A Greek endgame?

Paul De Grauwe, CEPS Senior Associate Research Fellow and Professor of Economics at the University of Leuven

The crisis that started in Greece has spawned into a crisis of the eurozone as a whole. There is no doubt that the major responsibility rests with the Greek authorities who mismanaged their economy and then deceived everyone about the true nature of their budgetary problems. The financial markets and the eurozone authorities, however, also bear part of the responsibility for letting the crisis degenerate into a systemic crisis of the eurozone.

The financial markets showed how unreliable their judgments can be in moving from excessive optimism before the crisis to deep pessimism after the crisis broke. The use of CDS (credit defaults swaps) allows market participants driven by pessimism to speculate in unlimited amounts against particular countries, thereby greatly amplifying the underlying problems.

The crisis was allowed to unfold also because of missteps on the part of both the eurozone governments and the European Central Bank. The former failed to give a clear signal of their readiness to support Greece. The ECB, in turn, created ambiguities about the eligibility of Greek government debt as collateral in liquidity provision.

The Greek government debt crisis should and can be stopped. It should be stopped because failure to do so could set in motion an unstoppable process of contagion that would affect the entire banking sector of the EU. This would in the end force governments to bail out banks once again at great economic cost. Thus the choice today is between one of two evils. The first one arises from moral hazard. Bailing out Greece is bad because it gives a signal that irresponsible behaviour will not be punished. The second evil arises from the contagious effects of letting Greece default.

Authorities have to choose the lesser evil, which in this case is the second one. This is also the choice that was made when they bailed out the banks that had been at least as irresponsible as the Greek government.

The Greek government debt crisis can be stopped. There can be little doubt that the eurozone member countries have the financial capacity to bail out Greece if the need arises. It would not cost them that much: if Greece were to default on the full amount of its outstanding debt, a bail-out by the other eurozone governments would add about 3% to these governments’ debt levels. This would be a very small number compared to the sums spent to save the banks during the financial crisis.

The crisis has exposed a structural problem of the eurozone, created by the fact that the monetary union is not embedded in a political union. This imbalance leads to a dynamics of creeping divergencies between member states and there is no mechanism to correct or alleviate it. These divergencies in turn lie at the core of budgetary divergencies and crises.

Ideally the eurozone member countries should move forward into a closer political union, but there is very little prospect of this happening in a significant way in the foreseeable future. Some small steps are possible however. One is the creation of a European Monetary Fund; the other is the creation of common Euro bonds designed in such a way to minimise the moral hazard problem (see elaboration of these ideas in the texts referenced below). These steps have the important quality of signalling a determination on the part of the eurozone members to commit themselves to a future intensification of the process of political union.

On 2-3 February, CEPS researchers Jørgen Okem, Mortensen, and Felix Roth participated in the kick-off meeting in London of the INDICSER project, aimed at investigating indicators for evaluating international performance in service sectors and sponsored by the 7th Framework Programme. The project will identify and develop indicators of service sectors required by the academic and policy communities in their attempt to understand economic developments in these sectors, including their impact on aggregate growth. In this project CEPS is contributing to research on the role of intangibles and non-market services in service sector development, with the particular task of reconsidering the methodology of measuring output in health care and education.

Info: jorgen.mortensen@ceps.eu & guldem.okem@ceps.eu

**Public goods from private land**

How public policy can be made to both stimulate farmers to provide public goods and environmental services and simultaneously remove negative incentives was the subject of debate at a workshop on February 1st hosted by CEPS, in cooperation with the Rural Investment Support for Europe (RISE) Foundation. Johan Swinnen, CEPS, chaired the event, together with Corrado Pirzio-Birolli of RISE. Three new studies were presented by their main authors, respectively Allan Buckley (European Landowners Organisation), David Baldock (Institute for European Environmental Policy) and Patrick Ten Brink (Economics of Ecosystems and Biodiversity). The ensuing discussion with the audience explored the implications of these questions for the reform of the Common Agricultural Policy after 2013.

**Kick-off meeting of the RELIGARE project – Religious diversity and secular models in Europe**

CEPS, together with the Katholieke Universiteit Leuven (KU Leuven), launched an exciting new project on religious diversity, secularism and intercultural dialogue in Europe (RELIGARE). The kick-off meeting took place on February 4th in the celebrated historical beguinage in Leuven, dating from the 13th century. The event continued at CEPS on the following day. The meeting gave the partners of the consortium the opportunity to discuss the project’s objectives and to exchange views on various elements related to the framework of the project and its research areas. RELIGARE is funded for a 3-year period by the FP-7 Socio-economic Sciences and Humanities Programme of the Directorate-General for Research of the European Commission and is coordinated by KU Leuven (Project Coordinator: Marie-Claire Foblets).

Info: miriam.mir@ceps.eu

**Will Greece become the straw on the Stability Pact’s back?**

The ‘Greek debt tragedy’ certainly represents the biggest, but hopefully not fatal, test for European Monetary Union since its creation. To debate policy solutions on February 10th, CEPS hosted a seminar on “The Greek case: The straw on the Stability Pact’s back?”. As the guest of honour, Georges Zanias, Chairman of the Economic Advisors of the Greek Ministry of Finance, opened the interventions by introducing the tough initiatives that the Government has committed to with the aim of reducing the country’s imbalances and restructuring the economy. CEPS Director Daniel Gros stressed that the issue of sovereign debt crisis should be addressed more broadly and deeply at European level. He suggested, as desirable and feasible action, the constitution of a Euro(pan) Monetary Fund that could provide financial support to a troubled country and limit moral hazard arising from bail-outs. Lastly Paul De Grauwe, CEPS, focused on the destabilising role played by the financial markets and invoked the case for the EU to support Greece.

**Former Chairman of Morgan Stanley addresses CEPS Corporate Members**

Sir David Walker, former Chairman of Morgan Stanley International, spoke at a CEPS Corporate Breakfast meeting on February 19th on the Governance of Financial Institutions. In February of last year, Sir David was asked by the UK Prime Minister to review corporate governance in UK banks and financial institutions in light of the critical losses suffered in the financial system. He published a consultation paper and a report with final recommendations in 2009.

Info: staffan.jerneck@ceps.eu

**Prospects for the European trading and post-trading landscape debated at ECMI event**

On February 1st, the European Capital Markets Institute (ECMI) jointly with the London Stock Exchange Group, held a one-day conference on “MiFID & EU Markets: What is next?” at the exchange headquarters in London. Xavier Rolet, CEO LSE Group, gave introductory remarks on the role of post-MiFID equity markets in attracting liquidity. He observed that the interoperability seems even more of a chimera in current fragmented markets, even for simple products. David Wright, Deputy Director General, European Commission, confirmed that the MiFID review will only look to some specific aspects, while markets need to be revived. Carlo Comporti, Secretary General of the Committee of European Securities Regulators, pointed out the necessity to face two issues: transparency and fragmentation. Alasdair Haynes, new CEO of Chi-X, highlighted the importance for competition of having a European consolidated best bid and offer solution. Finally, the third and fourth panel dealt with the missing implementation of best execution and the latest developments in the post-trading markets and infrastructure. Among other speakers were David Lawton, Head Market Policy, FSA; Jean Baptiste de Franssu, CEO Invesco; Claudio Salini, Head of Financial Markets Division, CONSOB; Richard Balarkas, CEO Instinet Europe; Diana Chan, CEO EuroCCP; Klaus Loeber, Head Oversight Division, ECB and Fabrice Demarginy, Global Head of Capital Markets Division, Mazars.

Info: www.eurocapitalmarkets.org/node/441

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**RECENT EVENTS**

Okem. Mortensen. Roth

De Grauwe, Zanias & Gros
On February 5th, CEPS held the fifth meeting of its Task Force on Innovation in the EU. The meeting began with a presentation from Katja Reppel (DG Enterprise and Industry, European Commission) who discussed the governance of innovation policy in the EU. Following this, Harald Gruber (European Investment Bank) examined the different financing mechanisms available to firms wishing to perform innovative R&D. Last, Jacqueline Hunter (GlaxoSmithKline) offered an industry perspective on the current EU policies for public-private partnerships for innovation. A roundtable discussion then ensued in which all participants discussed the format and contents of the Task Force’s final report which will be drafted in the coming months. The next meeting of the Task Force, scheduled for March 16th, will be devoted to reviewing a draft of the final report.

Info: andrea.renda@ceps.eu

NEW CEPS TASK FORCE REPORTS

OVERCOMING TOO-BIG-TO-FAIL: RESTORING INVESTOR CONFIDENCE IN EUROPEAN CAPITAL MARKETS

Co-organised by ECMI & CFA

1. The Treatment of Exclusionary Abuses under Article 82
Chair John Temple Lang, Cleary Gottlieb Steen & Hamilton LLP & former Director, DG COMP, European Commission

2. CDM and post-2012 Flexible Mechanisms
Chair Ulrika Raab, Senior Advisor, Swedish Energy Agency, former Member of the CDM Executive Board

3. A Green Budget for a Sustainable Future: Adapting the EU Budget to Climate Change
Chair Anders Wijkman, former Member of the European Parliament

4. European Investors’ Working Group; Co-organised by ECMI & CFA
Chair Fabrice Demarginy, Head of Capital Markets Activities, Mazars and former Secretary General, CESR
Report launched 23 February

5. Benchmarking for the EU ETS and beyond
Chair Anna Törner, Head of Section, Ministry of Enterprise, Energy and Communication, Sweden
Report under preparation

6. Securing European Energy Supplies: Making the Right Choices
Chair Knud Pedersen, Vice President, DONG Energy
Report under preparation

7. State Aid to the Financial Sector: Fragmentation or integration?
Chair Alastair Sutton, Partner, White & Case
Report under preparation

8. Internal Market for Retail Financial Services
Chair Anton van Rossum, former CEO, Fortis Bank
Report under preparation

9. Banking Crisis Resolution Procedures
Report to be launched 15 March (details page 4)

10. Innovation Policy: Boosting EU Competitiveness in a Global Economy
Chair Maria Anvret, Senior Executive, Scientific Expert and Advisor, Confederation of Swedish Enterprise
6th meeting 16 March

11. European Security Forum
Chair François Heisbourg, Chairman, Fondation pour la Recherche Stratégique
Next meeting: 22 March: The Political Future of Afghanistan
Info & Registration: esf@ceps.eu

12. Critical Infrastructure Protection
Chair Bernard Haenmerli, Vice President, Information Security Society, Switzerland (ISSS)
4th meeting 23 March

13. E-communications: Regulatory Challenges for the post-Lisbon Era
Chair Staffan Jerneck, Director & Director of Corporate Relations, CEPS
4th meeting April

14. EU and Global Climate Change Policy and the Increasing Role of Cities
Chair Laurence Tubiana, Director, Institut du développement durable et des relations internationales, Paris
4th meeting 23 April

15. The Solvency II Regime: A Revolution for European (Re)insurance Companies
Chair Jos Streppel, former CFO & Member of the Executive Board, Aegon
3rd meeting April/May

16. Completing the Doha Round of WTO Negotiations
Chair Hanns Glatz, former Delegate of the Board of Management, Daimler AG
6th meeting April/May

17. Corporate and Commodity Standards and Sustainable Trade
Chair Corrado Pirzio-Biroli, former Chef de Cabinet of European Commissioner Franz Fischer
2nd meeting April/May

18. Transport and Climate Change

1st meeting - date to be announced
On February 17th, CEPS organised a conference on the contentious Presidential election held in Ukraine earlier this month. The speaker, Konstantin Bondarenko, Director of the Gorshenin Institute of Management Issues in Kyiv, presented his analysis of Yanukovich’s likely policies, including the formation of a ruling coalition, and his views on foreign policy, economic relations, gas policy and the presence of the Russian fleet stationed in Crimea. He argued that Ukraine had stood the test of democracy by holding free and fair elections, but pointed to concerns that this democratic process could be reversed.

Bondarenko & Emerson

LATEST CEPS TITLES - FREE DOWNLOAD AT WWW.CEPS.EU/BOOKS

Understanding India’s Climate Agenda, Noriko Fujiwara and Christian Egenhofer CEPS Policy Brief, February 2010
The Political Economy of India’s Climate Agenda, Noriko Fujiwara, CEPS Working Document, February 2010
Future Impacts of Climate Change across Europe, Arno Behrens, Anton Georgiev, M. Carraro, CEPS Working Document, Feb 2010
On Thin Ice? (Mis)interpreting Russian Policy in the High North, Roderick Kefferpütz, CEPS Policy Brief, February 2010
“Capital Brussels: What kind of political actor will the Lisbon EU be?”, Piotr Maciej Kaczynski and Adriaan Schout, 24 Feb 2010
“Greek burdens ensure some pigs won’t fly”, Daniel Gros, CEPS Commentaries, 1 February 2010
Towards Common Standards on Rights of Suspected and Accused Persons in Criminal Proceedings in the EU?, M. Jimeno-Bulnes, Liberty and Security series, February 2010
Europe 2020: Employment Prospects and Challenges, Iain Begg, Christine Erhel & Jørgen Mortensen, CEPS Special Report, Feb 2010

Please tick the meeting(s) you wish to attend:

- [ ] 4 MAR 4 MAR 13.15-14.30 Open Trade vs. Protectionism: Developments in Trade Policy since 1995
  Mauro Petriccione, Chief Negotiator, DG Trade, European Commission
  Christofer Fjellner, MEP; Constanze Picking, Director, EU Corporate Representation, Daimler AG
  Johan Kraft, Deputy Director General for Trade Policy, Swedish Board of Trade

- [ ] 8 MAR 9.00-13.00 The future of EU electricity grids: Who will benefit from smart grids and at what costs?
  Tadhg O’Brien, DG TREN, European Commission
  Jaap Strengers, European Climate Foundation; Frans Nieuwenhout, ECN
  Rafael Cossett, Comillas, Spain; Henrik Jacobson, Risoe DTU, Denmark; Hans ten Berge, Eurelectric

- [ ] 15 MAR 13.15-14.30 Overcoming too big to fail – Launch of a CEPS-Assonime Task Force on Banking Crisis Resolution Procedures
  Stefano Micossi, Director General Assonime and Member of the CEPS Board of Directors
  Daniel Gros, Director, CEPS

- [ ] 22 MAR 13.30-16.30 The Political Future of Afghanistan – 34th session of the CEPS/IISS/DCAF/GCSP European Security Forum
  H.E. Karl Eikenberry, Ambassador of the United States to Afghanistan
  Oksana Antonenko, International Institute for Strategic Studies, London
  Radha Kumar, Delhi Policy Group, New Delhi; Anatol Lieven, King’s College, University of London
  Fabrice Pothier, Director, Carnegie Endowment for International Peace, Brussels

- [ ] 25 MAR 13.15-14.30 The Limits of Legislation: How much regulation is necessary?
  Andrea Renda, Senior Fellow and Head of the Regulatory Policy Unit, CEPS
  Marianne Klingbeil, Director for Better Regulation and Impact Assessment, SecGen, European Commission
  Edward J. Calabrese, University of Massachusetts; Jack Koopman, CEO, Koopman International

Attendance at CEPS Membership Meetings is a benefit of membership. Non-members may be admitted for €50 per session, paid in cash at registration.

An informal sandwich lunch is served at 12.30 before lunchtime meetings (€6). For organisational reasons, we cannot accept telephone registrations.

Registration: Please contact Anne-Marie Boudou, per e-mail: amboudou@ceps.eu or fax: +32 (0)2 201.46.89.

Feedback or comments on CEPS News? Please send to: katharina.mueller@ceps.eu