Online Appendix to

# The Political Economy of the Greek Debt Crisis

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## OA1: Major bills passed in March 2010-March 2011

2010

3 March: bill on Hellenic Statistical system and authority
23 March: bill on a new system to select heads of units in civil service
24 March: bill on decentralizing and making more efficient procedures connected with the National Strategic Reference Framework
20 April: bill on tax reform
27 April: bill on liberalizing the provision of services in the internal market
4 May: bill on flexibility and security in labour market
11 May: bill on the new school (rules for hiring assessing performance of teachers and school units, meritocratic selection of head of units)
18 May: bill amending provisions of early legislation and of the penal code in corruption
1 June: bill on the restructuring of regional and local government and the decentralization of public administration (Kallicrates law)
7 June: set-up a single payment authority for general government employees
8 June: bill on simplification of business start-ups
5 July: bill on transparency of public administration and online publication of general gov. decisions
12 July: bill on pension and labor legislation reform
13 July: bill on financial stability fund
30 July: e-census of general gov. employees
15 July: social partners sign the private sector 3 year wage agreement on minimum wages and wage growth
16 July: bill on public sector (central government) pension reform
31 Aug: bill on rules on sea cruises
31 Aug: set-up of a structure of 5 task forces to fight tax evasion and improve tax compliance
28 Sept: bill on liberalisation of commercial road transport
26 Oct. Bill on restructuring and consolidation of state-owned enterprises and railways
23 Nov.: ill on electronic monitoring of doctors' prescription
1 Dec: closure of 18 public sector entities and merging of 13 into 5
13 Dec: Bill on rationalising procedures and speeding up administrative trials

2011

15 Feb: bill on structural changes in health system
22 Feb: bill on the opening p of closed professions

10 March: publication of law setting up 1 single authority for fighting money laundering ad checking asst statements of individuals
31 March: publication of law fighting tax evasion and restructuring of public administration

Source IMF, Bank of Greece, Greek Finance Ministry

**OA2: Major reforms passed in March 2010-March 2011**

Pension reform: combination of measures reducing the actuarial deficit by 2060 by 10ppt of GDP. Retirement age raised to 65 years and 40 years of work required for full pension. Pension benefits linked to lifetime contributions, retirement penalties increased and voluntary exit plans abolished

Labour market reform: fully symmetric arbitration system, reduction in severance payments by 50%, cut in overtime remuneration by 20%, extension of probation period from 3 to 12 months, increase of permissible dismissals from 2% to 5% per month; promoting part-time employment, firm level agreements

Independent statistical authority: president and majority of board appointed by a 4/5 majority of parliament; full validation of data by Eurostat after reform
Fiscal management: medium-term fiscal framework introduced; parliamentary budget office, expenditure monitoring mechanism strengthened by creating a commitment registry and imposing binding expenditure ceilings in ministries

Tax reform: new management information systems, a special administrative structure to assist reform, shortened judicial procedures for tax cases
Tax evasion: 3.4bn of fines (+182% relative to 2009). Increase in audits on self-employed professionals and penalties for undeclared assets (555 yachts seized, 10mil in fines for offshore real estate assets)

Local administration reform: reduction of number of municipalities from 1034 to 325; decrease in local authority entities from 6000 to 2000; decrease in elected officials from 30795 to 16657; abolishment of 30000 working positions in prefectures; fixed term contracts reduced by 50%

Health sector: reduction in average expenditures by 30% yoy. 10 hosptials out of 133 to be merged.

Online publication: of all decisions involving commitments of funds in general government sector

Simplification of the start-up of new business: set-up in 1 day from 19 days

Liberalization of road haulage sector: unlimited licenses with fees gradually declining to zero from Jan 2011 to June 2012

Liberalization of closed professions: new law imposes default of opening effective July 2011 and covers 150 professions: reversal of the burden of proof for retaining restrictions

Abolition of cabotage restriction to boost cruise tourism

Source IMF, Bank of Greece, Greek Finance Ministry

# OA3: Review of Press Commentary on the May 2010 Greece bailout

In the next few tables we review commentary from The Economist, The Financial Times, The Wall Street Journal, The Financial Times Deutschland (which sells 101,981 copies a day from Monday to Friday and since 2008, is fully independent from the London Financial Times), Handelsblatt (138,039 copies a day from Monday to Friday and is the largest German business and economics daily), Der Spiegel (an influential weekly news magazine that sells 906.804 copies per week), Le Monde, and Les Echos.

The first set of tables covers commentary in May 2010. The announcement from the EU and IMF to provide €110bn of loans to Greece came on May 2nd. The announcement that the ECB would commence its Securities Market Program together with the creation by the Eurozone countries of the temporary loan facility, the EFSF, came a week later on May 9th.

The overwhelming majority of the comments indicates that the author is skeptical as to the chances that the agreement will result in Greece stabilizing its debt dynamics.

The second set of tables covers commentary in late 2010 – early 2011. The announcement from Eurostat that Greece's 2009 deficit would be revised upward from 13.6% to 15.4% came on November 15th 2010. Analysts at the time said this would have limited impact since a revision was widely expected.[1]

In the Tables, a "successful bailout" is defined as one in which no further financing is required from the official sector, there is no restructuring and Greece returns to private sector borrowing according to the details of the program.

[1] See http://uk.reuters.com/article/2010/11/15/uk-greece-economy-idUKTRE6AE21H20101115

| | | | The chances of a successful May 2010 bailout | | | | |
|---|---|---|---|---|---|---|---|
| Publication | Date | Article | More likely to fail | Ambiguous | More likely to succeed | Reason | Suggestions of policy makers' true goals |
| The Economist | May 2 | The EU Rescue for Greece | ✓ | | | Not enough time to regain market confidence; adjustments to take place during a large contraction. | "Shock and awe" markets with a big number, so that Greece and its toxic public finances are ring fenced behind a wall of political will. |
| The Economist | May 4 | The Crisis is Catching | ✓ | | | Interest rate is too high relative to the growth rate. | Prevent further contagion. |
| The Economist | May 6 | Coming to a City Near You? | ✓ | | | Debt overhang too great; large and sharp fiscal adjustment needed. | Prevent further contagion. |
| The Economist | May 10 | Markets Soar | | ✓ | | The ECB's bond buying announcement amounts to a closer fiscal union but German voters may be against the move. | n/a |
| The Economist | May 11 | Crisis Averted? | ✓ | | | Fiscal adjustment too great; possibility of weaker than forecast growth; weak regional growth. | "Prevent a meltdown". |
| The Economist | May 13 | Emergency Repairs | | ✓ | | The recent actions buy time for adjustments to be made but this time may be wasted. | Prevent further contagion. |
| The Economist | May 20 | Europe's 3 Great Delusions | ✓ | | | Debt overhang too great. "Greece's debt problem is one of insolvency, not illiquidity." | n/a |
| The Economist | May 24 | Bad News for Everyone | ✓ | | | The Short term fiscal adjustment required is too | n/a |

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| | | | | | | great. | |
| The FT | May 2 | Europe's Choice is to Integrate or Disintegrate | ✓ | | | Debt overhang will be too great at the end of the deal. | Prevent further contagion; maintain the Euro. |
| The FT | May 4 | A Bailout for Greece is just the Beginning | ✓ | | | Overly optimistic growth forecasts; unfavourable conditions for fiscal consolidations. | Bailout of creditor banks. |
| The FT | May 9 | America has Good Reason to Worry About Greece | ✓ | | | Debt overhang too great. | Delay making decisive action. |
| The FT | May 10 | Greece's debt | ✓ | | | Debt overhang too great. | n/a |
| The FT | May 16 | Eurozone Crisis Averted – For Now | ✓ | | | Debt overhang too great. | Delay an inevitable sovereign restructuring which will take place sometime between 6 and 18 months. |
| The FT | May 18 | Eurozone plays "beggar my neighbour" | ✓ | | | Poor growth; lack of substantial devaluation. | Buy time before a restructuring. |
| The Wall Street Journal | May 2 | The New Greek Math – Part II | ✓ | | | Possibility that €110bn will not be enough to cover Greece's financing over 3 years. | n/a |
| The Wall Street Journal | May 4 | Greece's Costs Seen Exceeding EU-IMF Help | ✓ | | | Greece will not be able to return to private sector borrowing according to the program schedule. | n/a |
| The Wall Street Journal | May 8 | Euro Zone Pledges Bailout Fund | | ✓ | | Written in anticipation of an announcement over the coming weekend so refrains from making judgement but | Prevent a banking crisis in France and Germany whose banks own large amounts of Greek debt. |

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| | | | | | | described Europe’s response thus far as “muted” and remarks that delays have dented investors’ confidence in EU crisis management. | |
| The Wall Street Journal | May 18 | Greek Myths and the Euro Tragedy | ✓ | | | “Germany and France simply cannot borrow or tax enough to cover Europe's debts and looming deficits;” poor growth; Greece is being forced to borrow short term, not long term, debt. | Save the Euro; prevent contagion and systemic risk; save the banks. The author John Cochrane questions the logic of each of these claims. |
| The Wall Street Journal | May 21 | Privatization can Help Greece | ✓ | | | Debt overhang too great; inflexibility of the Euro makes adjustments difficult. | Force other EU governments, especially Spain, to tackle their deficits. |
| The Wall Street Journal | May 28 | Greece May Yet Have to Restructure Its Finances | ✓ | | | Debt overhang is too great; fiscal adjustment too great; weak domestic growth; | As the ECB is buying Greek government debt, a restructuring will be easier in the future. |

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| Financial Times Deutschland | May 4 | Griechenlands Anleihen erholen sich kräftig | | | ✓ | Greek bond spread falling, Greek bankruptcy "practically impossible in next three years" (LBBW bank economist). | |
| Financial Times Deutschland | May 4 | Spekulanten gehen aufs Ganze mit Anti-Euro-Wette | ✓ | | | Deficit crisis will spread to other Eurozone countries and Greek debt is too great. | Buy time. |
| Financial Times Deutschland | May 5 | Märkte misstrauen Griechenland | | ✓ | | Fiscal adjustment too great; credits to don't cover Greek requirements. | Calm Eurozone bond markets. |
| Financial Times Deutschland | May 4 | Hungerkur für Griechenland | | ✓ | | Fiscal adjustment may be too great. | |
| Financial Times Deutschland | May 10 | Gestärkt wider Willen | | ✓ | | Unclear how bond markets for Spain and Portugal will react, crisis may spread. | |
| Financial Times Deutschland | May 10 | Kalte Insolvenz für die Griechen | ✓ | | | Restructuring will be necessary. | Buy time. |
| Financial Times Deutschland | May 11 | Ende der deutschen Schulweisheit | ✓ | | | Bankruptcy only delayed. | Buy time. |
| Financial Times Deutschland | May 11 | Euro um jeden Preis | ✓ | | | Greek fiscal adjustment too great. | Mistaken belief in the importance of the Euro for the Eurozone economies. |
| Handelsblatt | May 3 | Deutschland hilft! | | ✓ | | Fiscal programme a “good sign.” | |
| Handelsblatt | May 3 | Jetzt beginnt der Countdown | | ✓ | | Greek fiscal adjustment and public inefficiencies may be too great. | |
| Handelsblatt | May 5 | Bis an die Schmerzgrenze | | ✓ | | Fiscal adjustment may be too great. | |
| Handelsblatt | May 7 | Wer ist der Gewinner der | | ✓ | | Fiscal consolidation is key. | |

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| | | Krise? | | | | | |
| Handelsblatt | May 7 | Fatalismus ist beim Euro fehl am Platz | ✓ | | | Restructuring will be necessary. | Buy time. |
| Handelsblatt | May 7 | Merkel muss die Wahrheit sagen | ✓ | | | Restructuring will be necessary. | Further measures would be unpopular with the German electorate. |
| Handelsblatt | May 11 | Der Euro wackelt wieder | | ✓ | | Fiscal adjustment may be too great. | |
| Handelsblatt | May 28 | Mit Donald Rumsfeld den Weg aus der Finanzkrise finden | | ✓ | | Unclear whether Greece will need restructing in the future („know unknown“). | Buy time. |
| Der Spiegel | May 10 | Der Stab ist gebrochen | | ✓ | | Fiscal adjustment may be too great. | |
| Der Spiegel | May 17 | Der ausgehöhlte Euro / "Wir haben nur einen Schuss" | ✓ | | | Need further action by ECB. | Avoid general financial collapse. |
| Der Spiegel | May 31 | Schlimmer Verdacht | ✓ | | | Greek fiscal adjustment too great; need restructuring or monetary policy in future. | |

| Publication | Date | Article | More likely to fail | Ambiguous | More likely to succeed | Reason | Suggestions of policy makers' true goals |
|---|---|---|---|---|---|---|---|
| Le Monde | May-05 | Greece: A European Tragedy | X | | | Fiscal austerity will suppress domestic demand. Debt overhang will be too great. Growth is slow in Europe relative to other large regions. Author suggests that the answer lies in flexibility of prices and wages (market economy). | N/A |
| Le Monde | May-09 | Economy; one half? That makes 15 francs Monsieur! | X | | | It's impossible to reduce the Greek deficit by 11 points of the GDP. Deflation. | Prevent the collapse of Greece |
| Le Monde | May-11 | A Shock Treatement that Doesn't Cure | X | | | The bailout plan will ease the crisis but not solve it. It does not correct the structural problems of the monetary union such as the lack of economic governance and fiscal solidarity, competitiveness gaps between countries, growth problems, and solvency problems of Southern countries. | Avoid collapse of Euro, prevent future contagion. |
| Le Monde | May-11 | Greece: why the plan will fail | X | | | The plan doesn't include debt restructuring. Economic slow-down because of the strict austerity | Avoid contagion |

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| | | | | | | measures | |
| Le Monde | May-18 | The long crisis of Europe | X | | | The bailout plan ignores the problem of solvency and the transitory problem of liquidity. | Maintain the Euro |
| Le Monde | May-18 | Chronicle of the week: The banks are what was saved, not Greece | | X | | The author talks about the uncertain monetary consequences of the bailout on the Euro. The article focuses on the intentions of the German Chancellor for "saving Greece" | Merkel needed to bailout Greece because the greek debt is held by German Financial institutions. 28 billion euro of greek debt are on the balance sheets of German institutions, half of which are owned by the German government. Therefore a collapse of the Greek economy would directly affect the German tax payer. According to the author, Germany prefers to justify the "heroic" act of saving Greece instead of admitting that saving the german banking system in 2008/2009 didn't fix the problem. Same applies to the French. " The Franco-German solidarity that was put forward on 9 May, is not based on hellenophilia. Far from being a new crisis, the euro crisis is an extention of the 2008 banking crisis." |
| Les Echos | May-03 | Interview: The Greek austerity measures are | | | X | Liquidity problem will be solved for the next three years. Even though the question of solvency | N/A |

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| | | ambitious and more realistic than the past ones | | | | remains unanswered and the ability of Greece to repay its debt is uncertain, the bailout is a lifeline. | |
| Les Echos | May-04 | The Greek Bailout plan is good for the Creditors | | X | | A restructuring of the debt is more fair (creditors will be held accountable and will help future creditors to be more responsible) and possibly more effective than the bailout. | States are intervening on behalf of the creditors where public money will be used to pay short-term interest for the creditors. |
| Les Echos | May-05 | Europe caught in Greek debt | X | | | The plan delays the immadiate risk but does not solve the problem of the Greek debt (only buys time). Debt overhang is too great. | Prevent furthur contagion. |
| Les Echos | May-06 | Why the Economy will plunge | X | | | Austerity measures will affect household income and contract demand, not only in Greece but also in Europe because of the similar austerity measures in other European countries. | Prevent furthur contagion. |
| Les Echos | May-07 | The Escalations of the Greek Crisis Seem Uncontrollable. | X | | | Markets are not reassured. Austerity conditions might lead the country into recession. | N/A |
| Les Echos | May- | German Fantasies | | X | | The decision has achieved its role | The ECB is not independent of Germany in the sense that the bailout |

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| | 19 | | | | | of calming the markets for now. | decision was triggered by historical German fears of hyperinflation even though other Europeans don't share the same concerns. |

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| The Economist | Dec 29 | In a Spin | ✓ | | | Interest rate too high | The May bailout bought time. |
| The Economist | Jan 13 | Bite the Bullet | ✓ | | | Debt overhang is too great; debt servicing will be too great in the medium term. | n/a |
| The Economist | Jan 13 | Time for Plan B | ✓ | | | Debt overhang too great; the contradiction of policy makers who had wanted to prevent default in the short term while restructure debts in the medium term. | Default in May could have plunged Greece into chaos, lead to a bond crisis and a banking catastrophe; the loans prevented Greece from defaulting in the short term before a later restructuring. |
| The Economist | Feb 3 | Repayment Days | ✓ | | | Debt overhang too great; Annual budget surpluses would need to be too high to maintain sustainability | At the time of publication, the article claims that France and Germany want to arrange an orderly restructuring of Greece’s debt. |
| The FT | Nov 28 | Europe is Edging Towards the Unthinkable | ✓ | | | Debt overhang is too great. | n/a |
| The FT | Dec 14 | Germany Must Lead Fightback | ✓ | | | Debt overhang is too great. | The “wait-and see” attitude and a lack of political courage is preventing an inevitable restructuring (the authors are Frank Walter Steinmeier and Peter Steinbruck of the SPD). |
| The FT | Dec 16 | The European restructuring should not be “too” easy | ✓ | | | n/a | A restructuring should not have been “too” easy because of moral hazard issues. |
| The FT | Feb 8 | Greek debt and the | | | | Debt overhang is too great; | n/a |

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| | | “grand bargain” | ✓ | | | large long term budget surpluses required for sustainability are unprecedented. | |
| The Wall Street Journal | Nov 16 | Germany, Greece Grapple Over Debt | ✓ | | | The Greek government’s 2010 revenue will be much lower than originally projected; upward 2009 deficit revision. | n/a |
| The Wall Street Journal | Dec 14 | Greek Politicians Fail the Nation Again | ✓ | | | The lack of political consensus among Greece’s politicians and the indecisiveness of the ruling PASOK party. | n/a |

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| Financial Times Deutschland | Nov 17 | Die Hütchen-Spieler | ✓ | | | Greece is practically bankrupt. | Buy time. |
| Financial Times Deutschland | Dec 3 | Wer gegen die falsche Krise kämpft | | ✓ | | Using expansionary monetary policy, confidence may be restored and Greece bond spreads will lower in the future. | |
| Financial Times Deutschland | Dec 20 | Eine Fantastilliarde, bitte! | ✓ | | | Further financing will be required. | Calm Eurozone bond markets. |
| Financial Times Deutschland | Jan 12 | Höchste Zeit fürs Umschulden | ✓ | | | Restructuring will be necessary. | Buy time. |
| Financial Times Deutschland | Jan 18 | Beweglich bleiben | ✓ | | | Restructuring will be necessary. | Protect (German) banks and savers. |

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| Handelsblatt | Nov 15 | Schuldensünder Griechenland attackiert Deutschland | ✓ | | | Restructuring will be necessary. | Germany wants to avoid paying for other countries' debt without assurances of their fiscal adjustment. |
| Handelsblatt | Nov 18 | Schon wieder retten wir Europas Banken | ✓ | | | Restructuring will be necessary. | Protect banks and savers. |
| Handelsblatt | Jan 20 | Griechenland übertrifft Sparvorgaben | | ✓ | | Greek exports growing, but success of fiscal adjument is unclear. | |
| Der Spiegel | Nov 22 | Die unendliche Krise | ✓ | | | Debt crisis seems "infinte", measures do not go far enough. | Germany wants to avoid paying for other countries' debt without assurances of their fiscal adjustment. |
| Der Spiegel | Nov 29 | Außer Kontrolle | ✓ | | | Crisis is spreading to other Portugal and Ireland. Further financing needed for Greece. Greek bond spread too great for private market borrowing. | Buy time to involve private sector in the restructuring of Greek debt |
| Der Spiegel | Dec 6 | Europa brennt | ✓ | | | Greek debt too large, EU politicians do not appreciate extent of crisis. | Avoid general financial collapse. |
| Der Spiegel | Jan 24 | Modell Manila | ✓ | | | Greek debt too large and restructuring will be necessary. | Avoid general financial collapse. |

# OA4: Market Reaction to the May 2010 Bailout Details

Greece officially applied for a bailout on April 23rd 2010 and a formal agreement was formed on May 2nd 2010 but important details about the bailout were revealed both before and after these dates. This document attempts to interpret the market reactions to the publicly known details of the bailout agreement by analyzing the spread of Greece's 10-year bond yield over Germany's comparative 10-year bond yield. Figure OA1 shows graphically the spread during the first 6 months of 2010 and pinpoints when the major details of the bailout were revealed.

Following the October 2009 revision to the country's debt statistics, Greece began 2010 with the highest bond yields in the Eurozone. The Reuters news agency commissioned a poll of financial analysts in January 11th-14th that showed the median estimate for the probability for Greece seeking a bailout during 2010 was 20%.[2] Although this 20% figure helps to explain why Greece had the highest yield in the Eurozone, it also illustrates a certain optimism in the market that the unprecedented step of a bailout would not be required at all.

Speculation about the need and viability of a bailout had been present throughout the first months of 2010 with officials repeatedly declaring that the Greek government's efforts were sufficient to address the country's fiscal difficulties. One of the first signals that preparations were being made by governments for a future bailout was the declaration by the President of the European Commission José Manuel Barroso on March 22nd that bilateral loans would not breach the "no-bailout clause" in the Treaty of Lisbon. From the chart in the appendix, there appears to have been minimal reaction to this confirmation and one can therefore conclude that the market already believed that the treaties would not prevent European countries providing financial assistance in some form if they deemed it necessary.

The announcement of March 25th that the bilateral loans would be based proportionally on the ECB capital key and the commitment to additional IMF financing, should a bailout be needed, also appear to have had little immediate impact on the yield spread from the graph. For a variety of reasons such as the repeated visits by EU and IMF officials to Greece and further reports of the financial mismanagement by the Greek government, one could suppose that analysts' expectations in late March of the probability of a bailout would be at least the 20% suggested by the Reuters poll in January. Therefore, if these decisions were judged to be important by market-makers, they should have impacted the yield spread in some way.

At first glance, the next major detail of the bailout agreement to be publicized, the calculation of the interest rate on the bilateral loans, appears to have received a significant negative reaction as it was followed by a sharp rise the spread in the following 2 weeks. However, reports suggest instead that the market reaction on first working day after the interest rate announcement was actually somewhat favorable.[3] One must remember that the interest rate of "around 5%" had been negotiated *down* from the previous position, originally insisted on by Germany, of providing loans at "market rates". A number of other factors are much more likely to have led to the rapid rise in the bond yield spread through April. For instance, on April 9th Fitch downgraded Greek debt by 2 notches to BBB-. There was also a string of negative reports in the financial press claiming either that Greece's finances were unsustainable or that European politics would prevent a successful deal.[4] Finally, on April 22nd Eurostat again revised Greece's 2009 deficit upward to 13.6% from 12.7% of GDP.[5]

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[2] http://www.reuters.com/article/2010/01/14/us-markets-bonds-greece-poll-sb-idAFTRE60D43720100114

[3] http://www.businessweek.com/ap/financialnews/D9F1ECQ00.htm

[4] See The Economist articles *Not Enough* of April 12th, *Greece's Sovereign-Debt Crisis: Still in a Spin* of April 15th, *Charlemagne: Sticks and Bailouts* of April 15th and the Financial Times Articles *Greek bail-out teams face*

The full confirmation on April 23rd that a bailout of some form would take place would have come as little surprise to markets as the yield on Greece's 10-year bonds had already risen above 8% which was substantially above the "unsustainable" level. The announcement on Sunday May 2nd that €110bn loans would be provided by the IMF and the Eurozone countries over 3 years only marginally reduced the spread on the following working day and this reduction was cancelled out on Tuesday 4th. By the close of markets on Friday 7th, the yield spread had risen a further 380bps as the perception grew that the May 2nd deal would not be enough to prevent default. The yield spreads of Irish, Portuguese and even Spanish bonds over German bonds also widened which showed that the bailout also appeared to be failing at preventing contagion.

European-wide market fears finally showed some signs of abating when the ECB declared that it would purchase an unspecified quantity of Greek bonds in the secondary market. Having publicly stated only several days earlier that the central bank would not engage in such a program, this action shocked the markets. The officials were now seen to be prepared to take the unprecedented steps required to protect private bond holders. Whether investors believed that this action made Greece's debt dynamics substantially more sustainable is perhaps another question.

The only other major detail not mentioned thus far is the decision that a bailout would not involve a private sector restructuring. Bluntly, a restructuring was never considered by officials. "That is not something we are working on," the IMF's managing director Dominique Strauss Kahn stated in an April 22nd press conference.[6] A full verification of this claim only came with the May 2nd agreement but markets were unlikely to have expected a restructuring before this point because even the most lenient private sector involvement would have required lengthy consultations with creditors which would have inevitably been publically known.

Overall, many of the main details of the bailout appear to have had little effect on the Greece-Germany bond yield spread. The ECB's decision to buy Greek bonds proved to be a significant shock to the markets but the other details were considered somewhat predictable given the circumstances. The general rise in the spread over the first 6 months of 2010 (and after) can more likely be accounted for by a growing realization of the perilous state of the Greek government finances and the difficulties of undertaking such an unprecedented fiscal adjustment. Despite the loan of €110bn from official creditors and the ECB's decision to purchase Greek bonds, as the graph in the appendix shows, the yield spread quickly returned to its upward trend after the bailout.

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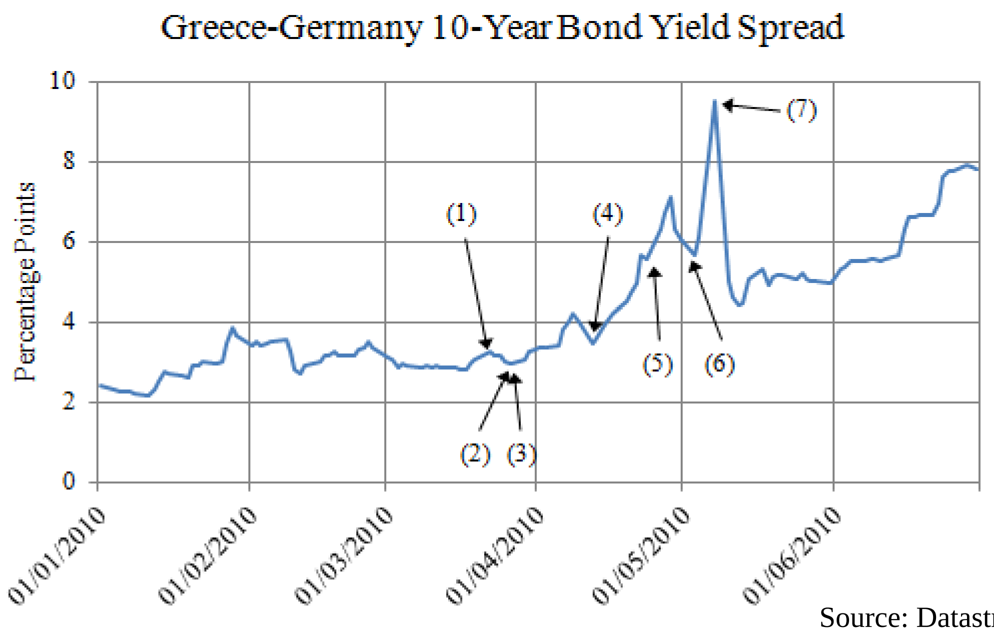
*hard balancing act* of April 19th, *Fears rise of Greece rescue plan falling short* of April 21st, *Greece is Europe's very own sub-prime crisis* of April 25th.

[5] See: http://www.reuters.com/article/2010/04/22/us-eu-deficits-idUSTRE63L1G420100422

[6] See: http://www.marketwatch.com/story/greek-debt-restructuring-not-on-table-imf-chief-2010-04-22-102780; Confirmation from the IMF rather than European ministers may have been a little more credible due to the political incentives to understate the severity of the crisis.




Source: Datastream

Key

| Number | Date | Description of Bailout Details |
|---|---|---|
| (1) | 22 March | Jose Manuel Barroso announces that after a European Commission investigation, bilateral loans, if used, would be constitutionally viable.[7] |
| (2) | 25 March | A statement from the European Council reveals that the contributions to the potential future bilateral loans from Eurozone countries would be proportional to the ECB capital key.[8] |
| (3) | 25 March | The European Council statement also announces that should there be a bailout, it would involve "substantial IMF financing and a majority of European financing." Up to this point, the IMF had maintained that its role was to share technical expertise. |
| (4) | 11 April | The interest rate on the possible bilateral loans from the Eurozone countries is decided as the 3-month Euribor rate in addition to a 300bps margin and 50bps service charge (or "around 5%"). The Eurogroup also commits "up to €30bn" of loans for its part in the first year of the bailout.[9] |
| (5) | 23 April | The IMF and Eurozone countries formally accept the Greek government's request for loans which was made on the same day. |
| (6) | 2 May | The IMF and Eurozone countries commit to €30bn and €80bn of loans respectively for Greece over the next 3 years. |
| (7) | 9 May | The ECB decides that contrary to previous public statements, it would purchase Greek bonds in the secondary market. |

[7] See Reuters News Agency article.
[8] See EC Statement.
[9] See Eurogroup Statement.

# OA5: Electoral Support during Previous Consolidations

We analyzed the electoral success of governments conducting previous large fiscal adjustments. The results of national elections are displayed in the table below and we define 3 possible outcomes:

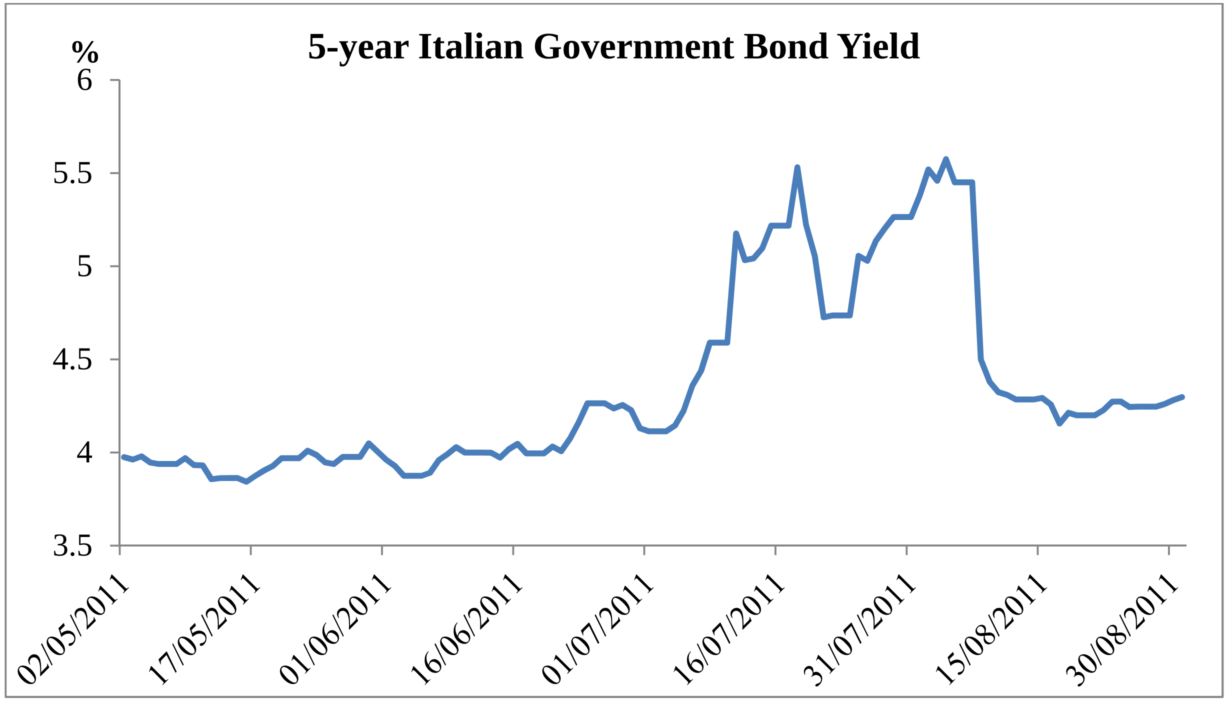
i) Victory – The incumbent executive government remains in power and increases its share of the popular vote.
ii) Survive – The incumbent executive government remains in power but with a reduced share of the popular vote.
iii) Defeat – The incumbent executive government loses power.

Elections in the 2 years after the end of fiscal adjustments (denoted by shaded cells) are also included in the analysis here.

| | NLD 96-00 | BEL 84-90 | UK 94-00 | DNK 83-86 | SWE 94-98 | CAN 93-97 | IRE 87-89 | FIN 94-98 |
|---|---|---|---|---|---|---|---|---|
| T | | | | | Defeat | Defeat | | |
| T+1 | | Victory | | Victory | | | | Defeat |
| T+2 | Victory | | | | | | Victory | |
| T+3 | | Survive | Defeat | | | | | |
| T+4 | | | | Survive | Survive | Survive | | |
| T+5 | | | | | | | | Survive |
| T+6 | Defeat | | | | | | | |
| T+7 | | Survive | Survive | | | | | |
| T+8 | | | | | | | | |

If we ignore elections taking place in the first year of a fiscal adjustment (where we can see from Table A3 that only minor reductions in the primary deficit had taken place), only 3 of the 14 elections in the sample were lost by the respective incumbent governments. It therefore appears unlikely that a government engaging in a fiscal adjustment is “doomed either way” when considering whether or not to default; fiscal adjustments have been welcomed by many voters in previous episodes. Stegmaier & Lewis-Beck (2011) show that the IMF-led bailout of Hungary in 2008 had a positive impact on the support for the ruling party.

OA6: Italian yields and PSI



## OA7: Pre-summit Pronouncements

The Second Bailout was officially agreed upon on the 21st July 2011.

Contents


1. Germany
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1. Germany

18th Oct 2010**: Deauville** bilateral summit between Sarkozy and Merkel marks the first suggestion of possible private creditor involvement in **future EU debt crises**. This is a proposal from Merkel (explained below) which Sarkozy agrees to while other issues related to the Lisbon Treaty are also discussed.

1st Nov 2010: "In Deauville, President Sarkozy and I spoke primarily about **what will happen when the euro bailout package expires in 2013**. For quite some time now, we have been in agreement within the coalition **that we need amendments to European Union treaties** in order to create a new and markedly improved crisis management mechanism -- one that **also includes private creditors, like banks**, for instance. We don't want to see the member states, in other words, the taxpayers, have to foot the bill again." - AM[10]

11th Nov 2010: FT reporting: "Earlier this week German finance minister Wolfgang Schäuble said in an interview with Der Spiegel magazine that they might be looking at a two-stage approach where the first [private] "participation" would come via an extension of maturities, while bondholders would suffer a haircut (in exchange for a guarantee of remaining debt) only if fiscal sustainability is not being achieved."[11]

6th June 2011: Finance Minister Wolfgang Schäuble addresses a letter to European Central Bank President Jean-Claude Trichet, the International Monetary Fund's then-acting chief, John Lipsky, and fellow euro-area finance ministers saying that **maturities should be extended** by seven years to give the debt-wracked nation time to overhaul its economy.[12]

[10] http://www.spiegel.de/international/germany/spiegel-interview-with-chancellor-angela-merkel-the-crisis-has-deeply-shaken-us-a-726433.html
[11] http://www.ft.com/cms/s/0/59e597dc-ec15-11df-b50f-00144feab49a.html#axzz1yzCRkn33
[12] http://www.businessweek.com/news/2011-07-06/germany-wants-greek-bond-swap-considered-official-says.html

17th June: Reuters reporting: “Merkel said **voluntary** participation of the private sector on the basis of the "Vienna Initiative" was a good foundation for a new deal.”[13]

6th July: “The model put forward by some French banks is still a good base for discussions and we are currently working on this," Deputy Finance Minister Joerg Asmussen said in the interview, referring to a French proposal to roll over Greek debt. "But since rating agencies have signalled that they will consider modalities (such as) the French proposal as a selective default -- that means a rating event -- we can also put other options like a bond exchange on the table," he said, adding discussions would take place over the summer break. “The model certainly has advantages in the sense that it gives clear incentives for financial market participants to contribute **voluntarily**. But the question is: are the incentives maybe too generous?” he said.”[14]

11th July: “Germany and all euro partners are steadfastly determined to defend the stability of the euro.” “Regarding Greece, I would like to say it must get a new programme very quickly, within a very short timeframe.” – Angela Merkel[15]

17th July: FT reporting: Ms Merkel has warned that she will only attend an emergency summit on the eurozone financial crisis in Brussels on Thursday [the 21st] if there is going to be an agreement on a new rescue plan for Greece.

She insisted on Sunday that she wished to avoid any Greek debt rescheduling, but underlined that **the key to a deal would be substantial voluntary involvement** of private creditors in easing the Greek debt burden.

“The more voluntary contribution the private creditors make, the less likely will it be that further steps are needed,” she said in an interview with German state television. [16]

17th July: “What we want is as few measures as possible and a **restructuring, as is constantly being mentioned now, also has the negative effect that the countries possibly will not make as much of an effort anymore**. **I am not working towards it** (a restructuring). We are trying everything we can to avoid something that is even tougher but I'm saying clearly that the involvement of private creditors shows that we have special problem in Greece due to the very, very high (level of) debts.”

“The more we can involve private creditors now on a voluntary basis, the less likely it is that we will have to take next steps, but we also have to prepare for things. But most important is that Greece does its homework and private creditors have to be involved” - AM[17]

19th July: Merkel confirms her attendance at the emergency summit on the 21st, which had been previously in doubt among the media[18]

19th July: “If you are going to be politically responsible, and this is what the (German) government wants and takes seriously, you know that such a spectacular, single step cannot responsibly be made, including on Thursday.” “Instead, we need a controlled and manageable process of successive steps and measures, a process that has one single purpose, one paramount aim, namely finally getting to the root of this problem. “**This means reducing debt and improving competitiveness**.” “Thursday will help in this, but further steps will be needed, not one spectacular event solving all problems.” - AM[19]

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[13] http://www.reuters.com/article/2011/06/17/eurozone-sarkozy-idUSPISHHE7SL20110617
[14] http://www.reuters.com/article/2011/07/06/us-eurozone-germany-greece-idUSTRE7651N120110706
[15] http://euobserver.com/19/32612
[16] http://www.ft.com/cms/s/0/15259f6e-b08e-11e0-a5a7-00144feab49a.html#axzz1ycpXPbZP
[17] http://www.reuters.com/article/2011/07/17/germany-merkel-idUSB4E7HR01U20110717
[18] http://www.irishtimes.com/newspaper/finance/2011/0719/1224300947185.html “After resisting a Brussels trip last week, Dr Merkel alarmed other EU leaders by remarking at the weekend that she would only go to Brussels if there was something to be agreed.”
[19] http://www.rte.ie/news/2011/0719/euro-business.html AM still appears to be concerned with the moral hazard problem of Greece 2 days before the summit.

19th July: Reuters Reporting: Merkel's junior coalition partners however rule out the [EFSF] fund buying back Greek bonds. “Key stances should be upheld,” Frankfurter Allgemeine Zeitung cited the head of the Free Democrats Philipp Roesler as saying. “The EFSF rescue fund should not become the creditor for Greek bonds.”[20]

2. Other Eurozone Governments

17th June: Reuters reporting: “Sarkozy said a second bailout programme for Greece would need the backing of the ECB. Any private sector involvement would need to be **voluntary** and avoid triggering a credit event, he said.”[21]

27th June: New York Times reporting: Nicolas Sarkozy, the French president, announced on June 27 that French banks had agreed to a plan under which the banks would reinvest most of the proceeds of their holdings of Greek debt maturing between now and 2014 back into new long-term Greek securities.

“If it wasn’t voluntary,” Mr. Sarkozy said at the time, “it would be viewed as a default, with a huge risk of an amplification of the crisis.”

Germany’s biggest banks have also agreed to roll over some of their Greek debt holdings.[22]

6th July: Guardian (UK) reporting: Eurozone finance ministers are sharply divided over how to handle the spiralling Greek debt crisis, Dutch finance minister Jan Kees de Jager revealed as he attacked France's plans for a new rescue package.

Speaking in London after a meeting with the chancellor, George Osborne, de Jager said it was "illusory" to hope that Europe's banks would voluntarily bear their fair share of the costs of a new bailout for Athens, and that President Sarkozy's current proposals let Greece's private sector creditors off too lightly.

"We do have concerns about the French scheme," de Jager said. "I think it's illusory to think of such a scheme as voluntary, so we have to work on solutions so that banks reach a level playing field."[23]

12th July: El Pais (Spain) reporting: In order to restore calm to the markets, "all of the countries in the euro zone have to accept responsibility, particularly the most powerful countries," Zapatero said at a joint news conference in Madrid with the visiting European Union President Herman van Rompuy.

**The main problem is the opening of the debate on private participation**. This debate was not opened well and it has not been closed," he added.

"When you make a proposal it has to be definitive, and the effects of it have to be evaluated. Spain maintains that exploring formulas for the participation of the private sector is not the right way to go, except in the case of a serious, credible proposal that instills confidence, because otherwise it could have a negative impact."[24]

19th July: European Affairs Minister, Jean Leonetti said the bank tax proposal (“special tax on eurozone banks”) "would have the advantage of not involving the private banks directly and so avoid the problem of a potential default".[25]

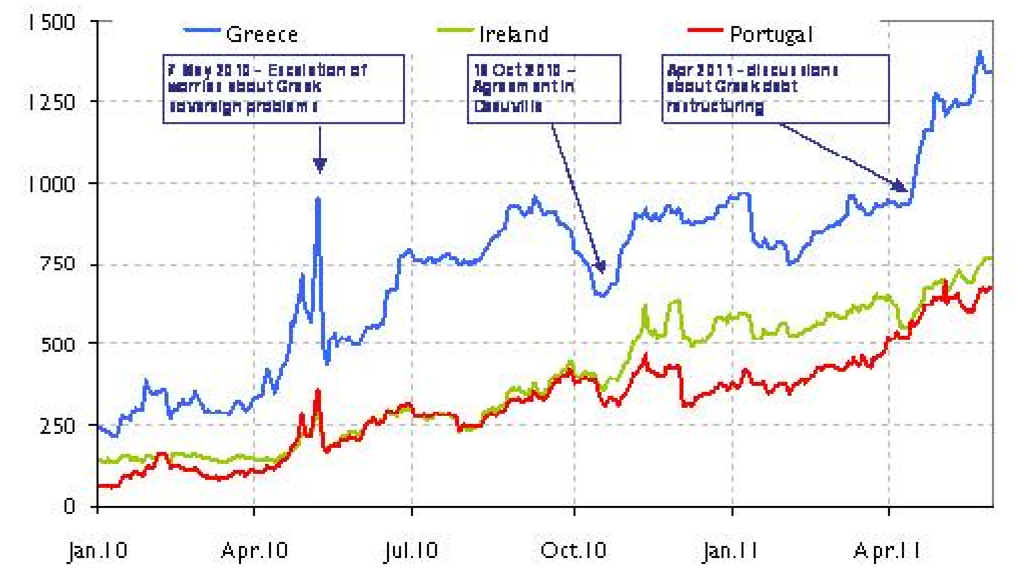
3. The ECB

[20] http://www.reuters.com/article/2011/07/19/eurozone-greece-germany-wisemen-idUSLDE76I1KL20110719
[21] http://www.reuters.com/article/2011/06/17/eurozone-sarkozy-idUSPISHHE7SL20110617
[22] http://www.nytimes.com/2011/07/05/business/global/05iht-euro05.html
[23] http://www.guardian.co.uk/business/2011/jul/06/eurozone-split-over-new-greece-bailout
[24] http://elpais.com/elpais/2011/07/12/inenglish/1310448052_850210.html
[25] http://www.bbc.co.uk/news/business-14204529

18th October 2010: Spiegel reporting: "You don't understand the seriousness of the situation," the ECB head [Jean-Claude Trichet] fulminated [as France and Germany voted to prevent stricter rules on the enforcement of the Fiscal Compact at the Luxembourg Eurogroup meeting]. Germany and France were endangering the continued existence of the monetary union, he said. The regulations still have to be made "much, much stricter" so the euro can return to a secure course, Trichet demanded. Contrary to the usual custom, he then switched from English to French and showered his compatriot Fernandez [who was standing in for the absent Christine Lagarde] with verbal insults.[26]

6th June 2011: "**Imposing haircuts on private investors can seriously disrupt the financial and real economy** of both the debtor and creditor countries. It ultimately damages the taxpayers of both the creditor and debtor country. This is particularly the case in a region like the euro area, consisting of advanced economies with highly integrated financial markets – an integration we have encouraged for years. This is why such **restructuring [PSI] should only be the last resort**, i.e. when it is clear that the debtor country cannot repay its debts." "A clear example is the **fear that private sector involvement would be sought automatically under the European Stability Mechanism**." "The proof of what I have just mentioned can be found in the data. Just looking at the yield spreads between the government bonds of the three stressed countries and those of Germany, it can be seen that they were gradually coming down last autumn until the day of the Deauville agreement and then spiked up after the October European Council, in which it was mentioned that preparatory work on the ESM would include "the role of the private sector". Renewed public comments about a possible "soft restructuring" or "reprofiling" of the Greek debt in April this year produced an immediate spike of the spreads on Greek bonds, with strong contagion effects to other euro area countries (see Chart 1)" - Lorenzo Bini Smaghi, Member of the Executive Board of the ECB during a speech entitled *Private sector involvement: From (good) theory to (bad) practice.*[27]

Chart 1




7th July: "Our message is no credit event, no selective default – no default! It is as simple as that!" - JCT[28]

[26] http://www.spiegel.de/international/europe/merkel-caves-in-to-sarkozy-germany-s-allies-shocked-by-euro-zone-backdown-a-725079-2.html
[27] http://www.ecb.int/press/key/date/2011/html/sp110606.en.html
[28] http://www.ecb.int/press/pressconf/2011/html/is110707.en.html

17th July: "If a country defaults, we will no longer be able to accept its defaulted government bonds as normal eligible collateral," "The governments would then have to step in themselves to put things right ... the governments would have to take care the euro system is presented with collateral that it could accept." - JCT [29]

17th July: Reuters reporting: Asked about the ECB's opposition to the private sector taking a hit to help solve the Greek debt crisis, Trichet said that in general terms, the sector's role is to provide hard-hit countries with funds by buying state assets and investing in them.

"All over the world, the best private-sector involvement is foreign direct investment, privatization and going back as soon as possible to spontaneous market financing."

Trichet also said the euro currency was in no danger.[30]

19th July: Even a partial Greek default would force the ECB to stop accepting Greek sovereign bonds as security, he [reportedly] said, "[leaving] the governments to make sure that the euro system is provided with securities it can accept". "The euro zone governments have been warned, loud and clear [about partial default]," said Mr Trichet to the *Financial Times Deutschland.*[31]

19th July: BBC reporting: ECB council member Ewald Nowotny appeared to break ranks with a **suggestion on Tuesday that the bank may compromise and allow a temporary credit event.**

"There are some proposals that deal with a very short-lived selective default situation that will not have major negative consequences," he told CNBC television.

4. The IMF

7th June: "Recurrent **discussions of private sector involvement have raised market fears** that undermined the credibility of Greece's commitment not to restructure the debt." - Bob Traa, Senior Resident Representative in Athens, IMF[32]

17th June: "Certainly the private sector involvement issue is on the table and that this is something where there are ongoing discussions. – Jose Vinals, Financial Counsellor and Director, Monetary and Capital Markets Department, IMF[33]

4th July: Consultations with Greece's creditors have begun in order to define the modalities for **voluntary** private sector involvement with a view to achieving a substantial reduction in Greece's financing needs. – IMF Letter of Intent[34]

6th July: "The Board meeting is scheduled on Friday. I have a briefing this afternoon on Greece. And, there are many issues and matters that are under development as we speak, including in Paris, concerning the private sector involvement that was sought by Germany, in particular, but other members of the euro zone." – Christine Lagarde [35]

12th July: "The IMF welcomes the statement by the Eurogroup reaffirming their commitment to safeguard financial stability in the euro area. The IMF will continue to work closely with Greece and European partners to support these objectives." - Christine Lagarde [36]

[29] http://www.ft.com/cms/s/0/15259f6e-b08e-11e0-a5a7-00144feab49a.html#axzz1ycpXPbZP
[30] http://www.reuters.com/article/2011/07/17/us-ecb-trichet-idUSTRE76G1C920110717
[31] http://www.irishtimes.com/newspaper/finance/2011/0719/1224300947185.html
[32] http://www.imf.org/external/np/speeches/2011/060711.htm
[33] http://www.imf.org/external/np/tr/2011/tr061711.htm
[34] http://www.imf.org/external/np/loi/2011/grc/070411.pdf
[35] http://www.imf.org/external/np/tr/2011/tr070611.htm
[36] http://www.imf.org/external/np/sec/pr/2011/pr11276.htm

13th July: "In **the last couple of months** there has been a discussion inside Europe that **it would be desirable to have public sector involvement** and the authorities and the Europeans have discussed this and agreed on that during the last few months." "**There will be some form for PSI, but the concrete modalities I won't comment on.**" – Poul Thomsen[37]

15th July: A strategy to address the financing gap has been agreed with the government and its European partners. The modalities are still being worked out, but it will likely involve a combination of **voluntary private sector involvement** and additional official support from euro area member states." – PT in response to the question ***Even with these new measures, there is a need for more external financing. What has been agreed?***[38]

19th July: "[The] Directors see three essential actions. First, we need to very quickly implement the commitments to scale up the EFSF, but maybe even more importantly, we need to make it more flexible to allow it to intervene in many different ways and also on easier terms. The second point is that the authorities should clarify their approach to private-sector involvement both in program countries and in the ESM. The third point is that European banks need to be strengthened throughout the Euro Area with a very strong follow-up to the current stress tests that came out and with a preference to private-sector solutions." – Luc Everaert[39]

5. Other

25th March 2011: Further details of the ESM (still designed to enter into force after 2013) are given at an EC summit. From the *Term Sheet on the ESM*, "The beneficiary Member State will be required to put in place an appropriate form of private-sector involvement, according to the specific circumstances and in a manner fully consistent with IMF practices." "ESM will enjoy preferred creditor status in a similar fashion to the IMF, while accepting preferred creditor status of IMF over ESM."[40]

8th April: The Eurogroup ministers meet in Gödöllö, Hungary to discuss Portugal's request for financial assistance and make a statement which does not mention Greece.[41]

Notice from the 10-year bond data that following this meeting, it is the *Greek* bond yields that soar. There were reports that at this meeting, the Greek finance Minister first requested for further assistance.

15th April: Wall Street Journal Reporting: The majority of euro-zone countries believe a restructuring of Greek debt is inevitable and could happen next year, two senior euro-zone government officials familiar with the matter said Thursday [the 14th].

"There is widespread belief inside the euro zone that a Greek debt restructuring will happen sometime next year. The European Central Bank and the International Monetary Fund believe the same," said one of the officials, who is directly involved in talks with the European Union and the IMF.

Another scenario could see Greece seeking a reduction in coupon payments and a longer maturity "which will be more drastic because it will involve a clear haircut," the official said, adding that when a country seeks debt restructuring it offers creditors at least two options to work on.[42]

**3rd June: "After a meeting in Luxembourg with George Papandreou, Jean-Claude Juncker, head of the euro group, insisted the final deal would "include private sector agreements on a voluntary basis". – FT reporting[43] FIRST OFFICIAL MENTION OF PSI IN SECOND BAILOUT DEAL**

[37] http://www.imf.org/external/np/tr/2011/tr071311.htm
[38] http://www.imf.org/external/pubs/ft/survey/so/2011/car071511a.htm
[39] http://www.imf.org/external/np/tr/2011/tr071911.htm
[40] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf
[41] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/121401.pdf
[42] See http://online.wsj.com/article/SB10001424052748703983104576262420806551278.html

18th June: Reuters reporting: "Because we have to seek a contribution from private creditors **due to German domestic politics**, everything will be more expensive," [Jean-Claude Juncker] told German newspaper Sueddeutsche Zeitung.

20th June: "We are working on a medium term strategy**, including voluntary private sector involvement** along the lines agreed upon by the Eurogroup." – Herman van Rompuy, President of the EC[44]

11th July: "Ministers stand ready to adopt further measures that will improve the euro area's systemic capacity to resist contagion risk, including enhancing the flexibility and the scope of the EFSF, lengthening the maturities of the loans and lowering the interest rates, including through a collateral arrangement where appropriate."[45] – Statement by the Eurogroup

9th December: "As regards the Private Sector Involvement (PSI), we have made a major change to our doctrine: from now on we will strictly adhere to the IMF principles and practices. Or to put it more bluntly: our first approach to PSI, which had a very negative effect on the debt markets, is now officially over." – HvR[46]

[43] http://www.ft.com/cms/s/0/d7fe613a-8dff-11e0-bee5-00144feab49a.html#axzz1zU54YnzM
[44] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/122931.pdf
[45] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/123601.pdf
[46] http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/126657.pdf

## OA8: Legal Constraints

Opponents of the first (and second) bailout often cited a number of European Treaty provisions and German Constitutional rules alleged to forbid certain forms of financial assistance. At the European level, some commentators asserted that a bailout would fall foul of the so-called no bailout clause, originally enshrined in the Maastricht Treaty and then reaffirmed in the Treaty of Lisbon. In reality, it was soon clear that there was no basis for this claim, as the clause does not forbid voluntary, bilateral loans among EU members. The European Commission made this point very explicitly as early as March 2010[http://uk.reuters.com/article/2010/03/23/us-eurozone-greece-barroso-idUSTRE62M0EQ20100323]. This is important because any challenge to national legislation on grounds of Treaty violation requires the approval of the Commission before it can be lodged with the European Court of Justice (ECJ).[47] Indeed, there have been no legal challenges to the ECJ on this score.[48]

Another treaty provision often invoked by opponents of assistance to Greece (and other peripheral countries) was the prohibition of monetary financing. As far as the bailout was concerned, this was a red herring, as the issue of direct purchases of government bonds by the European System of Central Banks is orthogonal to the issue of inter-governmental lending.[49] Once again, there were no attempts to legally challenge the bailout on the basis of the prohibition of monetary financing.

Concerns with the reaction of the Constitutional Court of Germany do not appear to have been much more binding. The strongest argument for a role for such concerns in shaping the outcome may be that they forced a higher interest rate on the bailout funds than would otherwise have been the case. In early April the Economist reported that "the German government believes it cannot be seen to subsidize an errant member of the euro zone, without instantly falling foul of German constitutional court rulings that elevate the stability of the euro to a binding legal duty for any German government." It was claimed that Germany's Basic Law meant that credit could only be provided to Greece at "market rates" or alternatively, "without subsidy". Germany had also pushed the Eurozone heads of state on March 25th to issue a statement announcing that the "rates will be non-concessional, i.e. not contain any subsidy element."

By mid-April however, the rising yields on Greek bonds clearly made "market rates" untenable and the interest rate to be charged to Greece for the bilateral loans was eventually agreed upon. Politicians and the media often quoted the agreed rate at "around 5%" which was over 2 percentage points less than what Greece would have paid in the market for comparable 3-year securities. If legal considerations had been paramount, it seems unlikely this would have happened. Consistent with this, the Constitutional Court heard no claims specifically based on the concessionary level of the interest

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[47] The formal procedure for complaints made by private citizens against the actions of a national government related to EU treaties, outlined in Article 258 of the Treaty of Lisbon (see Appendix B), requires the individual or organisation to petition the European Commission, who then decides whether or not to refer the case to the ECJ. Member states can petition the ECJ directly against actions by other members states.

[48] It is also sometimes suggested that IMF involvement in the bailout served the purpose of circumventing the no bailout clause. Nothing in the Lisbon treaty suggests that bilateral loans made simultaneously with an IMF programme have a different legal standing than any other bilateral loans, so if the bailout really had been on shaky legal ground it is doubtful that the IMF involvement would have made any difference. The key point, however, is that the bailout was simply not in breach of the treaties.

[49] The prohibition did limit the tools available to the ECB to support the goals of the bailout. In particular, as it decided to engage in puchases of government bonds, it was forced to do so on secondary markets only (Securities Markets Programme). However, we are aware of no indications that this constraint had a material impact on the effectiveness of the ECB's interventions. In any case, our point is that the constraint was nearly irrelevant for the design of the bailouts we are here concerned with.

rate.[50] Hence, we think that the German motivation for a high interest rate was much more political than legal.

To be sure, there were over 100 separate complaints made to the Constitutional Court of Germany between the passing of the bailout legislation in May 2010 and the start of its deliberations in July 2011.[51] Only 15 of the complaints were eventually heard in court and they were mostly based on the Basic Law articles related to property rights and the rights to elect the Bundestag (Articles 14, 20, 28 and 38 of the Basic Law). Germany's bilateral loan with Greece was argued to be inflationary and therefore in violation of the guarantee of property, while Germany's participation in the EFSF was claimed to surrender new budgetary powers to the European Commission which would have first required a constitutional amendment.

Many law professors and German constitutional experts were quick to state publicly that the Court would be unlikely to prevent Germany's involvement. Even before the first Constitutional Court hearing took place on May 8th, law professors Ulrich Haede, Frank Meyer, Martin Ibler and Christian Pestalozza had all independently remarked that the complaints were unfounded. Several of the most vocal complainants had also been defeated in previous legal challenges against the Maastricht Treaty, the introduction of the Euro and the Treaty of Lisbon. In the event, on September 7th, 2011, the Constitutional Court dismissed the main complaints about the first Greek bailout and the establishment of the EFSF, deeming them to be compliant with Germany's Basic Law Constitution. The Court stated that the EU's 2010 bailout for Greece and subsequent aid granted through the rescue fund was legal, but also that the Bundestag should have more say in any future major Eurozone bailouts, by the approval of the Parliament's Budget Committee.[52]

[50] A more precise definition of the originally agreed interest rate is the 3-month Euribor rate in addition to a 300 basis point "margin", rising to 400 basis points after 3 years and a 50 basis point "service" charge. In May 2010, our calculations estimate that the interest rate was 4.1%. The "around 5%" claim is likely to come from the expected average interest rate over the program's duration which includes the increased "margin" and perhaps a rising Euribor rate.

[51] On May 8th 2010 the German constitutional court refused to issue an injunction stopping the loan to Athens. Although the court in Karlsruhe could still eventually decide that the German decision to contribute €22.4bn to a combined eurozone rescue was unconstitutional, the judges refused to intervene immediately for fear of causing even greater damage. In their conclusions, the judges said that they found "no adequate grounds" to conclude that the German government was incorrect in its assessment of the currency and financial policy position. If an injunction was issued, they said, and the government action was eventually found to be constitutionally correct, the general public would suffer "severe damages" (http://www.ft.com/cms/s/0/4f957158-5b60-11df-85a3-00144feab49a.html#axzz24AzXgccg)

[52] Germany and the Euro Rescue Agreements, House of Commons Library July 2012; See also the Court's press release (in English): http://www.bundesverfassungsgericht.de/en/press/bvg11-055en.html