EU Trouble: US Banks Helped Hide Government Debt

American banks helped Greece and possibly other governments to run massive deficits and conceal them from European Union officials and the public, according to international news reports. Meanwhile, the consequences of the deception are echoing through world currency and debt markets while shaking the very foundations of the Eurozone.

Under EU rules implemented with the Maastricht treaty, all Eurozone countries are supposed to maintain an annual budget deficit of less than three percent of Gross Domestic Product (GDP) and an overall debt of less than 60 percent of GDP. Nonconforming nations can face fines and other action. But Greece has never been able to stick to the 60 percent rule, and has now been caught lying about its deficits. Last year the government ran a deficit of over 12 percent, an enormous figure by any standard.

In an effort to raise even more money and conceal the staggering levels of debt, Greece turned to American banks — Goldman Sachs in particular, according to an explosive story published by the German magazine *Der Spiegel*. The report, entitled "How Goldman Sachs Helped Greece to Mask its True Debt," alleges that the Greek government used obscure derivatives provided by U.S. banks to delay payment on obligations, borrow even more money and to keep the true figures off the official books.

"Around 2002 in particular, various investment banks offered complex financial products with which governments could push part of their liabilities into the future," said one "insider" cited by the magazine, who also noted that various other Mediterranean governments had engaged in the fraudulent activity as well. But according to the article, the deception was legal under Maastricht because it involved "cross-currency transactions." What really happened is that the government and banks colluded to use "fictional exchange rates" so the state could secretly receive additional credit without raising eyebrows.

In 2002, the official Greek government deficit was claimed to be at around one percent. It has since been revised upwards several times, standing at over five percent according to recent calculations. And the problem has not improved in recent years.

"Politicians want to pass the ball forward, and if a banker can show them a way to pass a problem to the future, they will fall for it," economist Gikas Hardouvelis, a former official who recently helped write a report about Greece's accounting, told the *New York Times*. The banks involved have thus far refused to comment.

In exchange for the sneaky loans, the Greek government and others promised that various revenue streams, such as airport fees and lottery money, would be mortgaged to the banks. But with the world enveloped in a financial crisis, the accounting gimmicks became too difficult to conceal.

Now, other European countries and the EU are pressuring the Greek government on several fronts. They want answers about the concealment of the billions in debt and the "assistance" provided by American banks like Goldman Sachs and J.P. Morgan. Additionally, the EU is calling for tough action including spending cuts and tax increases for the beleaguered nation.

Greece was even stripped of voting rights at a critical upcoming EU summit, and union officials are threatening that if the nation does not put its financial house in order, it will lose control of its own policies under article 126.9 of the Lisbon Treaty. Many Europeans are demanding that Greece be booted from the union altogether, with a recent poll of Dutch people revealing that 92 percent favor the expelling the Greeks (more than 90 percent of the respondents also favored the Netherlands leaving the Eurozone and restoring its own national currency).

There has been talk of an EU bailout for Greece, or even bilateral assistance from Eurozone countries. But officials have warned that there will certainly not be any monetary support before Greece agrees to take strong action to rein in its spending and debt. And on top of that, the populations of EU countries have balked at the notion of paying for Greek government excesses.

Greece, however, still claims that it is not seeking taxpayer money from its EU neighbors. "We haven't asked for money from German, French, Italian or any other taxpayers," said socialist Prime Minister George Papandreou, also the head of the powerful Socialist International organization. "What we want is political support to end profiteering and the defamation of our country."

Greece has announced a series of policy fixes supposedly aimed at restoring confidence and re-gaining control of the nation's fiscal train wreck. "The time has come for major changes, the country can't afford to wait any longer," announced Greek Finance Minister George Papaconstantinou at a press conference, noting that starting next year, most cash transactions over 1,500 Euros will be considered illegal (presumably in an effort to raise more taxes). Among the measures being proposed are more tax hikes and spending cuts, though critics have said that much more needs to be done.

But some prominent analysts have essentially dismissed all of the proposed "solutions" as futile and are instead predicting disaster, including the imminent collapse of the Eurozone. "My own view is that there is little 'help' that can be offered by the other eurozone nations other than temporary, confidence-giving 'sticking plasters' before the ultimate denouement: the break-up of the Euro zone," wrote strategist Albert Edwards in a note to investors for French giant Société Générale, one of the largest banks in Europe. Any "help" will simply delay the inevitable, he said.

Despite the focus on Greece, it is by no means the only Eurozone nation facing a crisis, even if it is the most serious calamity at present. Portugal, Spain, Italy and others are all facing their own major problems. According to analysts and observers, the problem is getting worse quickly, with some commentators speculating that these crises could be the trigger for the second round of the global financial meltdown. The Euro as a currency is obviously facing serious troubles.

And while the situation is developing rapidly, what will happen still remains to be seen. But there are some lessons emerging already that are clear and undeniable.

Borrowing vast sums of money to maintain the illusion that big government works is irresponsible and immoral. The Greek people and other populations whose governments engaged in this sort of deception should be outraged. They deserve honesty. Sure, the banks may have contributed to the problems for their own benefit, but if corrupt governments demand a service, the market will provide it; so the true responsibility still rests with the governments and with the citizens who allowed their representatives to behave so recklessly.

The problems are also systemic in a way, with central banking and the fractional reserve system contributing to a world where nearly every individual, family, business, and government finds itself trapped in perpetual debt. But socialism and the massive government spending in nations like Greece certainly contributed to the fiasco as well.

Lastly, this new crisis has illustrated the dangers of supranational integration schemes. Some analysts are calling for further “political integration” to keep the economic integration afloat. But this is the wrong path. Greece is being forced by bureaucrats in Brussels to respond in ways it might otherwise have avoided. The loss of sovereignty has become so obvious that even all the major news outlets are openly discussing it. And Greece’s fellow union members are also now in a bind, forced to decide between extorting their already-strapped citizens to bail out the reckless government of Greece, or face a possible monetary calamity. The options are not good.

The true solution to crises like these is multi-faceted, but not really that complex. First, drop the integration ploy. It isn’t working, obviously. Next, fix the banking system and institute sound money such as gold and silver in place of debt-based fiat currency. Finally, limit the scope of government and only allow it to spend beyond its means in extraordinarily rare circumstances when it is absolutely indispensable.

Following these simple steps, nations could be prosperous and free, with a reliable currency as the foundation for a sound economy. And citizens and governments could avoid becoming the prey of big banks anxious to trap them in debt and reap vast sums of interest. The current solutions being offered by politicians and media talking heads will not work. They have already been tried, and they have already failed. It is time to try something new for once: true change.

Photo of European Commissioner for the Economy Joaquin Almunia: AP Images