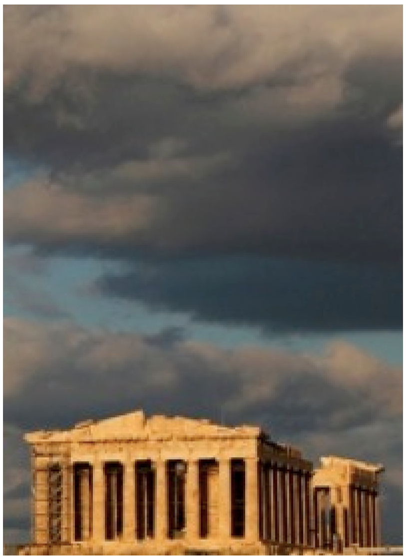
Greece, Euro, and Even the EU on the Ropes



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 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 told 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."

However, it will probably be too little, too late. Greece has so far been able to raise only about 14 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. According to one senior Greek official, the steps Greece has taken so far will only shave a couple of percentage points off the country's debt load. Greek government bonds are likely to be downgraded, 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. However, don't expect Goldman Sachs — also the architect of AIG's collapse — to offer Greece a helping hand.

The big worry on both sides of 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 19 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. 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.

All of which begs the question: Whither the euro? 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. Other weaker European economies shoehorned into the euro system face many of the same problems as Spain, 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 will probably recover their long-lost economic and political sovereignty.

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