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“Should Greece suffer more austerity?

The country is a serial offender and needs compulsion to correct itself. Allowing it a haircut with no fiscal and labour reforms will hurt the global economy.”

by S L Rao

The European Union brought disparate economies together. This became more so after others like Ireland and the East European countries were admitted. The countries varied in arbor discipline, government regulation, quality of management in companies, etc. The Union was driven by the powerful engine of a strong German economy. Many relatively poor countries were immensely benefited by a single currency. They borrowed heavily from banks in Europe, especially Germany. Much of the borrowing was used by most-Greece, Ireland, Iceland, Spain, Portugal-not so much for building assets and competitiveness as for enhancing consumption. Some like Ireland and Iceland woke up and reformed their economies. Their people suffered a lot of pain while this was done. Others like Greece, did not, and went through periodic crises of inability to service debts.

Comparing countries with individuals is unwise since countries have much greater options. In India, most households abhor debt. Borrowing was for an emergency, family investment (as in higher education, marriages-though most people save up over years for the purpose). Loans are

sought to be repaid as soon as is possible. The spate of farmers committing suicides whenever their crops fail is illustrative of the shame of not being able to repay debts. Since the liberalization of 1991, financing purchases through borrowings has become common particularly among the middle classes. Credit cards enable delaying payments for expenditures. Installment purchases have become very common for gadgets (mobile phones, etc), cars and other personal transportation, other conveniences, and even for services like travel. Paying for new houses in installments has been common. It has become more so as interest rates on housing loans fell from around 17% for home loans in the 1980s to around 10% now. But rare is the household that borrows to splurge far beyond its means. This is in stark contrast to North America and Western Europe, including (what were poor countries) recent joiners in the European Union.

Borrowings by companies and by governments are on a different footing. Companies usually borrow for working capital. When they borrow for asset acquisition, the calculation of the period over which it will be returned includes projection of risks, interest payable and revenues over a future period. In India in many cases, delays in getting the many permissions form governments might make the repayment period longer than envisaged by the projections. Since the lenders are usually commercial banks, (and mostly state owned banks), bank balance sheets show a high proportion of such “sticky” loans.

Governments borrow because their revenues are inadequate to meet current and capital expenditures and they are reluctant to raise taxes, cut expenditures or sell

unproductive assets to raise funds. Emergencies like floods, earthquakes, etc, have no financial cushions with governments, who have to borrow for alleviating hardships and reconstruction. Populist governments (like the Communist government in West Bengal), borrow and accumulate huge debts. They build few assets that could earn for paying off the debt fully in a given period. Successor governments then have to curtail their programmers or persuade the central government to help write them off.

Rarely however do governments borrow to enable their people live otherwise unaffordable lifestyles. This seems to have happened with many countries in the European Union, and especially after it expanded to include countries like Ireland, Greece and the East Europeans. India has never defaulted on debt repayments, nor asked creditors to take a "haircut"-forgive a portion of the loans. This seems to happen in Europe.

Many eminent people argue that Greece should not suffer austerity, that is, reduction in living standards. But they had gone up with little effort by the people and with funds from Europe, mainly Germany. The latter are now expected to support the Greeks in the life style they have got accustomed to because of other countries. This seems patently unfair. The Greeks must learn to cut their shirts according to the cloth. Ireland did this when it reformed after a similar crisis some years ago.

A Greek bailout (by lenders like the IMF and European banks), could lead to many other countries in Europe and elsewhere trying the same trick. They could ask creditors to take haircuts by forgiving a part or all of the borrowings.

They could refuse to plan a way to live within their means within a given period. While lenders like the IML are there to give emergency help, they must be repaid. If they and other lenders do not see the possibility of repayment international financial transactions could become very risky for better off countries.

Fortunately Greece is a serious serial offender and needs compulsion to correct itself. . Allowing Greece a haircut with no fiscal and labour reforms is also very likely to hurt the global economy. Others, who might follow a successful Greek attempt at making creditors pay for their economic incompetence, are much larger. There are few European countries that are not on the same path of fiscal imprudence as Greece has followed for years.

We must sympathize with the Greek people who are in great hardship that will continue for some years. But they must not be allowed to weaken the global financial system that has been built over the years. IMF and other lenders must conduct adequate due diligence in lending to countries. They must calculate a good chance of repayment of loans. (895)