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"Greek Lessons" by S L Rao

The gripping Greek drama of the last month or so could make a good play on a stage. A country is heavily in debt to other central banks, (European Central Bank), private banks (especially German ones), international financial institutions (IMF), and is unable to repay on schedule. It refuses to do the things the lenders feel might make it better able to repay. Its Finance Minister, a former Economics Professor, lectures lenders on what they should do, without getting their money back. The lenders ask for austerity in expenditures. Greece says its people are already suffering from severe austerity. The Prime minister of Greece calls a referendum by which Greeks agree that there be no more farther austerity. The lenders are not impressed. The Prime Minister then capitulates. Lenders are only interested in the return of their money and the possibility that the Greeks will be able to repay in future. The Greeks also want a lot more lending immediately, to keep their banks going.

Lenders have lent vast sums to Greece over the years without ensuring ability to repay. Greece has lived happily on borrowed money. Except for 1967 to 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 that 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 the II World War. A united Europe was an answer to the repeated attempt of Germany to expand. That resulted in two World Wars. The idea 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. A political union was blocked chiefly by Britain.

The European Union brought disparate economies together. They varied greatly in size of GDP, GDP composition, labor productivity, discipline, government regulation, quality of corporate managements, reliable statistical base, etc. The economic engine was the powerful and well led German economy. Many weak economies benefited by a single currency and the ECB. They borrowed heavily from European banks. Greece, Ireland, Iceland, Spain, did not so much build assets and competitiveness as enhancing consumption. Greece went through periodic crises of inability to service debts, asking for more time to repay, forgiveness of some debt, and more loans.

Europe faces a dilemma. Greece is the home of European civilization and must remain in Europe. The EU is a dream that requires all members to leave the common currency and take the steps for political union. Greek's exit could trigger 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 in a reasonable time to repay in future. Europe was determined that Greeks must face hardship through reforms.

It is incongruous for Europe to have a central bank and a common currency, to lend to member countries, but 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 a strong public opinion against economic union, a common currency and even more against political union. Britain may well exit the EU. The EU must go all out to strengthen the Union even if it requires a British exit. A Greek Exit and its economic collapse would have been a signal to others not to be in that position.

It is quite likely that Greeks will revolt from the hardships and the decline in their living standards that austerity has brought. These hardships will increase further. It is possible that Greece will either end up with almost Fascist rulers, or go back to military rule. This may well bring discipline to the economy. On past experience this may in time lead to Greeks wanting moiré freedom. Elections may well lead to the return of Greek socialism, with extravagant social schemes. Greece may be fated to an uncertain future.

Britain is to have a referendum later this year on the monetary and political union. There might well be a British Exit from the EU. However Britain also faces an exit by Scotland from the Kingdom. Scotland will probably want to remain in the EU. A United Europe that is more homogenous than if it had Britain in it is very likely. The map of the World will change. A United Europe driven by German conservative economics may become much stronger.

What is not clear is how the global financial system can be reformed. It must be more careful in lending and monitoring its loans. Years of low interest rates in the developed world, "quantitative easing" making funds more easily available, has given us a loosely managed financial system. It must begin to demand performance in 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. (902)