How to douse the Greek fire

The debt crisis is likely to spread to Portugal, Spain and Ireland, if not Italy. There is no way by which a bailout package can be worked out to meet all these demands.

Bhaskar Balakrishnan

The Byzantine Greeks developed a fearsome weapon called "Greek fire" for use against Islamic invaders. The Greeks kept its composition a closely guarded secret, but it included naphtha, quicklime, and sulphur, resembling the napalm of today. This liquid concoction was sprayed on the enemy and set on fire. Efforts to extinguish it with water resulted in it flaring up further. It clung to and burned the foe and could not be put out.

Today, a financial version of the Greek fire has been unleashed and threatens to consume the Euro zone. Greece is facing a big problem of managing its huge debt, especially the credibility of government bonds it has issued over the years. The IMF-EU have come up with a rescue package of €110 billion over three years, conditional on Greece carrying out a severe austerity programme to cut the government deficit to below 3 per cent of GDP by 2014, from the present 13.6 per cent.

The German cabinet has just approved €22.4 billion for this, despite strong public opinion against lending money to support Greece. This package may not be sufficient to achieve the task. Even this programme has not doused the Greek fire, which now threatens to spread to Portugal, Spain, Ireland and possibly Italy.

The present effort to put Greece on track is seen by many infuriated Greeks as an attempt to bail out European banks and institutions at their expense.

FISCAL PROFLIGACY

Greece has come to this pass due to the profligate and unwise management of government finances over many years. Both major parties, the centre-left Pan Hellenic Social Movement (PASOK) and the centre-right New Democracy (ND), are responsible for this.

Populist policies, generous pension benefits, bloated government payrolls, and gross mismanagement of state enterprises, large scale tax evasion, together with failure to check corruption and undertake major reforms in the economy are some of the reasons that have led to Greece's present situation.

Greece was never really ready for the euro, and, in fact, some creative accounting was used to meet the Maastricht criteria, at least on paper. Under the PASOK government Greece joined the Euro zone. The truth about budget deficits emerged much later on in 2005, after the government changed hands from PASOK to ND.

By then the damage had been done. Many Greeks associated the entry into the Euro zone as responsible for high prices, for example "rounding up" the price of a cup of coffee to €3, one of the highest in the Euro zone.

BUSINESSES, EDUCATION HIT

Massive government spending for the 2004 Olympics projects led to a boost for the economy, which petered out by 2007.

Overregulation and complicated business regulations made Greece a difficult place to do business in, despite obvious advantages of location and proximity to the African, Middle Eastern and East European markets. The shipping sector which had won for itself a tax-free offshore status did well; Greek-controlled shipping tonnage ranks No. 1 in the world, but its contribution to Greece's tax revenues is relatively small.

The tourism sector benefited from a rich variety of islands and cultural sites, plus a favourable climate. Despite these advantages, the high prices of tourism products made it uncompetitive compared to North African and Asian destinations, leading to a decline in winter tourism. Nevertheless Greece still manages to pull in a significant number of foreign tourists, and could do even better once the present crisis eases.

The ND government made intensive efforts to reform Greece's higher education system plagued by evils such as poor management, lack of focus on academic excellence, and excessive interference of student and faculty unions in management. Greece has one of world's highest figures for number of students abroad per capita.

Many brilliant Greek students, academics, and successful businessmen are working abroad due to lack of opportunities and frustration in Greece. The Greek diaspora of several million is vibrant and dynamic and has strong political clout in the US and Australia, for example.

To sum up, Greece was already on a weak economic track, with reforms badly needed in critical areas, such as higher education, public sector management, tax compliance, corruption, and excessive trade union activism. The financial meltdown of 2008 dealt a severe blow to already weak economies such as Greece.

DEBT RESCHEDULING

What lies ahead? The present effort to put Greece on track is seen by many infuriated Greeks as an attempt to bail out European banks and institutions at their expense. These entities are not being asked to share in the sacrifices to be made through debt rescheduling or restructuring arrangements.

The far left Communist Party (KKE) and extreme right party (LAOS) have seized the opportunity to whip up support against the government, and a period of political polarisation lies ahead. The Papandreou government seems determined to stay on course and has a comfortable majority, but this could get eroded. The Greek fire raging within the country will not die down easily. The implementation of the austerity measures promised to the IMF-EU will be difficult, as past experience shows.

Abroad, the Greek fire is most likely to spread to Portugal, and then on to Spain and Ireland, and possibly Italy, countries in the vulnerability zone.

There would be no way to put together a bailout package to meet all these demands. Therefore a debt restructuring/rescheduling operation is the only option, however unpalatable it may seem to the world's bankers.

The very idea of this will of course send negative signals to the market. But global financial institutions have done it before, in the case of Argentina, and they should do it again, if needed.

(The author is a former Ambassador to Cuba and Greece. blfeedback@thehindu.co.in)