A New "Greek Tragedy"

Let us be perfectly clear: The fiscal woes of Greece, one of the European Union's weaker economies to begin with, are quite likely beyond even the abilities of the denizens of Mount Olympus to solve. Greece, a thoroughgoing socialist basket case for decades, is probably going to lead the rest of the soft economic underbelly of Europe — Spain, Portugal, and eventually Italy — into insolvency, a chain of events that may dissolve Europe's decades-old experiment in economic unity.

With the onset of the great global recession, Greece's public debt soared to 12.7 percent of the GDP, the highest in the eurozone. Fifteen percent of all tax revenues will be required to service Greece's debt this year alone.

Initially reluctant to impose austerity measures of any sort, and confident in a full bailout from the rest of the EU, Greece indignantly resisted calls to cut benefits for its massive public sector (more than 700,000 Greeks are on the government payroll, and they are compensated for 14 months of work every year). Greece's safety nets are far more lenient than those in the United States; the retirement age is only 55, for example. Add to the mix the fact that Greece's four-month-old Papandreou government was swept to power last fall amid promises not to cut benefits, and we have the makings of a full-blown meltdown, Iceland on the Aegean.

In recent days, chastened by the reluctance of the EU's heavy hitters (Germany in particular) to subsidize Greece's pampered public sector, the Papandreou government has reluctantly introduced cost-cutting and austerity measures, including tax hikes, government hiring freezes, and curtailment of public-sector benefits. "The dilemma is — are we going to let this country go bankrupt or are we going to react?" Papandreou asked Greek legislators. "We have an obligation to the Greek people to do everything we can now, today, to face immediate dangers because tomorrow will be too late." Other, economically stronger members of the EU — notably France and Germany — have been making noises for weeks about not leaving Greece in the lurch. Heartened by the perceived likelihood of a bailout lifeline and by the news that Greece will be raising taxes and cutting spending by $6.5 billion this year, world markets have reacted enthusiastically to Greece's March 4 $6.8 billion bond issue. Investors eager to snap up new Greek debt offered a total of three times the asking price. According to the Greek finance ministry, the ease with which Greece was able to peddle new government debt to finance the old "shows that despite the extremely difficult circumstances, investor confidence in the Greek economy remains strong."

Well, no. What the latest global Gadarene rush into absurdly risky investment vehicles shows is that investors have full confidence in the willingness of other governments — France, Germany, and even, perhaps, the United States — to do whatever it takes to try to prevent a total international currency meltdown and cascade of sovereign defaults.

However, it will probably be too little, too late. Greece has so far been able to raise only about 19 billion euros in revenues to defray obligations of more than 50 billion euros this year, including debt payments in excess of 20 billion euros coming due in April and May. Greek government bonds are likely to be downgraded eventually (once global markets acquiesce to the inevitability of cold, hard facts), which will prompt a mad rush to divest from Greek government debt. As the value of its outstanding debt plummets, Greece will very likely conclude it has little to lose by a partial or full default on its obligations.

"Our view for some time now has been that the government will be hard-pressed to push through this financing hump with only commercial or internal sources of funding," an analyst at Wall Street investment banking behemoth Goldman Sachs wrote of Greece.

"Some external assistance may therefore ultimately be required, likely in the form of bilateral aid or loan guarantees from individual member states." The irony in the Goldman Sachs prognosis is rich, considering that the bank is now under scrutiny for allegedly helping the Greek government conceal underlying fiscal weaknesses with exotic investment vehicles known as credit default swaps, to enable Greece to qualify for membership in the European Union.

Eurozone Collapse

The big worry on both sides of the Atlantic is not the Greek collapse per se, but whether it will lead to contagion among other vulnerable economies in the EU. Spain, the EU's fourth-biggest economy, is the most worrisome prospect, with its 20 percent unemployment rate (projected to soar as high as 25 percent over the next couple of years), its collapsing real estate bubble, and its burgeoning national debt. Spain's $1.6 trillion economy is roughly twice the size of the combined economies of Portugal, Ireland, and Greece (all bailout candidates) combined. With an economy likely to shrink by around a half a percent this year and a budget deficit of more than 10 percent of its GDP, Spain will face calamity if investors refuse to buy up some 85 billion euros' worth of new debt Madrid is expected to float in the next few months. A bailout of Spain would be reckoned in hundreds of billions of dollars, a sum the cash-strapped, debt-laden European Union simply cannot afford. France's and Germany's own fiscal woes are considerable, for one thing; their respective budget deficits are running at 7.5 and 6.3 percent.

Beyond Spain looms a still greater potential crisis, Italy. A member of the G-7 and the world's seventh largest economy, Italy is — like most other Western economies — still trying to borrow and spend its way back to prosperity. With over $2 trillion in total debt, Italy may be able to forestall the inevitable for a while, thanks to projections for slender economic growth this year and a deficit equivalent to "only" 5.4 percent of the GDP. But when the Italian house of cards finally does collapse, the shock to world markets will be the financial equivalent of a megathrust earthquake of the sort that recently shook Chile.

All of which begs the question: Will the euro — once touted as the world's last, best hope for a strong currency, an upstart rival to the mighty U.S. dollar — survive? The common currency, launched in 1999 to toasts and bonhomie among the internationalist elites, is on the ropes, crippled by an economic crisis whose severity no one on the Continent anticipated. With independent currencies, the likes of Spain and Greece would have some control over exchange rates and could protect their domestic markets. Spain could, for example, keep a national currency devalued relative to the dollar to make its Mediterranean resorts more attractive. But yoked to the euro, the relatively weak Spanish economy is forced to reckon with the same pricing scale as more prosperous Germany and France, which has hurt Spanish exports and seaside resorts.

Spain, like the rest of the EU, no longer has any say over monetary policy; all such decisions are made by EU authorities at the European Central Bank. Not only that, there are no legal provisions in the eurozone for an orderly exit from the common currency; there are no mechanisms in place for Greece and Spain to revert to the drachma and the peseta, respectively. Other weaker European economies shoehorned into the euro system face many of the same problems as Spain and Greece, and stronger economies like Germany have already expressed strong reluctance to bail out weaker members of the EU. All things considered, the coming string of sovereign defaults across the eurozone does not bode well for the future of European economic unity.

When — not if — the euro collapses, and with it the meticulously and disingenuously crafted European economic union, the world economic and financial order will be shaken to its core. But the inevitable result — the breakup or severe curtailment of European political union — will be a severe blow to the dreams of generations of internationalist world government partisans. In the short term, the demise of the House That Maastricht Built will be painful. But in the long run, European nations may recover their long-lost economic and political sovereignty.

Seeing Us in Them

In the meantime, there is plenty of pain coming, and not all of it will be confined to European shores. “What we in the western world are about to learn is that there is no such thing as a Keynesian free lunch,” wrote Harvard economic historian Niall Ferguson in the *Financial Times* recently. He continued:

> For the world’s biggest economy, the US, the day of reckoning still seems reassuringly remote. The worse things get in the eurozone, the more the US dollar rallies as nervous investors park their cash in the “safe haven” of American government debt. This effect may persist for some months, just as the dollar and Treasuries rallied in the depths of the banking panic in late 2008.

Yet even a casual look at the fiscal position of the federal government (not to mention the states) makes a nonsense of the phrase “safe haven.” US government debt is a safe haven the way Pearl Harbor was a safe haven in 1941.

Even according to the White House’s new budget projections, the gross federal debt will exceed 100 per cent of GDP in just two years’ time. This year, like last year, the federal deficit will be around 10 per cent of GDP. The long-run projections of the Congressional Budget Office suggest that the US will never again run a balanced budget. That’s right, never.

In other words, the United States is doing precisely what Greece has done, but on an immeasurably greater scale, and withal one which no coalition of foreign economies could possibly bail out, even if they were inclined to do so.

The ineluctable economic truth that big, debt-addicted government will never admit is that the markets always liquidate bad debt. Even governments are ultimately limited in their ability to run up fantastic debts and deficits by the willingness of others — states and private investors alike — to purchase their debt. At the moment, the European fiscal crisis has prompted investors to bid up the dollar, as Ferguson points out. But eventually, investors will sour on U.S. government debt and on the dollar as the full fiscal effects of the inflationary policies of the Federal Reserve come into sharper focus.

And, lest we forget our history, even great powers default on their obligations in extreme financial straits. Great Britain did precisely that when it renounced the gold standard in 1931, admitting it no longer had the reserves to honor its pledges to redeem the pound — the currency that was once the world's strongest and most trusted. So did the United States when, in August 1971, President Nixon "closed the gold window" — that is, he unilaterally reneged on U.S. promises to redeem dollars in gold for foreign investors.

Flat-out default on obligations has always been regarded as the ultimate act of irresponsible government, the calling card of tin-pot dictators and banana republics. But when the United States and other Western nations can no longer find anyone to purchase their debt, default and national insolvency will become unavoidable.

There is, of course, a solution to the impending financial apocalypse, if only governments and their citizenries would embrace it: cutting government expenses drastically and paying off debts. But as the political turmoil in Greece and Spain — angry mobs demonstrating against cuts in government-funded benefits — illustrates, countries seldom if ever find their way back to fiscal sanity on their own, preferring instead to continue robbing Peter to pay Paul until the exceptionless laws of economics have their say.

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