The rain in Spain… February 13th 2010

The debate over the legality of the UK government taking the country to war with Iraq is about to be eclipsed by the decision the EU will have to make over bailing out the Greeks. Of the 10 options listed by "Open Europe" (www.openeurope.org.uk/research/greecebailout.pdf) only one is strictly legal; the early release of cohesion funds.

As Open Europe describe it - "An early release of cohesion funds to Greece under the EU's structural funds or through the involvement of the European Investment Bank (EIB) has been mentioned as a way to bailout Greece. Greece is one the largest recipients of EU subsidies. The 2007-2013 EU budget allocated €20.2 billion in structural funds to Greece, with some €18.1 billion of this still to be paid out. The disbursement of the remainder of these funds could be fast-tracked to provide Greece with extra cash in case of a liquidity crisis. This has already been done under the EU's economic stimulus package for central and eastern European members, to help them cope with the economic downturn. Fast-tracking the payment of the structural funds can be decided by the European Commission, so it would be by far the easiest option to execute."

They go on to say that – "In one sense this operation would be budget neutral as the funds are already allocated to the EU budget. But in another sense, there is a de facto cost to taxpayers for raising the funds in the first place. In addition, the early release of structural funds would effectively reward Greece's mismanagement of its economy, which in turn raises moral hazard concerns and sends the wrong signals to other countries. Greece also has a weak track record in absorbing the structural funds and allocating money to value-added projects, which begs the question of how effective the funds would be."

So the only legal option under the current EU constitution is of dubious merit as the Greeks would not be under any obligation to take steps to "balance their budget". Of the other nine, four come in the category of probably not legal, in two cases it is unclear and in the remaining three the answer is "no". The EU response has been greeted like a limp handshake, but the truth is that they don't have one that's legal or that they could sell to their voters.

Re-jigging the constitution is going to take the agreement of all member states, which is highly unlikely when they realise that six of the 10 options would involve their own taxpayers footing the bill, and there isn't the time to achieve it anyway. Things will start going downhill very fast if a cunning plan is not devised in the next week or so.

There are of course two other options which have no legal ramifications for the EU but some significant political and economic ones. The first is to let Greece go bust. It only accounts for 3% of EU GDP and the European banks are not in for anything like the write-offs they have suffered so far. Some pundits feel that we need another "Lehman Bros" to set an example. That could turn out to be a classic nose cutting exercise; not that letting Lehman go in the first place wasn't one either.

European CDS rates have come off the top but imagine the carnage the Bond Vigilantes would cause if they realised the cavalry wasn't going to arrive; it wouldn't just be rain falling mainly in the plains. The non-nuclear option would be to let the IMF handle the issue but as the Economist commented: "Pride is at stake. To turn to the fund for aid would be a humiliation for Europe, never mind the Greeks." The Greeks know all about hubris – they invented the word.

So in this third week of February we will all be living in very interesting times. Sitting here in the UK on a grey and cold Sunday morning it seems that it is not just the weather that is going to suffer a prolonged freeze.

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