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## Dissecting Three Aspects of the Euro-Zone Drama

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There are three facets to the unfolding drama in euroland: the immediate finances and inevitable defaults; the post-default euro zone; and the political fallout.



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The first, and most obvious, is the financial. It is now clear that for all practical purposes Greece is bust. Whether the default takes the form of haircuts—only partial repayments—or of "reprofiling" the debt so that creditors wait longer for their money is irrelevant. The rating agencies say either one is a default. Jean-Claude Trichet, head of the European Central Bank, says default is not in the cards. He must know, then, that Chancellor Angela Merkel is being economical with the truth when she says she will not agree to easing the terms or increasing the amount of the three-year €110 billion (\$155 billion) Greek bailout. Her ability to find a way to back off her current position is complicated by the fact that Greece needs more than a minor uplift—€60 billion in addition to its €110 bailout—to get through 2013. She won't find it easy to ask her taxpayers for an even greater sacrifice when Greece is not meeting the targets it agreed when its euro-zone

partners bailed it out: tax revenues are falling short, spending is exceeding targets, and the privatization program is far behind schedule. So it's more German money in return for more impossible-to-fulfill promises, or default.

Then there is Portugal. By a large majority, the Bundestag has approved the terms of that country's €78 billion bailout. But the terms, in some aspects more stringent than those dictated to Greece, make a restructuring of Portuguese debt a virtual certainty, even if Portugal meets Finland's demand that it sell off state assets.

The Greek government has agreed to auction off some €50 billion of state-owned assets. That, says Antonio Borges, director of the International Monetary Fund's European department, comes to only 20% of what could be sold off. But the trade unions are preparing for vigorous opposition of the sort that has so far prevented the effectuation of promised mergers and closures of hundreds of state organizations. Worse, two of Prime Minister George Papandreou's cabinet colleagues and close allies are opposed to the privatization program.

Which leaves Ireland, with its 14.7% unemployment rate, and debt equal to some 160% of its GDP. Morgan Kelly, holder of professorships in economics at University College, Dublin and Cornell University, writes: "With the Irish government on track to owe a quarter of a trillion euro by 2014, a prolonged and chaotic bankruptcy is becoming inevitable... National survival requires that Ireland walk away from the bailout."

He recommends withdrawing support for the banks, taking the tough step of balancing the budget, and thereby "disentangling ourselves from the loan sharks" at the ECB and euro-zone institutions. That won't happen soon, and bankruptcy might not come about precisely as Prof. Morgan describes, but its likelihood in some form mounts daily as Irish taxpayers increasingly object to years of hardship in order to save investors in and creditors to six privately owned banks

The second aspect is the post-default world, best summarized as *après default, le déluge*. Simon Tilford, chief economist at the Centre for European Reform, has done some interesting arithmetic that

suggests that even after a default relieves Greece of interest burdens, its stagnant economy cannot produce sufficient revenues to reduce its still-huge deficits. Private investors will guess that Greece's euroland partners will not fund a second bailout, leaving Greece no choice but to regain competitiveness and growth by leaving the euro. Portugal will follow for the same reasons. Of course, that dénouement can be avoided if the north continuously ships money to the south. Not a platform on which many German, French and other politicians will wish to run.

The third aspect of the euro-zone woes is the political, which might prove in the end more consequential. If a transfer union is established to prevent exit from euroland—and never underestimate the power of the unelected eurocracy—the euro zone will consist of an angry group of rich northern countries, its taxes raised to support the profligate, and an equally angry group of poor peripheral countries, resentful at the loss of sovereignty and the harsh austerity that will be the price of a second bailout.

There are signs that nerves are frayed. The cherished goal of free movement of people within the EU is giving way to the re-erection of border controls to prevent one country from passing unwanted immigrants on to its neighbors. France has increased its attacks on Ireland's low, 12.5% corporate tax rate, accusing it of lacking "financial solidarity." Germany is being criticized by some of its EU partners for its refusal to join the Libyan military campaign.

This no longer happy Band of Brothers seems unlikely to be capable of working as closely together as it has in the past. That might be the enduring legacy once the inevitable defaults become part of the history of euroland.