Written by Bruce Walker on May 10, 2011

Greek Tragedy: EU Mulls Another Bailout of Greece

There seems no end to the Greek tragedy unfolding within the European Union. One year after a staggering €110-billion ($160-billion) bailout by the European Union barely saved Greece from bankruptcy, EU and IMF officials are meeting in Greece to consider another bailout in hopes of solving the ancient nation's massive debt crisis. Last May's bailout engineered by European Union politicians was roughly €10,000 for every man, woman, and child in Greece, or approximately half of its entire gross domestic product for a year.

The latest financial news provides an exclamation point to the dire situation of Greece. Standard & Poor's has just downgraded Greek national bonds from BB- to B, a drop of two levels which places them deep into the category of junk bonds. The credit rating agency observes that not only may the Greek government have to default on some bond loan payments, but it might end up reneging on as much as half its debts. If that happens, then Standard & Poor's, as well as other rating services, will have to downgrade Greek debt instruments even more. S&P explained its downgrade: "Private second burden sharing would likely constitute a distressed exchange … for which we assign a rating of selective default." Likewise, Moody's has also alerted investors that it is reviewing the ability of the Greek government to repay its loans with an eye to a possible downgrade. The Greek Finance Ministry labeled the downgrades "not justified."

But other nations — most notably Germany, whose cooperation would be indispensable to any additional bailout — have been leery about promising to help Greece again. German Finance Minister Wolfgang Schaeuble met Friday in Luxembourg with the finance ministers of France, Italy, and Greece as well as EU Monetary Affairs Commissioner Olli Rehn. The whisperings out of this conference were that another bailout for Greece was far from certain.

The downgrading of Greek government bonds means that the country's borrowing to solve its problems — so common to welfare states — is coming to a practical end. Ten-year Greek public bonds will now have to promise an interest rate of 15 percent, and for shorter term two-year bonds, the interest rates would have to be 25 percent. An indication of just how disjointed the European Union has become can be seen by comparing the interest rates for Greek bonds with the 2-percent or 3-percent rates on German bonds.

In fact, these numbers appear to understate the severity of Greece's debt. The actual rates which investors are proving willing to receive for Greek government notes is higher: 15.62 percent for 10-year loans and a stunning 25.42 percent for two-year notes. Even more troubling for statists who hope to see a prosperous and stable European Union in the future, the problems of Greek bonds are now seeping into the Portuguese and Irish bond markets. The interest rate required to sell Portuguese two-year bonds has risen two full points to 11.87 percent, and Irish two-year bonds are now at 12.03 percent. The ability, or even willingness, of other EU nations to bail out Greece becomes more problematic as the possibility increases of costly bailouts for both Portugal and Ireland.

Greece is spending much more than it is taking in through tax revenues. A shortfall in the range of €30 billion is projected, or about €3,000 for every person in Greece — not government expenditures, but simply the gap between expenditures and revenues in this “austerity” period. Small wonder that investors see a high likelihood that the government will simply not be able to pay its debt obligations, particularly when the mere interest payments on that debt seem to rise every time a bond rating service analyzes the fundamentals.

Jane Foley, senior currency strategist at Rabobank International, summed up the situation:

> It had already become apparent that Greece probably cannot meet its debt obligations over the next couple of years without further assistance. Rather than return to the market next year as the original bailout has assumed, it now seems fairly likely that Greece will instead ask for more funds from the European Union.

Societe Generale analyst Christian Carrillo noted: “The chain of events is increasingly proving the limits of the European Union’s muddle through strategy.” Political parties in more responsible European governments agree. Finland’s True Finns Party has already indicated its opposition to the bailouts of both Greece and Portugal. The resistence by solvent nations to rescuing improvident EU member states is almost certain to intensify.

This is not stopping the bureaucratic governors of the European Union and associated organs from standing behind Greece and its other member states. The European Central Bank on Monday became just the latest of such groups to throw support behind a revamped assistance program for Greece.

However, the mood within the different nations of the Union is increasingly lugubrious. The Greeks, Portuguese, and Spanish are beginning to view the strictures on their national sovereignty as not worth the dubious benefits of union. The Finns and Germans, standing on economically higher ground, are wondering more and more why their fates are tied to nations with such different attitudes toward honoring debt obligations.

Over the last few days rumblings have been heard that Greece may withdraw from the European Union and reissue its own currency. The reckless behavior of Union members — encouraged by rampant welfare-statist politics in the euro zone and the folly of a transnational currency — has created a situation in which the only question about the withdrawal of member states from the EU may not be “if” but “when.”

The unhappy marriage which is the European Union may finally be headed for divorce court.

Photo: Greek Finance Minister George Papaconstantinou speaks at a conference hosted by Transparency International on May 9, 2011: AP Images