An uncontrolled European crisis?

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The speculative attack against Italy this week makes it clear that the real problem that Europe faces today is no longer to avoid the crisis – it is there already – but to go through it under reasonable control. The primary obstacles to a suitable solution are the international bureaucrats from the European Central Bank and from the IMF, who reject the managed restructuring of the debt, and the Institute of International Finance that wants to reduce the cost of the restructuring for the major banks which represents more than it is already being reduced.

Greece is today in a position of insolvency. The IIF's document acknowledges this fact. In view of the situation, the only reasonable solution to the problem is *default* and debt restructuring – the reduction in the total amount to be paid and the extension of the payment term – made in a negotiated and orderly way. Germany put forward this solution, which would share the losses between the states and the banks. The banks rejected the proposal with the support of the European Central Bank, of the IMF, and of the European Commission, and, three weeks ago, the German proposal was discarded for an alternative according to which the major banks would participate in the total support of €115 billion, by replacing their €30 billion short-term credits with long-term credits at a discount. The IIF now gives its answer. It wants to annul or reduce part of Greece's €350 billion public debt. It agrees, therefore, with the restructuring it had refused, but it wants the public sector to pay the loss sustained by the banks when they lent money to Greece.

The opponents of restructuring argued that the contagion of Greek restructuring would affect other countries. But this is already happening, and is reflected in the high interests that the other affected European countries are being forced to pay. Now, with the leak of IIF's document, Italy is the new target. Due to the public debt overhang, the interest rates on its securities increased dangerously. It seems that IIF went too far. This weekend, faced with the worsening of the crisis, European Finance ministers are reconsidering the restructuring proposal, now called “selective default”, which will force the creditor banks to accept the discount. And the IMF finally indicates that it favors this solution.

The restructuring of the Greek debt controlled by the European Union, the BCE and the IMF is no guarantee that the crisis will be peacefully overcome, because the risk of contagion will always exist, and because the solution will be a partial one. It solves the problem of Greece's public debt, not of its private debt. Nor does it solve the problem of excessive production costs in the other debtor countries, because the increase in wages in those countries was higher than the increase in productivity, whereas the opposite was taking place in the European creditor countries, which resulted in the implicit overvaluation of their exchange rate. The solution merely provides an organized solution to part of the problem. Let's hope that the other part – the necessary depreciation – will be gradually settled through the adoption of austerity plans by the governments, and through productivity increase in the enterprises. The essential thing is to keep the European economy under control.