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Columnists

This bailout is not enough to save the euro

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Ireland, Greece and Portugal will never recover locked in the single-currency straitjacket

The Irish Government will, despite its initial reluctance, be bailed out by the EU and the IMF. But rather than solving Ireland's economic problems, this rescue package merely defers them.

Ireland is in a mess. Its economy shrank by more than 10 per cent last year, after a fall of 3.5 per cent in 2008. Bad debts have rocketed, property prices, on some estimates, are down by half and unemployment is approaching 14 per cent. In September last year the Irish Government announced that guaranteeing its banks could cost €50 billion, a third of GDP. These estimates pushed the deficit-to-GDP ratio to 32 per cent, undermining the solvency of the State.

Ireland needs growth to get out of this, but being part of the euro makes that difficult. Although the country is highly unlikely to leave the eurozone in the immediate future, the need to be free of its straitjacket will prove hard to resist if the economy fails to recover. Leaving may be necessary if Ireland is to maintain fiscal sovereignty, improve competitiveness and stimulate growth.

Recovery will also be difficult if France and Germany insist that, as a condition of the bailout, Ireland must increase its competitively low 12.5 per cent corporation tax rate. Such a move would undermine its attractiveness to overseas investors and foreign multinationals — the one aspect of the Irish economy that has proved successful in recent years.

The bailout was designed to reassure the sovereign bond markets that financial "contagion" would not spread from Ireland to Portugal and Spain, which also have huge debts.

But we should be sceptical about whether this will work, for the problem goes deeper than Ireland. Granted, market confidence was damaged by Angela Merkel's comments this month that bondholders would have to take some of the financial pain. But this is not the underlying reason for market nervousness about Ireland, Greece, Portugal and Spain. The markets worry about whether any of these states are solvent and have any prospect of growth in the euro. All these countries have different problems, but all their prospects are diminished by being in the euro.

With each new set of figures the situation looks worse in Greece, a country suffering from a heady combination of gross mismanagement of its public finances, an inadequate tax base and a basic lack of competitiveness. Eurostat recently revised the deficit-to-GDP ratio from 13.6 per cent to 15.4 per cent for 2009. Greece's ability to deliver the austerity measures promised in return for May's €110 billion EU-IMF rescue looks more unlikely. Austria has suspended contributions because of its doubts.

Portugal's problem is lack of competitiveness — its economy failed to grow even in good times — coupled with high public sector debt, while Spain's inflexible labour markets (unemployment is 20 per cent) and sclerotic economy are coupled with a collapse in the property market.

The EU may hope to stop "contagion" spreading, but there is increasing speculation that Portugal will need a bailout. That would be manageable. But what about Spain? There are doubts over whether the EU and the IMF would have the resources left in the €750 billion rescue fund set up in May. Bailing out Italy, if the need arose, is simply out of the question.

All that these bailouts can achieve is to buy time. They do not solve the eurozone's basic problem that it is dysfunctional. No bailouts can stop economic reality from tearing it apart.

Before the launch of the euro in 1999, Europe's politicians were warned about the lack of economic convergence, but such worries were tossed aside — euro membership would somehow, by Harry Potteresque magic, "force" it. This did not happen. The German economy became no more Greek than the Greek one became German. On the contrary, the imbalances are worse now than in the late 1990s. Short of full fiscal union, which is not on the cards, this cannot last indefinitely.

Whether you talk to fund managers or City economists, speculation is growing that the eurozone will break into a core and a periphery, or that the weaker countries will unilaterally peel off. Such thoughts were considered high treason as recently as the beginning of this year. But analysts see the economic troubles in the weaker countries and speculate that the pain will become intolerable, rather as Britain's did in the ERM in 1992, and that these countries will head for the exit. The odds that Greece, Ireland, Portugal and, perhaps, Spain will leave the eurozone within the next three years, or maybe sooner, are shortening by the day.

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