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Euro Crisis Is Tip of the Iceberg

What we see is scary enough, but the hidden part is something virtually every nation will have to navigate around over the next couple of decades.

Someday the euro debt crisis that started in Greece and spread to engulf Europe will be over.

Politicians in the nations that use the euro will figure out the right mix of carrot and stick to get Greece, Portugal, Spain, and other member states to adhere to European Monetary Union limits on debt. They'll figure out how to balance national pride with the clear need for more integrated fiscal systems among the members. They'll gradually earn back the trust of financial markets, and someday, we'll all be back talking about the euro as a rival to the US dollar as a global reserve currency.

Hard to believe right now, when the euro's troubles are driving plunges in the world's stock markets and rampant fears that the world is about to fall back into economic and financial crisis.

Hard to believe, but true.

Here's something, however, that may be even harder to believe: The euro debt crisis, for all its power to shake financial markets and the global economy, is just chapter one in a story that will run for the next two decades. This crisis is only our introduction to the kinds of wrenching changes that virtually every nation's economy will face over the next 20 years.

The euro debt crisis is a crisis coming to a nation near you. And let's hope the next chapter suggests that there's an ending to this story that doesn't involve street riots and a long-term decline in living standards for entire populations.

Let's hope. But the lesson from the euro debt crisis is that it's not going to be easy. It may not even be possible.

You probably don't think of the euro debt crisis as part of some larger global story that is going to pull in you and your family as starring characters. But it is. This isn't just a story about some feckless Greeks who went on wild shopping sprees with money lent to them by hardworking Germans who didn't check the books carefully. (But it is that story, too.)

Soon-to-Be-Ancient Greece

Some basic economics make the Greek crisis universal.

From the first quarter of 2001 to the third quarter of 2009, unit labor costs in Greece —that's how much a worker earned for producing one unit of something—rose 33%. That's a 33% increase in the cost of producing one gimcrack in Greece after you've deducted all the benefits of any increase in the productivity of Greek workers. In other words, if a Greek worker went from making one gizmo an hour to making two an hour and got paid twice as much for that hour, the unit-labor-cost increase would be 0%.

Greek productivity did climb, at an average annual rate of about 2% from 2000 to 2010. Greece showed the same productivity growth as Germany, but wages climbed faster. According to Greece's national collective labor agreement, wages rose 6.2% in 2006, 5.4% in 2007, 6.2% in 2008, and 5.7% in 2009.

The result was that Greece priced itself out of global export markets. If your unit labor costs climb 33% while those of Italy go up just 30% and those of Spain 28%— and while Germany's costs increase just 6% and US costs plummet 27% (as they did from 2001 to 2009)—you can be sure that selling your exports will get harder.

And as Greece was becoming less competitive, it was growing older. In 1971, 11.1% of Greeks were 65 or older, according to the Organisation for Economic Co-operation and Development (OECD). By 2001, that was up to 17%. By the end of 2009, 18.7%. The OECD takes its estimates out all the way to 2050. By 2031, 25% of Greeks will be 65 or older. By 2050, the figure is likely to close in on a third, at 32.5%.

The combination of falling competitiveness and an aging population would be lethal enough—fewer workers making less-competitive products to support an increasing number of retired workers—but the Greek government has made it worse. To win voters' support, governments of all parties not only promised those hefty wage increases, but they also promised generous pensions at earlier ages.

Before the crisis, for example, Greek civil servants employed before 1992 could retire after 35 years on the job if they were 58 or older. And the pension benefit is 80% of pre-retirement salary. The legal retirement age for all workers was just 61 before the crisis. In reaction to the crisis, the current government has proposed raising the retirement age to 63. (No wonder German taxpayers are steamed at the idea of having to fund a Greek rescue plan. The German retirement age is 67. For more on how German politics are making the crisis worse, see this recent post.)

To understand the full extent of Greece's debt problem, you have to look beyond the current deficit problem. That's bad enough, with the net debt level forecast to rise to 120% of gross domestic product this year.

But you have to add in the value of all those promises made to the retired and soon-to-be retired. Economist Jagadeesh Gokhale, in a report for the Cato Institute, a libertarian think tank, calculates that adding the value of the liabilities in those promises brings the level of government liabilities to 875% of GDP.

Greece can't pay that bill by cutting public sector wages, eliminating extra holiday pay, or the like. Yes, the government will have to impose drastic spending cuts and tax increases, but it will also have to massively renege on those retirement promises.

I mean massively renege. The proposed change to a retirement age of 63 from 61 is just a modest down payment.

Downsizing Promises

Greece isn't alone in Europe in facing this long-term problem, just as it isn't the only country in Europe with an unsustainably large current deficit. All of Europe is aging: 21% of the French population will be 65 or older by 2022, and in that year, 24% of Germans will fall into that demographic, the OECD calculates.

The United States isn't aging as fast. Only 17% of the US population will be 65 or older by 2022, according to projections. China's older population is calculated at just 13% by then, but it's likely to catch up quickly: By 2036, 20% of Chinese are expected to be 65 or older. (Looking for youth? Try India, where only 7.1% of the population will be over 65 in 2022, or Brazil, with 9.3% in 2022, according to the OECD.)

Greek politicians weren't alone in promising future benefits to voters. The average burden of debt, plus liability for pension and other social-service promises, averages 434% of GDP across the European Union. France, with its relatively generous social benefits, comes in at 549%. The United Kingdom stands at 442%, and Germany at 418%. Spain, which has a bigger current deficit, but relatively modest promises to its citizens, shows up in Gokhale's calculations at 244%.

And the United States? By these calculations, the debt-plus-promises burden comes to 890% of GDP. Move over Greece. Who's your daddy?

Now governments could take the next decade or two to plan ways to meet or shirk this burden. Countries could set a schedule of raising the retirement age so that everyone would know what was coming and could plan for it. More generous incentives for private savings for retirement and retirement health care could help make reductions in government-funded pensions less punishing. Subsidies could give some retirees incentives to choose less-expensive retirement housing.

Governments could do that.

But the evidence of the Greek crisis is that they won't. Politicians in Greece didn't take action until the country's back was to the wall and they had the cover of a crisis to excuse their cuts to wages and future promises. It's sad to think that a country's leaders would prefer riots in the streets to proposing painful measures before the situation reaches a crisis, but that's the conclusion I draw after watching how the Greek crisis has played out.

The transition that I'm describing from a world of glorious promises to an admission that we can't pay for the promises to a long period of reneging on those promises would be painful enough if carefully planned and managed. But without that planning, I think we're going to see most—but not all, I hope—countries lurch from crisis to crisis as governments downsize their promises to fit an aging world. (For more on how Europe's politicians see a falling euro as the way out, see this recent post).

I don't know how this story comes out. But I know that the Greek chapter has only introduced us to the characters and plot twists that we'll see over and over in the next 20 years.

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