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COMMENTARY

Bailout for Greece

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Given Greece's dramatic soaring public debt servicing cost, its 23 April request for the activation by the EU and the IMF of the mechanism of financial support was an expected and necessary step of the George Papandreou government. The earliest possible launch of a three-year program, which could total 45 billion euros this year alone, is the priority.

Greece's decision to seek financial support came amidst soaring yields on its government bonds. The situation became critical following the release by Eurostat of data showing that Greece's 2009 deficit and public-finance debt had been higher than previously reported (13.6% and 115.1% of GDP, respectively). This prompted Moody's, a leading rating agency, to downgrade Greece's credit rating. Neither has the request for a bailout cheer up the markets: on 26 April the bond yields rose again on the previous week, driven by investors' uncertainty as to when the bailout package would become operative.

Under an agreement made by the heads of state and government of the Euro area countries on 25 March, the financial package for Greece is to consist in two-thirds of bilateral loans made by these states and in one-third of resources provided by the International Monetary Fund (IMF). At a teleconference of 11 April the Eurogroup members agreed that this year the EU could provide up to EUR30bn as its share of the aid package, which would leave the IMF to supply up to EUR15bn. The different Euro area states' contributions to the bailout program will be determined on the basis of their respective shares in the capital of the European Central Bank (ECB). This year Germany will be the highest contributor putting up EUR8.4bn, followed by France (EUR6.3bn), Italy (EUR5.5bn) and Spain (3.7bn). The Euro area states will provide both fixed-interest and variable- interest loans on terms which, while non-concessional (a condition on which they, Germany in particular, insisted) will nevertheless be more advantageous than the current market rates. Both types of interest rate will be based on the Euribor rate (the rate on euro-denominated loans offered on the European interbank market) taking into account the IMF's pricing formula. Thus an interest rate on a three-year fixed-rate loan could be about 5%. The EU-provided share of the package will be managed by the European Commission.

The details of the bailout for Greece are to be laid down in a three-year program currently under preparation by the European Commission, the ECB and the IMF. For the EU-provided part to become operative, a unanimous decision of the Euro area states is required (it will probably be taken at the level of Ministers of Finance), subject to prior assessment by the European Commission and the ECB. Presumably, this assessment will focus on Greece's capability to continue raising funds on the market and on the level of risk to the stability of the entire Eurozone. As for the IMF contribution, it is for the IMF Executive Council to decide on activating the loan.

The dynamic of the situation makes it imperative that the EU and IMF institutions agree and launch at the earliest possible date the financial support program for Greece. This is a necessary condition for reassuring the markets. It is crucially important that the full amount of the bailout over its three-year term is credibly determined, the conditions for drawing on the package established and a timetable for the provision of support are developed and the coordination of activities among the IMF and EU institutions are agreed. Greece will have to proceed with its consolidation efforts, which can have a strong negative impact on its GDP (IMF forecasts speak of a 2% GDP fall this year, the steepest of all the Euro area states). Neither can it be ruled out that, faced with the scale of Greece's debt crisis, the Greek government will have no option but to restructure the country's public debt which stands at some EUR300bn.

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