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Even if Bailout Ends Contagion, Euroland Is Changed Forever

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Kostas Tsironis/Bloomberg News

George Papaconstantinou, Greece's finance minister, outlines the rescue package during a press conference at the Greek finance ministry in Athens on Sunday.

The future course of events in euroland is now more or less clear. The International Monetary Fund and Greece's euroland colleagues will come to the aid of Greece to the tune of a bit more than €100 billion (\$132 billion), but it remains more rather than less likely that there will be some sort of restructuring, with creditors probably taking a haircut—a.k.a. a loss—on the order of 30%. German officials are so frightened of a euro-zone-wide meltdown, and the possibility of deep losses for its banks that have lent generously to Greece that they are prepared to ignore their voters who, by 57% to 33% (10% don't know), oppose aid. In the future, says German Chancellor Angela Merkel, miscreants should be hit with sanctions. The words "moral hazard" apparently were not mentioned.

It is difficult to tell just how effective the Greece bailout will be in stemming the contagion spreading to other euroland countries. There are too many ifs. Spain's debt-to-GDP ratio is only about half that of Greece's, and it might escape further downgrading of its debt if its socialist government can

be frightened out of its lethargy. But with president José Luis Rodríguez Zapatero insisting the worst is over, stasis is more likely than action. Italy tapped the bond markets for €6.5 billion last week, and found investors relatively eager to buy its IOUs at rates below those on outstanding debt. If it can stick with the spending cuts engineered by finance minister Giulio Tremonti, and bring down its deficit, running at 5.2% of GDP (Greece's is 13.6%), Italy might avoid a downgrade. Portugal has tightened and accelerated its austerity program, and might avoid a further downgrade if it follows through. Ireland's economic-stabilization program and its recapitalization of its banks are deemed to be working, and if the Irish continue to remain on their couches and in their pubs rather than take to the streets, the flow of red ink might abate before the nation's debt level becomes unmanageable. And if British voters put a deficit-cutting government in place on Thursday, the nation might avoid losing its triple-A rating.

Even if all of these ifs come to pass, the world will not return to any semblance of its pre-crisis condition. The days of national fiscal policy determination are over in Europe. EU President Herman Van Rompuy is calling for the creation of an "economic government" run from Brussels, and European Commission chief José Barroso claims the Lisbon Treaty gives him the power of "economic management." National sovereignty takes another hit, courtesy of the Greece crisis and the ever-ready eurocracy.

Also changed forever is the standard by which sovereign debt will be judged. The rating agencies are under pressure to be less generous in rating debt instruments, and not only those issued by euroland governments. In America, these agencies gave their coveted triple-A rating to the securities that [Goldman Sachs](#) is accused of unethically, fraudulently

or perhaps even illegally, flogging to knowledgeable investors. In Europe, the agencies are accused of delaying too long in reconsidering their ratings of the bonds of euroland's periphery countries, and ignoring the effect on sounder economies of their link to shakier ones.

The rating agencies now know that the Greek bailout means euro-area nations are indeed their brothers' keepers, which in practice means that every country's debt is on every other country's balance sheet. Germany and France can no longer argue that the relevant fact is that their own finances are sound, now that they are assuming responsibility for the debts of Greece and other countries, and will have to bail out their own banks if loans made to Greek, Portugal, Spain and perhaps others are not repaid in full. British voters, their nation brought to its knees by excessive government spending, might temper their harsh judgment of Gordon Brown by recalling that as chancellor he prevented Tony Blair and Peter Mandelson from consigning sterling to the fate of the deutsche mark by adopting the euro.

The more skinflinty rating agencies will also have to take into account the condition of private-sector institutions or government agencies that might look to the central government if trouble strikes. A troubled bank that can turn to the government should have its woes reflected on that government's balance sheet, as should states in America that the federal government will not allow to go broke. In the private sector, the day when off-balance sheet financial obligations were ignored when rating a security are over, or almost so.

With this new, consolidated approach to the appraisal of credit-worthiness, and greater transparency comes greater knowledge by investors of the real risks they face, and with

greater knowledge will come a demand for higher interest rates.

Time to dust off those forecasting models and plug in those higher rates when guessing at future growth.