

to get things done, but by no means do I intend to spend my whole life down there. The system was intended for people to come from various different parts of life . . . and to not necessarily make a career out of it.”

Runyan and the 3rd District are a

good reminder of the consequences of presidential failure. Seemingly safe districts come into play. And individuals who might be otherwise engaged—say, doing color commentary for the NFL—suddenly become formidable candidates. ♦

Greece's Financial Crisis

Tragedy or farce?

BY IRWIN M. STELZER

Greece may account for only 2.5 percent of the economy of the 16 countries where the euro has replaced national currencies, but its financial woes are having a huge effect on the future not only of “euro-land,” but also of the 27-nation European Union. And on the United States: The problems of Europe’s debt-ridden PIGS—Portugal, Ireland, Greece and Spain—have highlighted the finances of nations that are running huge budget deficits, including ours. As investors and rating agencies put it, the problems of the PIGS have put national balance sheets in play. We are on notice that our triple-A bond rating is under review.

Economists have always wondered whether a single currency, circulating in countries with 16 different budgetary and fiscal policies, could long survive. After all, the area’s central bank would have to find a one-size-fits-all interest rate that would control inflation in countries with overheating economies while at the same time stimulating growth in economies in recession or growing too slowly to maintain full employment. Answer: It can’t be done. At least, not very well.

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But it turns out that is the least of euroland’s problems. The inventors of the euro have always known that monetary union without political union would be unsustainable. Germany would keep its fiscal house in order, a result of its historic experience with the consequences of inflation, while other countries such as Greece might go deep into debt, borrowing at attractive interest rates because investors assumed that should it run into repayment problems its euroland colleagues would somehow bail it out.

In anticipation of this problem the inventors of the euro required that all members sign on to a Growth and Stability Pact, pledging not to allow their fiscal deficit to exceed 3 percent of their GDP, or total debt to mount to more than 60 percent of GDP. European federalists always saw this as a temporary measure, eventually to be replaced with formal political union and the emergence of a United States of Europe, never mind that voters in many European countries want no part of such a surrender of nationhood.

Greece, eager to trade its drachma for the euro so that it could borrow at the lower interest rates that membership would make available, readily agreed to the 3 percent limit on its deficit, was inducted into the exclusive euro club—and then went on a borrowing spree concealed by a variety of accounting

tricks and some outright economizing with the truth. With the help of Goldman Sachs and other banks, Greece engaged in exotic financial transactions and also sold future income streams such as revenues anticipated from landing fees at its airports for current cash, and then concealed the liabilities with a variety of off-the-balance-sheet devices that Goldman now admits were insufficiently transparent. (At one point the Greek government considered selling off future revenues from the sale of admission tickets to the Acropolis, but it finally decided that headlines like “Greece Sells the Acropolis” might attract unwanted attention to its financial shenanigans.)

Investigators from the European Central Bank, aided by experts from the International Monetary Fund, are still trying to determine the size of Greece’s deficit, a process not made easier by a strike of Greek Finance Ministry staff in protest against efforts to cut their benefits or raise their retirement age. The best guess is that last year’s deficit came to almost 13 percent of GDP, total debt is well in excess of 100 percent of GDP, and unless spending is cut and taxes raised, the flood of red ink this year will be no lower. Problem: Greece has to borrow about \$75 billion to repay debts due this year, and unless the deficit is brought under control investors are either going to just say no or demand punishingly high interest rates to make their capital available. Unless, of course, Greece’s euroland or EU colleagues guarantee repayment, setting the stage for similar requests from Portugal, Spain, and perhaps Italy and Ireland. Call it moral hazard.

Here is where history matters. To get the Germans to give up their cherished, stable deutsche mark in favor of the euro, their leaders had to promise that under no circumstances would Germany become the lender of last resort to countries that failed to keep their fiscal houses in order. Indeed, Germany went along with the European “project”—replacement of nation states with a federal Europe—only because it wanted to end fears of a German Europe by creating a Euro-

pean Germany. The “project” from its inception was less about economics than about creating a political union so tight that war became unthinkable. The theory, rather charmingly Marxist in conception, as Gideon Rachman notes in the *Financial Times*, was that by creating economic institutions—the European Coal and Steel Community, then the Common Market, then the common currency—the founding fathers were ensuring that European political institutions would soon follow, consigning the nation-state to the dustbin of history. In the event, it is not clear that politics follows economics.

At least it doesn’t seem to be working that way so far. German chancellor Angela Merkel has made it clear that she has no intention of having her taxpayers (voters) pay for Greek profligacy. If the Greeks think that she will change her mind, so the joke making the rounds in Europe goes, they have really lost their Marbles. Not that the Greeks are eager to give Germans a say in how they run their country: Having once had experience with that circumstance, they do not want Merkel’s tanks wheeled onto the lawn of their finance ministry. Deputy Prime Minister Theodoros Pangalos says that Greece faces a period of austerity because Germany never paid adequate reparations for its occupation: “They took away the Greek money, and they never gave it back. This is an issue that has to be faced.”

One can’t help feeling at least a bit sorry for Greek prime minister George Papandreou, who inherited the mess he now confronts. Papandreou is an American-born sociologist trained at, among other places, the London School of Economics. He is also the son of a distinguished economist, with two brothers trained in that dismal science, and thus not short of economic advice. What he lacks is control of the voters in a country in which one in three workers is employed by the state, many in no-show jobs, and in which evading taxes is the national pastime—most shops have a two-price system, with hefty discounts for customers willing to do without a sales receipt.

Papandreou fears that if he accedes to the demands of his fellow eurozone

members and cuts spending even more than he plans by laying off large numbers of public sector workers, raises Value Added Taxes from 19 percent to 20 percent or 21 percent, and turns the tax collectors loose (only 70 percent or less of VAT due is actually collected), recent general strikes and protest marches will escalate into destabilizing, window-smashing social unrest. It seems that Greek public service workers are especially offended by the government’s proposal to raise the retirement age from 61 to 63.

The EU does hold one trump card: Article 126.9 of the 27-nation’s Lisbon Pact allows Brussels bureaucrats to seize control of Greece’s budget. That is not likely to happen, at least overtly. Creeping insertion of monitoring seems more likely. Meanwhile, negotiations continue. The EU is pressing Greece to get its deficit down, the markets are warning that Greek bonds will bear high premiums when the country seeks new financing, and Papandreou is denouncing his potential saviors for interfering in his country’s affairs—a bailout is fine, but attaching strings to incoming checks is not. For good measure he is accusing “certain other forces”—read U.S. hedge funds—of trying to bring down the euro, a cry also heard in Spain, where the intelligence services are investigating collusion between the media and U.S. investors to drive Spain’s economy to ruin.

Which brings us to California. And New York. Among others. We live in an age when private sector deleveraging is running alongside huge increases in public sector debt. Greece is not alone in running double-digit deficits, or pushing its debt-to-GDP ratio to levels that new studies show will stifle future growth. Nor is it alone in keeping huge future liabilities off the national balance sheet—as any analyst of the Obama budget plans will tell you. Of course, the United States is not Greece: We have a reserve currency that retains worldwide acceptability, a central bank that sets interest rates appropriate to our economic circumstances (or tries to), minimal tax evasion, a far smaller (but rapidly growing)

public sector, and a set of books that are more credible than those in Athens.

But we have been warned by the rating agencies that continuation of the triple-A rating granted our government’s debt is no longer certain, and that unless we mend our profligate ways, we will have to pay more to borrow, with a crippling effect on our ability to return to historic growth rates. Worse still, just as euroland countries are faced with the prospect of taking Greek debt onto the area’s balance sheet, our federal government is increasingly faced with the prospect of having to take states’ debt onto the national balance sheet, either by lending states money or by sending more and more funds from Washington to state capitals to prevent defaults.

“Drop Dead, New York,” and California, and Illinois, and Michigan are not headlines President Obama wants to take into his reelection campaign. Unlike the eurozone, the United States is a federal as well as a monetary union. If things get bad enough, the powers that be in Brussels can tell Greece to shape up or ship out—abandon the euro and start printing drachmas again, lots of them. Tempting as that solution might be to solvent American states that have avoided the regulatory and tax excesses of, say, California and New York, abandonment is not an option. Berlin can tell Athens it will let it default rather than bail it out; Washington can’t say that to Sacramento or Albany. Pity. The rating agencies know that, and are adding state debt to federal debt during their reviews of America’s financial health.

We will know soon how the Greek tragedy ends. My guess is that Greece will muddle through, with investors assuming that Greek debt has the implied backing of financially stronger euroland countries. But Greece will have to accept a loss of sovereignty, as its fellow euroland members demand a say in its spending and tax plans—rather as our bailed-out banks have had to accept supervision of bonuses by the government, and bailed-out auto companies will now have to produce the sorts of cars politicians deem in the public interest. He who pays the piper . . . well, you know the rest. ♦