

PRINT



READ THIS SKIP THAT

# BLOGS & STORIES

## A Greek Economic Tragedy

by *Jeffrey E. Garten*

February 9, 2010 | 3:38pm

**Athens' money mess has already triggered one spasm in the global markets. Jeffrey E. Garten on how this week could be worse—and set off a long-overdue confrontation over the West's public debt.**

On Wednesday, large-scale crowds are expected to gather in Greece to rail against upcoming austerity measures. And on Thursday, a "crisis summit" of the European heads of state will convene to agonize over the possibility of a Greek debt default—which, should it come to pass, would mark the first time a member of the European Union and a user of the euro snubbed its creditors. The New York Times, The Wall Street Journal, the Financial Times, and others have all devoted enormous coverage to the drama across the Atlantic. But Greece represents only about 2% of the European Union's GDP, so why all the fuss? And should we on this side of the ocean be worried?



Richard Drew / AP Photo

---

Greece may be an outlier, in statistical terms, but no one should be fooled into thinking that the agonizing struggles it faces are not coming our way.

---

Picture someone who has experienced a severe heart attack. He underwent extensive surgery, then entered intensive care. The doctors were cautiously optimistic about a slow recuperation, but then new problems began to appear not in the heart but in one of the patient's limbs. The physicians wondered, with great anxiety, whether this new complication could spread and set back the recovery, because these were the same specialists who themselves were humbled by the original traumatic event, which they failed to anticipate and totally underestimated. Now they were taking nothing for granted.

Think of the patient as the world financial system and the new complication as Greece, a small country, far from any great financial center, that is now in the global spotlight because of severe financial stresses stemming from massive deficits and rising debt. The doctors are central bankers and finance ministers. The big questions: how big are Greece's problems, are they contagious, and how great could the damage be?

Greece has been living way beyond its means and now needs to borrow approximately \$50 billion in the next few months or default on its government-issued bonds. In order for investors to buy these bonds, they will need evidence that the Greek government can tighten its belt beyond anything its parliament has been willing to do so far—demanding that Athens reduce its deficits from about 12% of GDP to closer to 3% over the next few years, the equivalent of Washington's paring its \$1.6 trillion deficit to \$400 billion. Even then, these lenders will demand an extraordinarily high interest rate to compensate them for the risk they will be taking that serious austerity will not be sustained. Alternatively, if the private markets don't come to its aid, Greece may receive a bailout from the European Union or the International Monetary Fund. But even that would come with severe belt-tightening conditions—and would follow a period of highly public and even confrontational negotiations, during which the markets for Greek securities will have deteriorated.

Either way, there are a number of reasons that the turmoil created by the Greek problem could spread throughout the global financial system.

Banks and other lenders are worried that the Greek situation could spread to other financially weak countries in the EU, namely Portugal and Spain; but some even talk of Austria and Belgium, where debts are also sky high. Bankers' anxieties would mean steeper borrowing costs for several of these countries. Higher interest rates could spread throughout the euro zone, constricting consumer demand, industrial investment, and the European recovery. Slower growth in the European Union, an area that accounts for some 30% of the global economy, would hurt recovery in the U.S., because it would reduce our trade and investment.

Since all these countries are part of the euro zone, investor confidence in the euro could quickly erode, as was happening last week. Euros would be exchanged for dollars, and the new demand for the greenbacks would cause its value to rise. A stronger dollar would damage us by making American job-creating exports more expensive in global markets. Only last week, President Obama announced a massive export push with the goal of doubling American sales abroad in five years and creating or saving some two million jobs.

There are a number of major European banks, institutional investors, and investment funds that hold Greek, Portuguese and Spanish bonds. The value of their holdings could diminish. The banks, in particular, may also have lent to the private businesses in these three countries, and the collective damage to their stock market values could drop materially-the last thing any bank needs today.

Growing concerns about all these developments could become a self-fulfilling prophecy as investors withdraw money from some or all of these countries to protect their assets. An especially pernicious development could be that massive hedge funds bet against Greece, selling its bonds short and forcing or accelerating a crisis. Today the Financial Times reported that hedge funds were already betting some \$8 billion against the euro itself, the largest short positions ever held against that currency. This kind of trading activity is now a routine part of the global financial scene, having added to the pressure to bring down Bear Stearns and Lehman.

What has everyone appropriately nervous is what the experts may not know about the hidden interconnections in the world financial system or the real state of political anguish that may exist below the surface. Could the Greek crisis fall particularly hard on one or two key European financial institutions, themselves with all kinds of tentacles to others? Could there be a political backlash in Greece to foreign demands for austerity that sets off similar political convulsions throughout Europe? Is this the spark that unleashes trade protectionism in Europe, one with contagious impact, as happened in the 1930s?

What is also worrisome about the emerging Greek tragedy is that although Greek debt is relatively much larger compared to its GDP than others in Europe or compared to the U.S., we may be witnessing the opening salvo in a decade-long struggle of the West to come to terms with the horrendous public debts that have been built up as governments have intervened in their economies with trillions of dollars of economic stimulus and bailouts to avert a major meltdown. Soon these obligations must be serviced with higher taxes or radical cuts in public spending. There is no history of democracies displaying such political courage voluntarily. Greece may be an outlier, in statistical terms, but no one should be fooled into thinking that the agonizing struggles it faces are not coming our way, and that if our political system can't handle it, the cold-blooded financial markets will.

In the end the Greek crisis may be manageable. But beware of turmoil on the periphery, especially when the center itself is weak. After all, it was a devaluation of the Thai baht that set off the Asian financial crisis in the late 1990s, one that spread from Indonesia, South Korea, and then bounced to Russia and even to Brazil. And it was a small corner of the global capital market called sub-prime mortgages that ignited the most severe global credit crisis since the 1930s.

*Jeffrey E. Garten is the Juan Trippe professor of international trade and finance at the Yale School of Management. He served in economic and foreign policy positions in the Nixon, Ford, Carter and Clinton administrations.*

For more of The Daily Beast, [become a fan](#) on Facebook and [follow](#) us on Twitter.

For inquiries, please contact The Daily Beast at [editorial@thedailybeast.com](mailto:editorial@thedailybeast.com).

URL: <http://www.thedailybeast.com/blogs-and-stories/2010-02-09/a-greek-economic-tragedy/p/>

**PRINT**

---