The Bad “Lesson” of The EU Debt Crisis Is That There Will Always Be A Bailout

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WASHINGTON – The situation in Europe turned from really dramatic into just chronic. No more talk of a “Greece Exit”. There are no defaults on the horizon. Still, there has been no qualitative change. Therefore it would be highly deceptive to call this calmer state of affairs a real improvement. The reality is that Southern Europe cannot travel at the same speed of its better organized Northern counterparts relying on its own means. This means that Club Med will have to receive aid and/or special treatment for a long, long time. Who knows, may be in perpetuity.

Bailout does not affect the fundamentals

Mostly for political reasons, wealthier Northern Europe (read: Germany) decided that it was and still is in its own self-interest to bail out its Southern poor, and perennially disorganized, cousins. Better to pay now, then to face the headwinds and possible chaos that may result from a sovereign debt default.

Still, nobody believes at this juncture that the bailout money and/or the indirect fiscal support via ECB bond buying programs or easy credit to battered banks will cause a real qualitative transformation within the South. While economic conditions may improve somewhat, the fundamentals remain bad. For example, Sergio Marchionne, the CEO of FIAT, still the largest Italian industrial conglomerate, in a call with analysts indicated that “***Italy continues to have an impossible***

environment for industry”.

Now, consider this rosy assessment on the economic fundamentals within the third largest Eurozone economy, coming as it does from a pretty seasoned practitioner. How is a profoundly uncompetitive country that continues to have impossible conditions for industry (i.e. growth) going to produce the extra wealth that will allow it to get out of its impossibly high national debt? The simple answer is: “Never”. Italy will probably limp along, supported by ECB bond buying and some other half measures. It may not drown, but it will never become an energetic, competitive economy. In other words, thanks to extra help it will not go under, even though the best it can hope for is survival.

Everybody gets a rescue package

And here comes the real point. If you are a policy maker in Slovenia, Poland or Hungary, having noted that Germany decided that Greece and the others are indeed “too big to fail”, you will conclude that, if your country gets into serious trouble, it will be considered too big to fail, just like all the others. Help will come. You will not be allowed to go under. This “message” unfortunately has a perverse effect, because it diminishes the pressure on other mediocre economies to get busy in order to jump-start serious growth.

Michigan allowed Detroit to go under, a lesson for all other troubled municipalities

In a different, but somehow related, context the State of Michigan allowed battered Detroit to go under. Michigan decided that its own domestic “Greece” was not “too big to fail”. It did not bail it out. It forced it into bankruptcy. The just initiated bankruptcy process in turn allowed the rest of America to see and evaluate the compounded effects of unfavorable economics and bad public administration, combined with over generous pensions to public employees.

As a result, local administrators in Chicago, Oakland and other challenged cities now have a strong extra incentive to get their own house in order. If Detroit is not “too big to fail”, chances are that their own municipalities, all of them headed Detroit’s way, may also go under. Therefore some at least may conclude that it is time to get busy and make changes, (renegotiating unsustainable pension benefits would be a good start), before it is too late.

Rescue packages are a disincentive to implement reforms

In contrast, policy-makers in Europe get essentially the opposite message. ***“Your countries are perennial economic under achievers. Your public accounts are headed the wrong way. But not to worry. Just as they did with Greece, the wealthy Northern partners will bail you out”.*** If this is indeed the “lesson” of the catastrophic debt crisis that began back in 2009, then you can bet that with the exception of a more solid North most of Europe will lack the incentive to do better and therefore will continue to underperform.