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Third time lucky?

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The third bailout assistance plan from the Eurozone (19 member counties) to its fellow member Greece, a country in deep debt ever since 2008, has been agreed to.

Already Greece has been benefitted by two bailout funds for a total amount of € 245 billion, the first one being in 2010 followed by the second in 2012. All the moneys received by Greece were used up for re-paying up debts rather than for spending on the economy.

The IMF has recommended the needed amount under the third bailout plan for a higher amount than €53.5 billion euros (US$60 billion) requested by Greece. The reason put forward is that Greece's debt €320 billion is still unsustainable. It is around 170 percent of the country's gross domestic debt (GDP).

Greece missed €1.6 billion payment to the I.M.F. last month; another €456 million payment early this week. Thus, the dues to IMF amount to €2 billion. Soon, there would be another payment due: €4.25 billion payment due to European Central Bank (ECB).

Commercial banks in Greece are short of cash. They are closed ever since June 29. Until June 28, depositors were allowed to draw not more than €60 per day. Banks want liquidity help from ECB.

The European Commission has formally proposed a short-term €7billion loan for Greece through the EU-wide European Financial Stability Mechanism (EFSM). The facility has been opposed by non-Eurozone members, who are still part of European Union (29 members). The leading opposing member country is United Kingdom with its own currency, the pound.

Rising debt/GDP ratio

The IMF estimates Greece debt would be 200 percent of GDP in next two years. It is also feared that annual debt servicing expenditure would rise to 15 percent of GDP.

The creditors, including the European Commission and ECB and the Eurozone's other 18 member governments, approved a third larger bailout: €86 billion (US$ 96 billion). The Eurozone leaders rejected any possibility of write-down of the outstanding debt.

The alternative to write-down is re-scheduling repayments or bailout funds to pay them. Will the third bailout assistance solve the debt crisis?

The Eurozone leaders have suggested austerity measures in return for the third bailout funds over a period of next three years. They are not much different from those prescribed earlier. They were just the same which were rejected by people in the July 5 referendum. They relate to tax increases and pension reforms.

Although the prime minister who surprised the creditors by announcing the referendum and succeeded in obtaining a vote against austerity to convince the creditors that Greece does not like austerity, now faces the hard task of getting the parliament's approval, which is dominated by his own party, the leftist leaning socialists.

The reforms, which need the parliament’s approval for the third bailout funds are:

(i) raising value added tax (VAT) to 23 percent on processed food and restaurant meals; and 13 percent on fresh food, energy bills, water and hotel stays; and 6 percent for medicines and books;
(ii) Abolition of special treatment in regard to VAT discount for the islands;
(iii) raising corporate tax from 26 percent to 29 percent for small companies;
(iv) luxury tax on big cars, boats and swimming pools; and
(v) increasing retirement age to 67

Additionally, Greece is required to setup a Trust Fund for € 50 billion. The amount will have to be acquired by selling government assets for two purposes:
(i) € 25 billion for recapitalization of banks;
(ii) € 12.5 billion for reducing debt; and
(iii) € 12.5 billion for investment.

Will the third bailout work?

As I write this on Thursday, the Greek parliament finally passed the reform proposals after a heated debate. Some members of the ruling party withdrew their support to the prime minister. But the government of the day was supported by opposition members who are strongly in favour of Eurozone membership. It remains to be seen how far the masses will take it as they voted against austerity just two weeks ago.

The news is also on hand that French parliament has approved the deal, while other parliaments have yet to approve. Some countries’ constitutions require such parliamentary approval as requirement for handing over funds to another country.

If a country wants a common currency, it has to abide by rules prescribed by the currency union. In a currency union with individual member countries retaining their political sovereignty, there are no fiscal transfers possible. Fiscal transfers are possible only in a political union. We have examples of the federations, including USA and India, where the federal governments come to rescue states which are in financial distress through fiscal transfers.

Until political union is reached economic integration cannot realize its full potential. In the absence of political integration, all member states have to go by rule book.