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## ECB Is Heading for Some Hefty Icebergs

By [IRWIN STELZER](#)

The Argentine government and the euro-zone policy makers have much in common: both have pistols at the ready, and aimed at unwanted messengers.

Argentina's government says the country's inflation rate is 9.7%. Most independent economists put the figure at 20%. So the government has filed criminal charges against one consulting firm, MyS for "publishing false information about inflation data," part of a coordinated campaign against independent economists.



Associated Press

ECB President Jean-Claude Trichet in Frankfurt, Germany, after the bank raised its interest rates last Thursday.

I am sure euro-zone policy makers chuckle at such behavior by a country famous for economic mismanagement. After all, wasn't it less than ten years ago that Argentina defaulted on its debt, something no self-respecting eurocrat would allow to happen in the zone—if they could prevent it, which they cannot. It seems that the rating agencies are threatening to declare Greece in default if private-sector players are forced to accept a haircut on their Greek debt. Which to eurocrats puts the rating agencies in the same class as the Argentine government puts independent economists—enemies of the people.

Rather than allow the big three rating agencies—Moody's, Standard & Poor's and Fitch—to get in the way of plans for the next Greek bailout, the Europeans want to set up their own agency, which will presumably better understand that "default" is not a word used in polite Brussels circles. After all, the big three are American, and who can deny that their real goal is to destroy the euro so as to preserve the dollar's role as the world's reserve currency?

In short, if you don't like the frigid temperature, buy a new thermometer rather than a scarf and gloves. Deny reality. Which seems to be the stock in trade of eurocrats. If the markets say that Greece must pay 20% to borrow money, blame it on speculators rather than Greece's failure to keep the promises made when it negotiated the initial bailout.

If simple arithmetic says that Greece is in or inevitably headed for default, which would make the European Central Bank unable to accept the collateral of Greek banks, it is an easy matter to do for Greece what the ECB has done for Portugal. When Portugal's debt was downgraded to "junk" the ECB waived its minimum rating requirements and continued to accept Portuguese paper as collateral for loans, adding to the tens of billions of euros of Greek debt already on the ECB balance sheet. Apparently, ECB President [Jean-Claude Trichet](#) feels that is a more prudent course than allowing Greece or Portugal to default.

The name of the game now is to reduce Greece's massive debt burden, around 150% of GDP, by somehow taking advantage of the huge discounts at which its bonds are selling. The myriad proposals for doing that are—you guessed it—to be discussed at a meeting of finance ministers of the 17 euro-zone countries Monday, another in a long line of meetings that have been held, with more to come. That this display of indecision and division might just scare off the sovereign wealth funds that the eurocrats are hoping to attract to the refunding party remains unmentioned.

So here is the state of play. Greece will receive a second tranche of the bailout funds originally promised, in return for its promise to fulfill its so-far unfilled earlier pledges. There is some hesitation about making additional funds available under the various mechanisms

existing and to come into being, but an almost religious belief that the euro must survive at all costs—the costs to be borne primarily by Germany—will probably trump any doubts. But the Greek ship-of-state is taking on water faster than German chancellor Angela Merkel and her crew can bail the ship out. It will sink.

Which is the least of the euro zone's problem. Everyone now knows that Portugal will need increasing financial assistance, that like Greece it has not kept its pledge to reduce its deficit relative to its GDP, and that also like Greece its economy is stagnant, unable to create jobs and produce tax revenues with which to meet interest payments on its debt and cover the costs of a still-unreformed welfare state.

There is worse. The good ship Eurotitanic might maneuver around the tiny ice cubes that are Greece and Portugal, but it is headed straight toward two huge icebergs: Italy and Spain, the third and fourth largest euro-zone economies.

Spain has a budget deficit equal to 9.2% of GDP, and Italy's debt:GDP ratio of around 120% is second only to Greece. Spain, which has caused greater investor nervousness than Italy, might actually be in better shape, despite its 20.7% unemployment rate. Its economy is growing a bit, while Italy's has managed to grow at an average annual rate of a barely discernible 0.25% over the past decade, less than one-quarter the rate of the sluggish euro zone as a whole, and its labor market is so rigid that one-in-three young workers is unemployed.

And Italy, its bond yields at a nine-year high, has to tap the markets for €100 billion (\$142.6 billion) this year, whereas Spain has to raise only €40 billion. If the results of the second round of bank stress tests, to be published on Friday, suggest Italy's banks are not as sound as Bank of Italy governor and to-be ECB head [Mario Draghi](#) claims, or if the tests prove as unstressful as the last round, which declared Ireland's banks sound, the price Italy will pay for that €100+ billion might just shoot up. Even rich Germany can't afford to bail out Spain and Italy should it come to that.

—Irwin Stelzer is the director of economic policy studies at the Hudson Institute, Washington.