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Looming insolvency in Greece

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With the Greek government having broken off debt negotiations, the country faces impending insolvency in the days ahead. There is no money left to pay back the IMF loan to the tune of around EUR 1.6bn due on Tuesday. Even if nobody wants it, this could trigger a process that leads swiftly to Greece's exit from the euro. This could unfold as follows: A Greek insolvency would initially plunge the Greek banking system, with its sizeable claims on the state, into a severe crisis. The European Central Bank is unlikely to offer further emergency loans to keep the banks afloat. People wanting to stash away their euros in safety would find the banks closed. The Greek government would have to issue IOUs or the like to pay its employees. A parallel currency would emerge. This development could only be halted with further bridging loans from the euro member states. But that would require a political accord, which the Greek government is evidently not willing to accept.

It is also questionable what might happen should Greek voters vote in favor of the stipulated reforms on Sunday. Support for tax increases and pension reforms is indeed now conceivable as fear of exit and the resulting losses of income and assets grows by the day. But can a government lead a country in a direction which it itself deems completely wrong? From an entrepreneurial perspective, that is fairly absurd. Such a situation would really call for fresh elections, but that would condemn the country to further turmoil. The worst thing about all this is that it is the Greek population that will suffer the most.

In the election campaign, Greek politicians were skilled at convincing people of the supposed dangers stemming from austerity and reforms. Saving in a debt crisis was nonsense because it would clobber demand and threaten economic collapse. The administered medicine could be fatal. Such arguments are used in an attempt to shift responsibility for the Greek crisis to the creditors who imposed this policy. That turns things on their head. It was the Greek government's laissez-faire approach to spending and debt that ultimately led to the crisis. In 2008 one in five people were employed directly or indirectly by the state, wages shot up by 50% between 1999 and 2007 and were well above those in the private sector. According to the OECD, the average ministry had 439 departments or units and a corresponding number of well-paid department heads. Clientelism and bureaucracy flourished. Such structures need to be changed in order to get the country back on its feet. Austerity must go hand in hand with reforms aimed at improving the efficiency of the public sector and the competitiveness of the economy. In this regard, little has happened to date, with the result that the painful cuts the Greek population has already endured have so far failed to heal the economy.