Writing a Greek Tragedy

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CHRIS MCCARTHY, JUN 3 2012

A friend of mine has worked in financial services for many decades. He was there for the 'Big Bang' of deregulation in 1986 and he was a first-hand witness when the system stood on the precipice of near-total meltdown in 2008. I have come to consider him a sage on these matters. He chooses his words carefully and is not prone to hyperbole. When I asked him after the Lehman Brothers collapse, as financial markets plummeted, just how bad the situation was, his answer was telling: 'People don't understand how deep this goes.'

At the time I took this to mean that most investors, general members of the public, politicians, and those working in the banking industry themselves, didn't appreciate how contaminated the system was with bad debt. Governments have been struggling ever since to chart a path out of that whole. What began as a banking crisis transmuted into a sovereign debt crisis that threatens to become a social and political crisis. It is clearer now that my friend was hinting at something much bigger than just the problem of bad loans.

As the Greek sovereign debt crisis accelerated in late 2009 I asked my friend again how bad he thought the situation was. His answer was brutal in its brevity: 'They are f**ked.' There was no schadenfreude in his remark. He simply recognised then what many still do not today. There is no way this ends well for Greece. It is unhelpful to even talk about an 'end', suggesting as it does that the situation is an aberration in an otherwise linear path of inexorable growth. Much of the current debate is focused on which is the lesser of two evils; a painful exit from the Euro or a severe package of austerity measures as the price for staying in the single currency. Regardless of the choice, Greece is confronted with a crisis that has *generational implications* and potentially grave consequences for social stability and security.

The writing is already on the wall. Now in its fifth year of recession, having lost 17% of GDP and wage cuts of 30% since 2009,[1] Greece has already seen a spate of violent protests. A huge general strike on 5 May 2010 not only paralyzed vast swathes of Greece's public infrastructure, but led to the death of three bank workers trapped in a building when a firebomb was thrown by a group of criminal, anarchist protestors.[2] Earlier this year a 77-year-old pensioner shot himself outside the Parliament building in Athens after reaching the end of his tether over the indignities he had endured as a consequence of his personal debt burden. There has been at least a 20% increase in suicides in Greece since the crisis took hold.[3]

The situation in Greece is clearly desperate. Severe cuts have been made to pensions, benefits, and wages; higher taxes have been compounded by new taxes; the Greek stock market has plummeted 88% from its 2007 high – by comparison, the S&P 500 fell around 85% during the Great Depression; unemployment is about 22% overall and stands at 54% for the under-25s; and for all intents and purposes, its banks are bankrupt.

The consequences of a 'Grexit' are even grimmer. In a report this week the National Bank of Greece spelled out what those might be. The new currency would depreciate by 65% against the Euro, immediately slashing the value of people's savings and more than doubling the price of imported goods. Unemployment would rise to nearly a third of the working population and it would be accompanied by a massive spike in inflation to 30%. Per capita income would fall by at least 55% and the recession would deepen by 22%.[4] This is predicated on the assumption that the rest of the euro zone does not unravel after the first piece of string has been pulled. It also assumes Greece would be allowed to stay in the EU, which is not a given when you consider that capital controls, which Greece would desperately require if it revived its old currency, are illegal under current rules. If Greece leaves the EU as well as the euro, Swiss-bank UBS forecasts this will cost between 40-50% of GDP in the first year.[5]

Much of the analysis of the current situation is misguided in two ways. First, it assumes that the 'third way' for Greece of lightening the burden of austerity will expedite a relatively swift return to competitiveness. It will certainly help if accompanied by fiscal discipline, structural reform and supported with targeted capital to industries that yield the greatest return. But it is akin to the salvage job to rescue the stricken Costa Concordia; it will take a very long time and nothing is certain.

Greece faces many more years of austerity regardless of which path it chooses. The damage has already been done. Youth unemployment, in particular, will leave a scarring effect for a generation of workers that will consist of the un-skilled and the under-utilised. They will be disposed towards saving money, fearful of another economic crisis, but further deflating domestic demand. Cuts in welfare spending, education, and health, will have unquantifiable consequences that will take decades to work through.

If it leaves the euro it will be locked in expensive legal disputes for years as creditors insist their loans are repaid commensurate to their original valuation in Euros. And whether it leaves or stays, Greece will find access to foreign capital dries up and that which it can access will be priced unsustainably high reflecting the country's history of reneging on its debts.

Greece's biggest problem at a macroeconomic level is its lack of competitiveness. Leaving the Euro will provide a boon for the tourism industry and lower the cost of exporting goods but it needs to support these with fiscal discipline and radical structural reform; neither have been hallmarks of Greek's political class. And this highlights the second problem with current analysis; it often gives primacy to the economic dynamic at the expense of the social situation.

Greece is in the throes of what Tedd Gurr described as *decremental deprivation.* This is when one's *value expectations* stay the same – namely, what people believe they are entitled to – but their *capabilities* to sustain or achieve those expectations fall. The greater the disparity between the two, the greater the likelihood of political violence flaring up. The gap is already acute and will worsen dramatically before it improves while the violence has already begun.

Greece is trapped in a vicious economic crisis. Domestic demand is deflated, the exodus of money from Greek banks is gathering pace, access to foreign capital is severely restricted and that which it can obtain mostly goes to servicing debt. It is common to hear that Greece is not the *real problem;* that the *greater concern* is the threat of contagion of a Greek exit to vulnerable economies such as Italy, Spain, and Portugal. This would be the real disaster, they suggest. The situation in Greece already is a disaster and the strain on the Greek people is intolerable.

Eurozone leaders must recognise that if they insist on continuing to squeeze blood from a stone, or decide it is preferable to save their own skin they will not only exacerbate Greece's economic misery but may be complicit parties to a descent into social chaos. Critics counter that giving a drug addict another massive dose of what made them sick in the first place will only exacerbate the problem. There comes a point where financial assistance becomes financial dependency but if you pull the safety net away too soon without the necessary substitute support structures in place, you risk a very hard, potentially crippling landing.

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[1] http://www.guardian.co.uk/world/2012/feb/21/greeks-five-years-eurozone-crisis

[2] http://www.nytimes.com/2010/05/06/world/europe/06greece.html

[3] http://www.guardian.co.uk/world/2012/apr/04/greek-man-shoots-himself-debts

[4] http://www.ansa.it/ansamed/en/news/sections/economics/2012/05/30/Crisis-Greece-National-Bank-warns-dire-Grexit-fallout_6955708.html

[5] http://www.economist.com/node/21555923?fsrc=rss

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