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## Global Banking Is What's Really in Crisis

By [IRWIN STELZER](#)

We are confronting a crisis, all right, but it is not a Greek crisis, unless uncertainty as to the date of that country's de facto default counts as a crisis.

If the insolvency of that tiny country were the world's only problem, it would be stretching the word "crisis" to apply it to the travails and insolvency of that tiny country.

What we have come to call the Greek crisis is, first, an international banking crisis. Like Lehman Brothers, Greece is definitely not too big to fail. It is too interconnected to fail, too interconnected to the international banking system, too interconnected to the political ambitions of those who have spent decades replacing the system of nation states with a united Europe.



European Pressphoto Agency (Rompuy);Reuters (Barroso) Agence France-Presse/Getty Images (Trichet)

Mixed messages are coming from Herman Van Rompuy, left, José Manuel Barroso, center, and Jean-Claude Trichet.

Start with Greek banks, which hold €70 billion (\$99.3 billion) of their government's sovereign debt. The Economist estimates that if Greek banks were required to recognize the fact that markets are valuing Greek government debt at about half the value assigned to this paper

on their books, shareholders would be wiped out and the banks would have to scramble to raise substantial new capital. Depositors would scramble to get their money out, and the European Central Bank would have to torture its rules to find a way to continue accepting Greek bank IOUs in return for the cash needed to maintain the liquidity of the Greek banking system.

Other financial institutions would also find life more difficult. Many of Germany's under-capitalized banks would be hard hit if they were forced to recognize that their books are in good part works of fiction, with IOUs of Greece and its banks and businesses recorded at values that have no relation to their true worth.

German banks are not alone in their predicament: The rating agencies are already expressing concern about the exposure of three French banks and some 29 Italian banks, and the governor of the Bank of England has called the problems of overly indebted euro-zone countries the "most serious and immediate risk" to the U.K. financial sector. It is also obvious that we have no clear idea of the exposure of U.S. money-market funds to Greece's insolvency, or of insurers—remember AIG, anyone? That's why \$51 billion has been pulled out of those funds in recent weeks by nervous investors, why America's banks have become reluctant to lend to their European counterparts, and why the Fed is asking U.S. banks about their exposure, including credit default swaps written on European banks.

Greece's problem has also revealed another crisis—a crisis of governance. The Tower of Babel that is euroland governance is collapsing. Markets have gone from puzzled to incredulous and on to near-panic as Herman Van Rompuy says one thing, José Manuel Barroso another, Jean-Claude Trichet another, Angela Merkel still another. Their failure to sing from the same hymn sheet is damaging—no, destroying—any confidence markets might once have had in the competence of the euro-zone governing class.

On to the next, and related crisis, a crisis of German identity. The current generation of German voters is no longer certain it must pay any price to subsume its nation in a wider Europe lest its nation's economic power stir fears of a rebirth of the "German problem." Germans remember the decades-long price they paid to bring

woebegone East Germany closer to the economic standard of the West, and are not sure they want to pay a similar price to bring southern Europe up to German standards of economic performance, if that is even possible. A Germany that wants once again to be a "normal" country is not a nation that will uncomplainingly consent to the perpetual southern shift of its income and wealth, which is the only alternative to default other than devaluation, unavailable to euro-zone countries.

What we are calling the Greek crisis is also a crisis of structural economic dysfunction. Illiquidity and insolvency are merely the symptoms of the deeper problem affecting a broad swathe of the euro-zone. Excessive debt is not the result of profligacy alone. It is also the result of demography and of a lack of economic growth. The ageing of the European population, and the increasing proportion that consists of immigrants not enamored of Western values and free markets, present problems Europe has yet to confront. Nor has it coped with the stifling effect on innovation and growth of the systematic protection of inefficient private- and public-sector institutions. Illiquidity and even insolvency can be cured with money; a lack of international competitiveness in countries unable to devalue requires the stronger medicine of structural reform.

But enough whining. In Philip Roth's wonderful novel "Portnoy's Complaint," a book closer to reality than the ledgers of many banks, a psychiatrist listens to the protagonist's complaints about his life for more than 200 pages, and then remarks, "Shall we begin?"

Let's. If we accept that the politicians have decreed that immediate default is off the table, we can, indeed, must:

- force the banks to recognize that much of what they count as assets aren't, and to recapitalize, even if this slows lending and growth in the short term;
- recognize the need to speak to markets with one voice;
- admit that perpetual dependence on the generosity of Germany is not a sustainable policy;

- remove incentive-numbing high taxes and barriers to innovation in order to generate the growth and tax revenues to support more sensibly constructed welfare states.

There's more, but that would be a start.

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