



Austerity Brings Greece to the Brink

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German chancellor Merkel has proclaimed that Europe needs to find “redemption” from its economic sins through austerity. In Greece another round of austerity measures could push the already fragile economy toward collapse and the public toward desperate alternatives.

Merkel and Finance Minister Schäuble recently pledged that there would be no new bailout measures for Greece or “haircuts” on holders of its sovereign debt. Financial markets believe these assurances are aimed at the German public before the September 22 general election, because markets know further assistance or debt write-downs to prevent a Greek financial collapse are well nigh inevitable.

There is some good news in Greece: the country may achieve a primary surplus in its national budget by the end of the year. The vital tourism sector is recovering, the beneficiary of turmoil in Egypt, Tunisia, Turkey and elsewhere. The new TAP pipeline to carry Caspian gas to Europe will be built across the northern part of the country. The governing centrist coalition—down to two parties from three—is cohesive enough not to face early elections (because serving ministers know they would lose their jobs).

The core news, however, remains very bad. Greece is in a depression, not a Great Recession like the rest of Europe. The losses in middle-class and working-class living standards are brutal. Prospects for young people who do not go abroad are dire. Prospects for their parents are not much better.

The economy is simply too weak to meet the goals laid down in the current European Union (EU) “bailout” package. Without some restored growth, fiscal policy will fail again. Potential earnings from privatization schemes are quite modest, while promised reforms in the bloated public sector are largely pipe dreams. Greece is a small and narrow economy, sustained by tourism, shipping, remittances and EU subsidies. It produces some agricultural exports, but very little else. Except for EU membership, Greece would be a third-world economy, with comparable living standards.

In recent decades, however, middle-class Greeks became accustomed to a European living standard, which is now lost. Note, it is the frustrated new middle classes that have taken to the streets in Brazil, Turkey, Russia and Egypt. Greece also has an increasingly militant working class that never enjoyed much of the new prosperity but is suffering disproportionately from EU-imposed austerity.

Greece created its own mess, but the crisis is unlike elsewhere in Europe. There was never a housing bubble; households held very little debt and the banking sector was relatively sound until the public sector imploded. True, all Greeks participated in a political culture that encouraged uncontrolled government deficits and outright lying in national accounts. In Greece, patriotism is strong, but civic responsibility is weak. The state is an abstraction with little moral suasion on citizen behavior, while violence remains an accepted form of political speech. For decades, the country’s political elite—both left and right—steered Greece toward disaster with a blithe belief the day of reckoning could be avoided indefinitely.

Nonetheless, when the crisis came in late 2009, the new administration of George Papandreou did not take the route of unilateral default on the country’s sovereign debt. This was a departure from established Greek practice. Had it done so, Greece might have better economic prospects today. The move would have destroyed the country’s credit for a time and imperiled its banks, but the damage would have been swift. Control of public policy would have remained in Greek hands. Instead, Athens chose to entrust its fate to its European partners.

In truth, European financial “solidarity” with Greece was motivated by fear of insolvencies among major German and French banks due to their huge holdings of Greek sovereign debt in the post-Lehman Brothers crisis. EU policy tried to quarantine the problem within Greece, rather than solve it. Had the Greeks—of any political complexion—known that EU “solidarity” would impose slow asphyxiation on their country, they might well have opted for a more nationalist and unilateral approach, with at least the gratification of watching their northern partners share in the pain.

It is easy to criticize governments in Athens for decades of violations of EU rules and norms (all true) and for recent reform pledges unfulfilled. No Greek government could achieve what Brussels and Berlin demanded. The alternatives now are a Trotskyite regime that would abandon what has been achieved or a complete collapse of constitutional politics. It is far too late for buyer’s remorse within Europe over Greece. The experience of the Greek crisis thus far shows enormous multiplier effects spreading from Athens across the developed world. Today, a failure of constitutional government or the collapse of the Greek economy would compound other crises across southern Europe and throughout the Middle East. The current level of Greek stability is therefore worth preserving.

Redemption through austerity has exhausted whatever utility it ever had in Greece. A restoration of some modicum of prosperity is required as the foundation for any future reform or recovery in that country. This is in Europe's collective interest, not just that of Greece.

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