Greece won't get easier terms

Country is euro area whipping boy

Last week, much of the news about the euro area was concerned with Greece's attempts to achieve easier terms on its bailouts. In contrast with earlier attempts, the focus this time was on extending the time to achieve the different targets set, as opposed to lowering the interest paid by Greece on its loans. However, regardless of what the Greek Prime Minister demands, he is unlikely to receive any respite – as was clear after last week's meetings. There are many reasons for this, but a few stand out:

First, Greece has singularly failed to achieve any of its fiscal commitments. Taxes have been raised – but budget deficit targets are not being met. This is partly because the tighter fiscal policy is weakening the economy, and so superficially supports the arguments for an extension of terms. But, crucially, most of what Greece has done is indeed on the tax raising front; less has been done in terms of cutting expenditure and above all in terms of simplifying the tax system and creating a healthier business environment. Next to nothing has been done on privatisation; most likely because nobody is going to buy a Greek asset today if it will be 50% cheaper tomorrow when Greece has left the euro and devalued – but even when this was not seen to be on the cards, little, if anything, was achieved on this front.

Second, all politics is local. While EMU ultimately has to become a political union in order to survive, it is not one yet. What this means is that politicians in the creditor countries – Germany, Finland et al – are responsible to their own electorates. Greek or Spanish voters have no influence on them. (This is a point developed by Holger Schmieding in his Berenberg Bank report Tough Love, 20th August 2012.) And those voters are generally not keen on further bailouts. Voters feel that times are hard and that money should preferably be spent at home.

Third, the power of example. Ireland and Portugal have both achieved easier terms. But these two countries are also perceived to have done everything asked of them; and perhaps also to have ended up in crises less through their own bad behaviour than due to circumstances at least partly beyond their control. By contrast, Greece is perceived to have broken every rule in the rule-book (or at least that could be broken) as well as being the cause of the euro area fiscal crises. If Greece were to get easier terms, this would be seen as rewarding bad behaviour. In addition, there is also a widely spread view that Greece will in any case be unable to fulfil its commitments. While no mainstream euro area politician is likely to want to go down in history as the person who forced Greece out of the euro (though this might perhaps be a vote-winner in some countries), pursuing a policy that eventually makes it impossible for Greece to stay but puts the onus of leaving on the Geeks, is a perfectly acceptable alternative. This could be achieved by refusing further tranches of bail-out on grounds on non-compliance, or by curtailing the ability of the Bank of Greece to provide emergency lending assistance (ELA) to Greek banks. The latter seems to be the preferred method of the Bundesbank. Moreover, insisting on rigorous terms for Greece ensures that other countries are not tempted to deviate from the path of 'fiscal righteousness'. Greece becomes the EA whipping boy .

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The key issue here is whether Greek euro exit could be managed without contagion. Probably not, certainly not without rapid further political/fiscal integration – but EA politicians may convince themselves that it can. If they do, Greece's EMU days will not only be numbered (they already are!) but the number will be very small.

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