CAN EUROPE AVOID

Greece is stumbling into another crisis and the IMF is itching to march into the eurozone and intervene. Without closer fiscal union, asks **Larry Elliott**, how long can Brussels hold the currency together?

Leave Greece to us. It's a family affair. That was the message from Brussels as shares plunged in Athens, customs officials walked off the job in protest at swingeing budget cuts, the financial contagion spread westwards across the Mediterranean and the International Monetary Fund started to cast a long shadow across the soft underbelly of the eurozone.

As far as the European commission was concerned, matters were simple. By a mixture of incompetence and deceit, the Greeks had allowed their deficit to balloon out of control, putting the credibility of monetary union at risk. They now had to put their own house in order, which they could do with the help of some tough love from the rest of Europe – likewise, the financially incontinent governments of Spain and Portugal.

European Central Bank president Jean-Claude Trichet said last week it was vital that Greece met its stated goals for cutting its budget deficit and that the steps announced by the government were encouraging. "The ECB governing council approves the medium-term goal ... we expect and are confident that the government will take all the decisions that will permit it to reach that goal," he added. "The measures taken last Tuesday – tax rises, the freezing of wages in the public sector, and the pension reform – are steps in the right direction."

But the reality is more complex. A crisis that began with the previous government in Athens cooking the books developed into three interlocking themes – the reluctance of the Greeks to swallow the nasty budgetary medicine prescribed for them, the medium-term outlook for the single currency and Europe's long-term role in a rapidly changing global economy.

Despite the hands-off warning from Brussels, the IMF has been itching to send a hit squad across the Atlantic to help sort out Greece's acute budgetary crisis. "We are there to help," says the managing director of the IMF, Dominique Strauss-Kahn. "I have a mission on the ground to provide technical advice requested by the Greek government. And if we're asked to intervene, we will." But he adds: "I understand that the Europeans don't want this for the moment."

They certainly don't, but a mission may still be sent, if only to prevent the contagion spreading. Nouriel Roubini, economics professor at the Stern School of Business at New York university, said in Davos last month: "If Greece goes under, that's a problem for the eurozone. If Spain goes under, it's a disaster."

He has been strongly advising the beleaguered socialist government of George Papandreou to seek help from Washington, a view shared by Harvard professor Kenneth Rogoff, former chief economist at the fund: "Greece is going to end up with an IMF programme of some sort in order to get credibility."

Rogoff, who has just published a book on eight centuries of financial crises, said that Greece was "a serial defaulter". Since the modern Greek state was founded in 1830, the country has, on average, been in sovereign default every other year and had been through five big defaults in less than 200 years. "Greece has been worse than any Latin American country," he adds.

The risk of another default or – the doomsday scenario – of Greece deciding to leave the single currency has spooked investors, who are demanding a high price for holding risky Greek debt. The gap between the interest rates on rock-solid German *bunds* and Greek bonds has widened sharply.

The IMF would probably already be involved were Greece outside the eurozone. But according to Charles Grant, director of the Centre for European Reform, the commission wants to keep the fund at arm's length because it would give the Americans a say in single currency affairs, a blow to European pride.

Grant says this is regrettable: "The IMF is very experienced in these matters; it is professional and is not subject to political pressure. There is a political point as well. If the commission sets conditions that lead to hospitals being closed, there will be demos against Brussels. If the IMF does it, the demos will be against the fund."

For the Greek public last week, it barely mattered whether the harsh measures were coming from their own government, the commission, the fund or a mixture of all three. All they knew was that they did not fancy higher taxes on fuel, working longer to get their pensions and, if they were civil servants, taking a 10% pay cut.

Similarly, trade unions in Spain bridled at plans announced by Prime Minister José Luis Rodriguez Zapatero to increase the number of years workers would have to make contributions before receiving state pensions. Still reeling from the effects of the global recession of the past two years, Greece, Spain and Portugal now face a prolonged period of weak growth and high unemployment.

> 'The eurozone could drift... eventually some countries might exit the monetary union'

Some argue that the cuts being inflicted on the eurozone's weaker economies highlight a fundamental weakness in the single currency – its lack of a centralised budgetary mechanism, such as exists in the US, to move resources from rich parts of the union to poor parts.

Gerard Lyons, chief economist at Standard Chartered, says there have been several examples of monetary unions that have collapsed because they were not accompanied by fiscal union: "For monetary union to survive, it has to become a political union. If it doesn't there is likely to be some sort of implosion and a move towards a two-speed Europe."

Roubini agrees: "The eurozone could drift ... with a strong centre and a weaker periphery, and eventually some countries might exit the monetary union."

Mats Persson, research director of the Open Europe thinktank, believes Greece should not have been allowed to join the euro in the first place, and that there comes a point during an extreme crisis when countries can see the desirability of having their own currencies, so that they can adjust through devaluation: "The question is whether Greece can ever compete as a middle-rank eurozone country without some proper structural reform, and whether that is possible without its own monetary policy."

Greek PM George Papandreou.

In the short term, leaving the single currency is not on the policy agenda in Greece, Spain or Portugal. Nick Parsons, head of markets strategy for NAB Capital, the wholesale markets division of National Australia Bank, says: "Has the euro been a disaster for Greece? No. You have to think about where they would have been without it. Arguably, the financial crisis would have been greater outside the eurozone."

Grant at the Centre for European Reform notes that Portugal, Spain and Greece had all been dictatorships until the final third of the 20th century and saw membership of the EU and the single currency as a sign of growing up politically: "That's why Europe is very popular in these countries."

But even the most ardent europhiles admit that the chances of constructing a fully fledged political union in order to make monetary union work better are remote. Instead, they say, countries will have to make themselves leaner and fitter through structural reforms of their economies and accept some centralised control over their budgets from the eurozone's big two, Germany and France.

Parsons says: "What will happen

Growing unrest: riot police during an anti-government protest in Thessaloniki in September last year. Photograph by Grigoris Siamidis/Reuters