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Greece's Downward Spiral a Sign of Structural Difficulties of the Eurozone

In a previous post, I indicated the reasons why Greece's downward spiral was a sign of the structural difficulties of the Eurozone.

Admitting Greece into the Eurozone was always questionable. After the real numbers were known, it became obvious that its failure to abide by its commitments under the Financial Stability Pact was more widespread and deeper than expected. However, the full light was only discovered after a daunting report of Eurostat, the European Statistical Agency of the Union, was established at the request of the Commission.

But the Maastricht Treaty that created the Euro does not provide for compulsory corrective mechanisms. Sanctions and corrections have to be decided at the political level. The lack of financial discipline is so widespread throughout the Union that no country, no matter how deeply deviant it is, has ever been sanctioned.

The recent agreement announced this week with the European Commission and the European Central Bank was not enthusiastic and was assorted with a quarterly monitoring by the Union.

But it is simply not credible in the absence of a massive EU financing support. And it is even more incredible without sanctions for infractions to the plan.

The market is not going to accept the prospect of a sudden drop of the budget deficit from 12.7% to 3% by 2012 on face value. Let alone after a mega loan that was priced at a record spread reflecting their limited confidence and will make the external debt more expensive.

The inaction and declarations of non support for Greece by the Eurozone leadership added to the confusion in a situation where Spain, Portugal and Ireland are forced to take corrective measures to reduce their deficits.

Where are we? The King is naked...The ill-conceived ratio of budget deficit has to be replaced from a fixed annual 3% to a rolling average over 3 to 5 years. The debt/GDP needs to be monitored in a more proactive way. Greece is at 130% while the ratio is 60%.

The Eurozone has to create new mechanisms that will not depend on political protracted negotiations but immediately suspends some privileges until the country corrects itself.

This is a demonstration in "real life" of the weakness of the underlying management of the Euro. It is a great opportunity, after ten years, to make adjustments which have long been overdue.

Will Europe have the guts to undertake such a reform? If the Greek crisis provides a necessary wake up call, it will have served a purpose.