor in Portugal. In contrast with other members of the Economic and Monetary Union, Greece has always been characterized by so-called „*creative bookkeeping*". Thus it was only seldom revealed that the data in their stability programs related to the public debt were inaccurate. With the debt crisis triggered in 2010, similar insecurity prevailed regarding the current deficit. All this indicates that the Greek public administration as a whole was not able to carry out the rigorous management of its public finances. Not surprisingly, the austerity measures assumed for the 110 billion Euro rescue package could not be implemented. (The idea of sending foreign experts to Athens to „direct" tax collection and privatization is worth an ironic smile.)

For these reasons we recommend treating the Greek debt problem separately from the other two Eurozone cases. Provided that the consolidation of the Greek public budget requires different kinds of tasks than in other countries, then we cannot rule out the final solution of a Greek exit from the Eurozone. Due to the peculiar features of the Greek crisis, it would not automatically motivate other countries on the periphery of the Eurozone to return to their national currencies. A certain loss of prestige for the Eurozone and for the Euro would be inevitable. But in this case they could stop throwing money into a dry well. This could even lead to a strengthening of the Euro after the news began to fade away.

If the new stability instrument is established in 2013, there will be liquid resources for managing problems of public financing, with clear rules for their functioning. Following IMF models, it is probable that, for financing the debt, individual member states will be asked to adopt measures related to the consolidation of national finances.

We should further consider the possibility that, before establishing the permanent stability instrument, another member state of the Eurozone could be plunged into crisis. Thus the constraint of harmonizing fiscal policy at some level will remain a component of the crisis management of the Eurozone. It remains a persistent possibility that evaluations can arise envisioning the disintegration of the Eurozone due to problems attached to the consequence of the crisis. Till now, only the small member countries have been affected by the debt crisis. The crucial issue is that the world economy will not return to its position from 2007 in 2012. This suggests a situation in which several members of the Eurozone can have long term bad growth results. We should thus consider the possibility that a new debt crisis will emerge in one or the other of the less developed Eurozone-members.

It is also probable that, in an extreme case, the Eurozone will be less and less capable of responding adequately, depending in particular on the requirement for allocating substantial liquid resources by a given date. It is important to consider the last remark of the German Finance Minister, according to which the private sector should be involved in the financing of the next Greek package. If Greece goes bankrupt, it may well be necessary to save some banks in a few other Eurozone countries.

The debt crisis will be a prolonged problem of the Eurozone in the 2010's, continuing to provide unexpected outcomes. It remains entirely possible that all the rules of fiscal solidarity and fiscal rigor that have been formulated to-date will be insufficient to solve the debt crisis. On the one hand, it is possible that the Greek drachma will be reintroduced. On the other hand it is also possible that some new form of common finance ministry will be established in the Eurozone (as recently mentioned by Joschka Fischer at an event in Switzerland).

We agree with the vision of President Barroso that the future of the Euro is at the same time the future of the European Union. All the Eurozone members would pay too high a price if, after more than a decade, the common currency were to come to an end. For that reason, the narrowing of the Eurozone seems a more realistic alternative. Regarding the future existence of the euro after the crisis, there is no alternative, whether one wants further fiscal deepening or not. The longer the debt crisis, inevitably the more necessary fiscal deepening will be. We can only hope the decision-makers—if not *ex ante*, at least *ex post*—will have enough strength and clarity of vision to adopt the necessary measures.

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