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An Unlawful Bailout

By SANDEEP GOPALAN

The details might still be uncertain, but the European Union appears determined to bail out Greece. The problem, though, is that such a move would be illegal.

To be sure, Greece needs help to prevent the contagion of sovereign-default risk to the other euro-zone countries with special borrowing needs—commonly referred to as PIIGS (Portugal, Ireland, Italy, Greece, and Spain). But the EU should not and cannot be the knight in shining armor. That role belongs to the IMF.

The Treaty of the European Union makes it illegal for the EU as a whole *and for individual member states* to come to the rescue of EU countries in financial trouble. Article 125 clearly says that the "Union shall not be liable for or assume the commitments of central governments . . . or public undertakings of any member state." Likewise, "a member state shall not be liable for or assume the commitments of central governments . . . of another member state" In order to prevent moral hazard, the treaty unequivocally rejects any wealth transfers to reward the spendthrifts.

Proponents of a bail-out for Greece, though, point to article 122 as the legal justification for the EU to act. This flies in the face of a plain reading of that article, which does allow for financial assistance but *only* if the member state's difficulties are "caused by natural disasters or exceptional circumstances beyond its control." No

doubt Greece's difficulties are severe. But they were not caused by any force majeure. Greece's troubles are very much homemade and the result of reckless economic policies. A bloated and inefficient public sector (willing to trigger crippling strikes at the very mention of austerity), to name just one of the country's many problems, is certainly not "beyond its control." A declaration attached to the Nice Treaty specifically says that article 122 must be read so as to be compatible with the no bailout rule in article 125. But the EU has a record of selective application of its own rules.

An illegal bailout for Greece would only continue the sort of disrespect for the law that directly contributed to this fiscal mess in the first place. It is because the euro zone has failed to enforce its Stability and Growth Pact's fiscal requirements—a debt-to-GDP ratio of below 60% and deficits of below 3% of GDP—that Greece now finds itself in this vicious debt spiral. But virtually every state is in breach of one or both requirements. This sort of lax enforcement combined with poor monitoring of budget numbers dished out by rogue states like Greece has now exposed the euro to a possible collapse.

Greek bad faith also rules out a European intervention as a practical matter. Athens has repeatedly lied about its budget. The current estimate of the public deficit—12.7% of GDP—is twice that forecast by the previous government.

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Given its track record of dodgy accounting and disclosure, how do we know whether even the record 12.7% figure isn't overly optimistic? Prime Minister George Papandreou says that he is making a clean breast of things. But unless Greece commits to better reporting and strict monitoring without immediately complaining about losing sovereignty, Greek numbers cannot be trusted. And unless those who cooked the books are brought to justice, Greece's Enron-like accounting culture will continue.

Part of the problem is structural. Concentrating monetary policy in the European Central Bank without a fiscal policy union was bound to lead to disaster. One way around this problem would be to agree on a significant constitutional change and transfer control over fiscal policy to the EU. This would be a massive step in the direction of deeper integration—almost a United States of Europe—and would allow for the kind of wealth transfer required for a bailout. This is, however, a political nonstarter. No member state would give away so much sovereignty to Brussels. So, a U.S.E. will have to wait for now.

The only clean option is for the IMF to step in. The Washington-based institution has a proven track record in rescuing states, particularly those with bloated public sectors and state-owned white elephants. India offers a good example of successful IMF intervention in the 1990s, and there is no reason why the same medicine cannot be applied to Greece.

Greek concerns about stigma and loss of sovereignty are misplaced. Everyone but the most pig-headed trade-union leader agrees that drastic measures are necessary. These must include wage cuts, higher retirement ages, and longer hours of work. As for Greek sovereignty concerns, bringing in the IMF would only be a consequence of Greek loss of fiscal control, not its cause. Greece already lost its financial sovereignty as a result of years of deficit spending. Now is the time to accept responsibility and take corrective action.

Bringing in the IMF will also offer political cover for the Papandreou administration to undertake the necessary but unpopular reforms that could

actually restore Greek sovereignty.

The IMF will also be better at policing Greek promises than the EU. Legal reforms mandating transparency and fiscal responsibility have always been essential components of every successful IMF rescue package. Desperate borrowers will sing whatever tune pleases reluctant lenders; the critical task is to ensure that those promises are kept with the threat of sanctions. Given Greece's record of financial fraud, sunshine has to be the largest component of the bailout. Otherwise, the same mistakes will be repeated and we will be history's fools.

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