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The Second Bailout for Greece and Possible Further Extension of the Crisis into the Euro Area

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In response to the worsening fiscal situation in the euro area and at an extraordinary summit in Brussels on 21 July, the heads of state and government of the euro area adopted a second bailout for Greece of €109 billion. In fact, they agreed to a partial restructuring of the Greek debt, with the participation of private investors, but the details of the plan remain unclear. Other solutions, such as extending the scope of EFSF, are moving in the right direction, but they are late and will be negatively assessed by the financial markets.

The New Phase of the Crisis. A recent tightening of the fiscal situation in the euro area was caused by several factors: uncertainty in financial markets, the possibility for a comprehensive solution to fiscal problems in the euro area, the further accumulation of public debt in Greece along with uncertainty about the prospects for implementation of its savings plan and the subsequent reduction of the rating of Irish debt. In the broader context, this seemingly trivial issue of downgrading the Irish debt was enough to dramatically aggravate the situation in the euro area. It surfaced on 8 July as a disagreement between the Italian Minister of Economy and Finance Giulio Tremonti and Prime Minister Silvio Berlusconi concerning the adoption of an austerity package for the country. The deterioration of their relationship caused an intensely strong reaction among investors and included declines in the stock market in Milan and Italian debt interest rates increase to a level threatening the fiscal stability of that country. The problems in Italy, the EU's fourth-largest economy and the second in relation to the public finance sector's debt-to-GDP ratio (around 120%), meant that the debt crisis in the euro area has entered in a new critical phase.

The Second Bailout for Greece. The difficult fiscal situation in Greece showed the need for a further aid package. It was planned to determine the details of the new loan after the holidays there. However, the spillage of the crisis into Italy and pressure from the International Monetary Fund forced the politicians to speed up their plans and to convene an extraordinary summit of the heads of state and government of the euro area on 21 July. A new aid package for Greece was adopted in the amount of €109 billion, which will consist of funds from the EFSF and the IMF. It was announced that additional financial sector participation in the financing of the Greek package (over the €109 billion in other aid) will reach €37 billion. Signals coming from the Member States and from the Institute of International Finance, which represents the interests of the private sector, however, are divergent. This may indicate a lack of consensus about the details of the package. It is estimated that due to the adopted solutions, the net present value of the Greek debt will be reduced, in the hands of private investors, to about 21%. The question remains, then, about the impact of this plan on the condition of banks since a variant of "selective default" for Greece was not taken into account in the course of recent studies of the banking sector's resilience to the crisis (stress tests). Taking this factor into account, the heads of state and government of the Eurozone decided to put additional funds into recapitalizing banks (€20 billion) and offer €35 billion worth of additional guarantees for the European Central Bank.

During the summit, it was agreed that the powers of the European Financial Instrument for Stability (EFSF) would be extended to activities aimed at the purchase of bonds on the secondary market and the security of liquidity in the banking sector. This is analogous to the competences of the future

European Stability Mechanism (ESM). The summit also resulted in lower interest rates on loans for Greece, Ireland and Portugal to 3.5% and a repayment period for loans extended to Greece.

Support for Greece in Implementing Reforms. The European Commission is trying to monitor the situation in Greece and faces the extremely difficult task to implement the reform package adopted at the end of June. On 20 July, shortly before the summit, the European Commission launched a special task force—led by Horst Reichenbach, deputy head of the European Bank for Reconstruction and Development—whose aim is to act to improve growth and employment in Greece. Reichenbach's group will work closely with the Greek Government and other Member States, as the technical coordinator of the implementation of remedial programs in Greece. Reichenbach will assume the position in September, when the first actions of the task force most likely will occur. The activity of this group can contribute to better problem-solving, which is a condition for further tranches of aid to Greece. The group primarily acts to increase the efficiency of the cohesion policy, however, it is possible that the support will be broader. The very existence of this team under the strong leadership of the High Representative of the EBRD, can have a positive impact on the markets, however, but what will be crucial in the eyes of investors will be the effective implementation of consolidation and privatization, which seems questionable.

Conclusions. Prospects for developments in the euro area seem to be fairly pessimistic. The aid package did not solve the basic problem of Greece's lack of ability to repay its obligations in full. Even if it manages to reduce its debt to about 110%–120% of GDP, its prospects for further repayment remain negligible because of a lack of competitiveness in the recessed economy. A negative assessment of the plan became apparent in the reactions of the financial markets to the cost of debt in Italy and Spain, in particular, which returned in an extremely short time to pre-summit levels. Given the current calm—even in the absence of an agreement on budgetary matters in the U.S.—a further worsening of the situation in the euro area is highly likely. The key to finding an exit from this difficult situation is to develop a bold, comprehensive plan with a profound restructuring of the Greek debt and the protection of other economies struggling with a difficult fiscal situation before there is an expansion of the crisis.

The Polish Presidency of the EU Council, despite its ambitions, probably will not be allowed to discuss issues related to the debt crisis in the euro area because it does not have the common currency and, therefore, has no right to sit in on the decision-making bodies of the euro area. This does not mean that Poland—regardless of the fact it is in the leadership of the EU Council—should only passively observe developments, but rather it should strive to make its voice heard and show that in the long run its proposals were considered and implemented at the EU level. However, this will require determination in Warsaw's short- and long-term economic and political goals at the European level. One of those goals should be the active participation of Polish experts who have experience in the transformation of the Polish system in the Greece task force. Another activity could be to have close cooperation with the European Parliament (Committee on the Financial, Economic and Social Crisis) and the European Commission in preparing proposals for crisis management in the euro area. In this way, Poland would validate its professional approach not only in the area of Greek debt but also in the broader context of economic governance in the EU, thereby legitimizing its right to have a voice on economic issues.

Above all, Poland should set an example to other countries through a profound reform of national public finances. Such measures appear to be necessary with an apparent economic slowdown on the horizon, which might entail a worsening fiscal situation for the state. Therefore, the announcement by Minister Jacek Rostowski to reduce the public finance deficit to 0% by 2015 and make a prominent reduction of the debt-to-GDP ratio should be evaluated positively, provided the announcement will be backed by actions. The government also should strengthen the macroprudential supervision of the financial sector in Poland. In this context, it should seriously consider creating a new financial market supervisory authority, acting on similar terms to the European Council of Systemic Risk, with a leadership role at the NBP—a plan recently postulated by NBP President Marek Belka.