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Greece Heads Into Another Economic Crisis: Time To Finally Exit the European Union?

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Constitution Square has been uncommonly quiet. When looking at the parliament building from my hotel window last month all I could see were cars and pedestrians. The crowds of demonstrators, so common in recent years as the Euro crisis enveloped one of Europe's poorer states, were absent.

But maybe not for long. Athens and its creditors are at loggerheads again.

When I spoke with the Defense and Foreign Ministers in early December, the conversations focused on Turkey's crisis, negotiations to reunify Cyprus, and security cooperation with America. The first was beyond Greece's control. The second has been a political football for more than four decades. The third has been a positive constant for years, with the current left-wing Syriza Party government as friendly to the U.S. as any right-leaning administration.

However, with Syriza lagging in the polls, Prime Minister Alexis Tsipras recently pushed through a pension boost and VAT suspension which, in Europe's view, violated the 2015 bailout, worth $92 billion (the value depends on changing exchange rates), by European institutions and the International Monetary Fund. Athens contended that it had met its fiscal targets while its creditors said they had to be consulted to assess the impact. They then suspended the package.

Insults started flying. The spokesman for the head of the Eurogroup of finance ministers said the moves "appear to be not in line" with the agreement. The spokesman for Wolfgang Schaeuble, Germany's Finance Minister and chief beta noire of the Greek public, explained "In order to make the program successful, it is necessary that measures are not decided unilaterally or reversed without notice." A member of Germany's Bundestag complained of Greece's "orgy of empty promises."

The International Monetary Fund clashed with the Euro-creditors, warning that the overall program was not "credible." The IMF indicated that additional tax hikes and pension cuts were necessary to meet program metrics and for Greece to qualify for debt relief. While the European Commission predicted that "investment is expected to take off in 2017," the Fund concluded that "growth prospects remain weak and subject to high downside risks."

Tsipras mocked "fool technocrats … who can't even get their numbers right." Looking toward a possible early election, he added: "we are not going to ask anyone about giving surplus money to those most in need." His finance minister charged the IMF with "economizing with the truth." The deputy education minister, representing a small, right-wing coalition partner, charged that

his country was being “blackmailed.” Indeed, he added, “For centuries, Greeks have been mercilessly oppressed by the Westerners.”

Interest rates on Greek debt soared. Planned negotiations over debt relief, long demanded by Athens, were postponed. The Fund threatened to pull out of the program. Germany, the biggest bailout contributor, insists on IMF participation before any further disbursements. Moody’s warned that the spat demonstrated a “hardening in creditors’ positions toward Greece, which we expect will prolong negotiations over the second review of the program.”

Yet coming elections in France, Germany, the Netherlands, and possibly Italy could stiffen European resistance further. Kathrin Muehlbronner of Moody’s noted that Europe’s “political dynamics” and “electoral calendar” were “likely to complicate the negotiations and prevent a rapid resolution.” After all, nowhere in the EU is backing more aid for Greece a vote-winner.

However, pressure on Athens for more cuts, especially in popular social benefits, could trigger elections in Greece as early as the spring. Tsipras has proved to be an adept politician, but he now lags in the polls. He can ill afford to retreat from the recent benefit boost or impose new austerity measures.

Observers again began to wonder if Greece could, and even should, remain a member of the Eurozone.

In recent years Athens looked to America for support. The U.S. has nothing directly at stake in Greece’s economic imbroglio, but the Obama administration, like its recent predecessors, freely offered its opinion on other nation’s problems. It obviously is easy to be generous with other people’s money: Washington urged the Europeans to give to Greece while receiving little in return. That isn’t likely to be the position of the Trump administration. Candidate Trump said “I would definitely stay back. Germany is very powerful and strong. I’d let Germany handle it.” And if that didn’t work, Russia could “save the day if Germany doesn’t.”

Most Greeks have had more than they want of Germany attempting to “handle it,” which meant ever more austerity. Moscow looks like an equally unlikely savior. While the Greek government officially says that it expects no change in U.S. policy, the opposition figures American pressure for debt restructuring will disappear.

Greece is a bit like your dissolute brother-in-law. A spendthrift, he gets himself into financial trouble and asks for a loan. You give it to him based on his promise to stop drinking, smoking, and romancing the ladies. He doesn’t, of course, but you really didn’t expect he would do so. However, you still want your money back. Although he promised to repay you, he doesn’t understand why you are asking. Your wife gives him some more money, based on his redoubled promise to reform his bad spending habits. And so it goes.

Greeks long have enjoyed a Mediterranean culture very different from that of the northern European states. Time is flexible, leisure is mandatory, and work is unfortunate. Government is a tool by which everyone attempts to live off of everyone else, though politics is the only sure means to succeed in doing so. Generous public benefits are the norm, irrespective of whether or not there is any money to pay them. It’s a wonderful system as long as everyone feels comfortable living a lie. And if it’s how Greeks want to live, why should anyone else complain?

The system worked for a long time. But then along came the Euro. It seemed like a brilliant idea for encouraging a tighter political union, but in the short-term it suffered one particularly grievous flaw: the Euro tied nations together monetarily without synchronizing their fiscal policies. Which meant by joining the Eurozone Greece got to borrow money at interest rates comparable to those paid by Germany while spending money like, well, Greece.

Athens lied when it claimed to meet the Eurozone's official economic criteria. But the rest of the Europeans knew Greece was lying when they approved its membership. Then Athens cheerfully borrowed to fund its unsustainable welfare state. The scam was truly grand, but by 2009 the good times ended. Greek leaders admitted that their economic statistics had little to do with reality. The lenders wanted to be paid and Greece was almost out of money. At particular risk were German, French, and Italian banks, which had lent the most, and German, French, and Italian politicians, who had put their people's fiscal security at risk.

Which led in 2010 to the start of three bail-outs cumulatively worth almost $370 billion. Greece was the nominal recipient of the cash, from the infamous "Troika," the European Commission, European Central Bank, and International Monetary Fund. To them more recently was added the European Stability Mechanism.

To solve a problem of bad loans which could not be repaid, the Troika loaded Greece up with more loans to pay. As Syriza's original Finance Minister, Yanis Varoufakis, explained: "The Greek state became insolvent a year or so after the eruption of the 2008 global financial crisis. Against all logic, the European establishment, including successive Greek governments, and the IMF extended the largest loan in history to Greece on conditions that guaranteed a reduction in national income unseen since the Great Depression. To mask the absurdity of that decision, new loans—conditioned on more income-sapping austerity—were added."

That's a pretty accurate description of the Grecian mess.

Greece's debt to GDP ratio hit about 100 percent in 2000, with the country preparing to replace the Drachma with the Euro. Debts began heading up in the latter part of the decade. When creditors finally noticed that Athens might be in a bit over its head back in 2009, Greece's debt to GDP ratio was about 127 percent. Today Greece owes around $320 billion and its debt to GDP ratio is roughly 174 percent, second in the world only to far wealthier Japan. (The debt relief being discussed would only drop that by about 20 points—by 2060!)

How will Greece ever pay back all this money? Since the onset of the crisis both manufacturing and the GDP have dropped by about 30 percent; economists hope the economy will stabilize this year. Unemployment is at about one-quarter, with youth joblessness double that rate. Most of the unemployed have been without work for a year or more. The overall poverty rate is an astonishing one-third. While there still is money in Greece—my hotel hosted a fancy fashion show while I was there—connections often are necessary to get it. Although some creditors took a hit along the way, the primary purpose of the bailouts was to preclude Greece from lightening its economic burden by writing off its debts.

Germany, France, and Italy wanted to save their banks. European Union leaders desired to move continental consolidation ever forward. Along the way the EU and European Central Bank

ignored their own rules to shovel money Athens' way. The price paid by Athens was austerity and reform, which the Greek people greatly resented. Why should they have to pay for the party that the Europeans were well aware was likely to occur when the Eurozone inducted Athens?

Perhaps even worse, however, there has been far less reform than austerity in Greece. Economic officials talk about creating a "business-friendly environment," but that's not evident in practice. According to the World Bank, Greece was number 61 in the world in "ease of doing business" in 2015. It rose one place in 2016, then fell back to 61 in the 2017 rating, where it is below Kosovo, Albania, Rwanda, Serbia, Moldova, Kazakhstan, Croatia, and Russia. In Europe only Malta and Bosnia are further behind.

The Economic Freedom of the World found that Greece was number 36 in the world in 1980. It was down to 48 in 2000. It was a poor 82 in 2010. Alas, it has kept on falling, to 84 in 2013 and 86 a year later, the last year for which figures are available. Greece comes in at 92 on business regulations, 129 on overall regulation, 142 on size of government, and 143 on labor market regulations. In fact, Nikos Filippidis of the Athens Chamber of Commerce and Industry recently wrote that economic sentiment and consumer confidence have dropped "to the lowest level recorded since September 2013."

Greece needs to free its people to be entrepreneurial. It isn't hard to construct a detailed reform agenda. Constantine Michalos, ACCI president, called for smoother operation of the banking system, end of "hostile tax-policy treatment of entrepreneurship," and expedited reforms "to improve the country's investment environment," including better public administration, judicial processes, and competition in markets. The transportation system and other infrastructure are poor and would benefit from privatization.

Nicholas Economides of the NYU Stern School of Business recently argued that "many Greeks, having tried everything else, now see reforms as the only way out of the crisis." However, such proposals, including what the IMF has called a "herculean" transformation of labor rules, generate fierce resistance from a panoply of vested interests which profit from the existing sclerotic system. Many Greeks prefer the certainty of government dependency, irrespective of the cost. Politicians on both the right and left also benefit from the system. Explained Kerin Hope of the *Financial Times*: "Each government's practice has been to delay or dilute already-agreed measures in the hope of fending off the political costs of austerity. Greece's political leaders are particularly reluctant to adopt structural reforms that would effectively end a system of clientelism, in which the party holding power hands out public sector jobs and contracts to its own supporters."

The traditional governing party of the left, PASOK, has essentially disintegrated. The radical left-wing Syriza Party has taken control, most recently winning the September 2015 election, but is philosophically uncomfortable with economic liberty. The right-leaning New Democracy Party is under a relatively new leader, Kyriakos Mitsotakis, and now leads the polls. It promises to fulfill the bailout conditions and enact additional reforms, but has a history of backing the status quo. And all the usual political pressures would fall upon it the moment it formed a government. Unfortunately, Greece has no strong liberal (classical) economic heritage to draw upon, let alone record of politicians courageous enough to back such policies during difficult times.

Austerity might seem to visit an element of justice on the spendthrift borrowers. However, creditors who cheerfully and wildly lent with "eyes wide shut" in expectation of being bailed out if anything went awry deserve no more sympathy. Nor the EU politicians practicing CYA with their people's money. And without growth-inducing reforms the bailouts offer no long-term solution.

Which suggests that the system is heading toward slow-motion catastrophe. IMF economists Maurice Obstfeld and Poul Thomsen recently concluded: "We do not believe that Greece can come close to sustaining even a modest primary surplus [before debt payments] and realize its ambitious long-term growth target without a radical restructuring of the public sector." Yet the current bailout plan envisions a 3.5 percent primary surplus by 2018.

Proposals to simply hack away at wages and benefits may have reached Greece's political limit. Dimitrios Papadimoulis, a member of Syriza and vice president of the European Parliament, is not alone in his opposition to "cutting pensions, wages and further minimizing public spending on social benefits." Filippidis explained: "Greece's middle class is collapsing under the weight of over-taxation, plummeting savings, and further impoverishment. In today's Greece, four workers are paying taxes and contributions in order to pay the pensions of three pensioners and cover the needs to provide public health services, education, justice, defense, etc. Obviously this model is not sustainable."

Pensions alone accounted for about 17 percent of GDP in 2015, compared to an EU average of nearly 12 percent. Further privatization would help, but the value of state assets has dropped by about 60 percent since the crash and, more important, parastatals are seen a politically-popular source of jobs.

Moreover, Greek goods and services cost too much for the economy to flourish. Jim Brunsden of the *Financial Times* reported that Greece's "lack of price competitiveness is cited by EU officials as one of the main factors holding the Greek economy back." On the Global Economic Forum's international competitiveness ranking Greece actually *fell* from 81 in 2015-2026 to 86 in 2016-2017. Even Papadimoulis admitted that "the Greek economy needs to be more competitive, more of the same won't do it."

However, most Greeks don't want to take the painful steps necessary to create a more competitive economy. Last month the European Court of Justice voided a law requiring government approval for layoffs. In 2013 a cement maker was prevented from cutting staff and sued. The ECJ ruled that the restriction was improperly vague and broad and inhibited "the exercise of freedom of establishment in Greece." But so far a majority of Greeks have backed parties determined to inhibit entrepreneurial freedom at every turn. No wonder Yves Lemay of Moody's observed that Greece is "in a very unpredictable situation from the credit risk standpoint."

Which leaves currency devaluation the best solution, but that is prevented by membership in the Eurozone. So Athens should consider doing what always seemed to make the most economic sense: abandon the Euro and repudiate the debt. The process would be messy. Wailing and gnashing of teeth would fill the halls of European banks and other financial institutions. Having squandered their people's money on bad loans, some European politicians might lose their jobs in upcoming elections. But Greeks could get a fresh start and organize their lives as inefficiently

and dissolutely as they desired, while creditors would have fair warning about the risks of lending in the future. Economides warned that “poverty and hyperinflation” would result, but pre-Euro Greece might no longer look so bad.

The Greek people aren’t sure what to do. A recent poll found that 84 percent of them believe the EU is moving in the wrong direction. They split 44-45 percent over whether membership is positive for Greece, yet a majority wished to remain part of the organization. The latter might change if the creditors demand more cutbacks in benefits and increases in taxes, however.

Forbes online columnist John Mauldin recently noted how Greece’s plight helps explain the growing challenge to the entire EU. Athens has followed the organization’s dictates, resulting in great pain, little reform, and even less respect for national sovereignty. “While Greece is on the periphery, its problems are hardwired into the entire EU, and those problems are spreading,” he concluded.

Whatever Greece’s present challenges, it is hard not to stand in awe when beholding the Parthenon atop the Acropolis, which dominates the cityscape. The “Golden Age” of Athens is long past, but the country’s history still resonates. For Greece to turn control of its economy over to foreigners capable of bringing relief would be understandable if still painful. To yield authority to those who have only delivered more hardship seems intolerable. At what point, one wonders, might economic pain cause the Greek people to reassert control over Greece’s future?

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