For Greece, there’s no escaping the pain

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It had got into the habit of splurging on borrowed money. The party cannot carry on forever

The gripping Greek drama of the last month or so would make for good proscenium theatre. A country is heavily in debt to central banks (the European Central Bank), private banks (especially German ones), international financial institutions (the International Monetary Fund), and is unable to repay according to schedule. It refuses to toe the lenders’ line to enable it to repay the loans.

Its former finance minister, who was also an economics professor, lectures lenders on what they should do, without getting their money back. The lenders ask for austerity in expenditure. Greece says its people are already suffering from the effects of severe austerity. The prime minister of Greece calls a referendum by which the citizens agree that there should be no more austerity.

The lenders are not impressed. The prime minister then capitulates. The lenders are only interested in recovering their money and the possibility that the Greeks will be able to repay their debts in future. The Greeks want a lot more loans immediately to keep their banks going.

Of lenders and borrowers

Lenders have loaned vast sums to Greece over the years without ensuring that country’s ability to repay. Greece has lived happily on borrowed money. Except for the period between 1967 and 1974 when a much vilified military junta ruled Greece, the Greek economy has been on the brink, with rising deficits. Austerity programmes led to record unemployment. Many said Greece should not be subjected to austerity measures. The implication was that the world and especially Europe owed it to Greece to continue living on borrowed money. The

European Union was mooted in 1945 after World War II. A united Europe was the answer to the repeated attempts of Germany to expand, resulting in two world wars. The idea of a united Europe progressed from the European Coal and Steel Community, to the European Free Trade Area, a European Economic Community, a European Council in 1975, a common European currency — the euro — in 1999, and the issue of euro currency in 2002.

While Britain was one of the countries opposed to the idea of a political union, the EU brought together disparate economies. They varied greatly in terms of GDP, GDP composition, labour productivity, discipline, government regulation, quality of corporate managements, reliable statistical base, and various other parameters. The economic engine was the powerful and well-led German economy.

Europe’s dilemma

Many weak economies benefited from the single currency, and the ECB. They borrowed heavily from European banks. Countries such as Greece, Ireland, Iceland and Spain did not exactly build assets and competition; they enhanced consumption. Greece, for instance, went through periodic crises of inability to service debts, asking for more time to repay, waiver of some debts, and more loans.

Europe faces a dilemma. Greece is the home of European civilisation and must remain in Europe. The EU is a dream that requires all members to join the common currency and take the steps for political union. Greek’s exit from the EU could trigger the exit of others. The EU will, therefore, do a lot to help Greece.

Last week, however, the European and particularly the German will to support Greece broke, as Greece wanted more but was unwilling to reform itself and be able to repay the loans within a reasonable time-frame. The others in the EU are determined that Greece must initiate reforms, even if it means hardship for its citizens.

It is incongruous that Europe has a central bank and a common currency to lend to member countries, but does not have the powers to limit a member state’s macroeconomic imbalance. That requires political union and central fiscal and monetary management for the EU. This will be the central debate of this decade.

Britain has strong public opinion against economic union, a common currency and political union. Britain may well exit the EU. But the EU must go all out to strengthen itself even if it means a British exit. A Greek exit and its economic collapse would be a signal to other members not to be in that position.

It is quite likely the Greeks will revolt against the hardships and decline in living standards in the wake of austerity. Things will only get worse and there is every possibility that Greece will end up with near-Fascist rulers or go back to military rule. This may well bring discipline to the economy.

Given past experience this may lead to Greeks wanting more freedom. Elections may lead to the return of Greek socialism, with extravagant social schemes. Basically, what this means is that Greece may be facing an uncertain future.

Towards a united Europe

Britain is set to have a referendum later this year on the issue of monetary and political union. Apart from prospects of its exit from the EU, it also faces an exit by Scotland from the United Kingdom. Scotland will probably want to remain in the EU.

A United Europe that is more homogenous than if it had Britain in its fold is very likely. The map of the world will change with a United Europe driven by German conservative economics becoming much stronger.

What is not clear, though, is how the global financial system can be reformed. There needs to be greater care in lending, and monitoring loans. Years of low interest rates in the developed world, with quantitative easing making funds more easily available, has given us a loosely managed financial system.

We need better macroeconomic management. However, the rewards and incentives system that private banks have for their employees, especially at the top, ensures that over-lending and bank crises will keep recurring.

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