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Is Greece's Debt Trashing the Euro?

By [LONDON THOMAS Jr.](#)

Athens

DIMITRIS DAMIANIDIS is a high school teacher and a strong supporter of Greece's socialist government. But that won't deter him from going on strike with hundreds of thousands of other public sector workers next week to fight for the 28,000-euro pension that he expects to receive annually after he turns 60 next year.

"Why should I as a worker pay for the errors in policies?" he asked, in response to reports that the embattled Greek state will cut his pay and, by extension, retirement benefits. "The worker can't be the scapegoat. So we have to defend ourselves."

As Mr. Damianidis and others on the state payroll prepare to stop work on Wednesday, fear is building that the country's new government may lack the nerve to cut public wages and pension payments, which make up 51 percent of its budget.

Over the past decade, Greece took full advantage of a strong euro and rock-bottom interest rates to fuel a debt binge by the country's consumers and its government. Now, if Greece can't persuade investors to buy 53 billion euros of its government debt this year, it may have to seek a bailout from its [European Union](#) brethren or the [International Monetary Fund](#) — or, worse, to default.

The stakes are high not just for Greece but for the entire euro zone, where efforts to forge a common economic identity are threatened by the [financial crisis](#). Last week, the panic spread to Portugal and Spain, and the cost of insuring their debt against a default soared to record levels as investors bet that, like Greece, governments in those countries won't be able to rein in bloated budgets.

“The risk of contagion is a real one,” said Scott Thiel, the head of European fixed income at the asset management firm [BlackRock](#) in London. “Investor sentiment is now focused on countries like Spain and Portugal, where fundamentals are weakest.” He said that for now, he saw little risk for Italy, given the relative stability of its economy.

The euro, which has become one of the world's strongest currencies since its introduction over a decade ago, is now down 5 percent against [the dollar](#) this year. The euro's decline picked up speed when the [European Commission](#)'s statistical office revealed in mid-January that Greece had been submitting false data to calculate its budget deficit. (Late last year, Greece stunned investors by saying that its government deficit would be 12.7 percent of its gross domestic product, not the 3.7 percent the previous government had forecast earlier).

Greece's problems, and those looming over its neighbors, have laid bare the dangers of divergent fiscal and political policies in [the euro](#) zone, calling into question the grand European experiment of squeezing 16 disparate countries into a monetary union.

“We have a centralized monetary policy, but we allow budgets and wages to move in different directions,” said Paul De Grauwe, an economist in Brussels who advises the president of the European Commission, [José Manuel Barroso](#). “Without a political union, in the long run the euro zone cannot last.”

Indeed, as core economies like those of France and Germany show signs of economic recovery, Greece, Portugal, Ireland and Spain are just entering savage recessions. Spain, the largest of the peripheral economies, announced last week that the number of its unemployed had reached four million — the highest in its history — and warned that the country's deficit might be worse than previously thought.

As growth slows and debt rises in these countries, government largess for university fees, secure government jobs and lifetime pensions will come under increasing pressure.

So, on a continent where the culture and legitimacy of the mother state are so deeply ingrained — and now in some cases unaffordable — a question remains: Can the European Commission say “no more” to prodigal nations like Greece and, to a lesser extent, Spain and Portugal? And how will the countries themselves confront the political fallout of economic distress?

“People view these welfare polices as acquired rights,” said Jordi Galí, an economist who leads the Center for Research in International Economics in Barcelona. “If the Spanish government were to stop paying the fees for students at universities or any move in that direction, there would be a major social uprising.”

To avoid such a possibility — and to calm the panic in the markets — the European Commission may decide to rescue one or more of the governments. But a bailout of Greece, Spain or Portugal would not be as easy as the United Arab Emirates writing a check to Dubai: The European charter includes a no-bailout clause. Even if such a clause were to be overridden, much of the financial burden — and it would be huge — would fall upon Germany, the richest member of the union, said Daniel Gros, who leads the Center for European Policy Studies in Brussels.

“That is why it would be easier to call in the I.M.F.,” he said.

TO be sure, Mr. Damianidis is among the smallest of actors in this saga.

Yet his sense of entitlement shows how hard it will be for governments in Portugal, Spain and Italy to persuade their citizens to accept cuts demanded by Brussels as well as bond investors.

Like many public-sector workers and civil servants in Greece, Mr. Damianidis has led a comfortable middle-class life over his 34 years working for the state. His house is paid for, he can afford to go away for a two-week vacation every year, and he has a daughter in a private school. His job is protected by the constitution, and the pay of public sector workers has doubled over the last decade. Much of the increase for workers like Mr. Damianidis is from bonuses, which the government wants to cut.

The bonuses, he concedes with a smile, have nothing to do with his skill as a high school teacher. “Over the years, whenever workers would strike, they would in some cases get a bonus,” he said, as he sat in a local union office here.

For decades, both conservative and socialist governments in Greece have rewarded the demands of public sector unions with higher pay and more jobs.

In 2009, striking farmers were paid 400 million euros by the government — and this year they are back again,

having briefly closed Greece's border with Bulgaria. Protesting dockworkers extracted big payouts from the government in November. And the country's tax collectors went on strike on Thursday even though their services are needed more than ever.

Striking is a bit of a national sport in Greece. Last month, the country's unionized prostitutes took to the streets, protesting unlicensed competition from Russian and Eastern European immigrants.

With concessions and accessions, the country's budget has become bloated. In Parliament, for example, the administrative staff has increased to 1,500 from 700 in the last few years, even though the number of members of Parliament has remained the same. Last year alone, 29,000 public-sector workers were hired to replace 14,000 who retired, according to the finance ministry.

"There is no end," said Stefanos Manos, a former minister for the economy in the 1990s and a persistent critic of what he considers spending abuses in Greece. "The hiring and the spending is uncontrollable."

The pressing question now is whether the new prime minister, the lifelong Socialist George Papandreou, can break this cycle of appeasing various constituencies. This will determine his success as a reformer, to say nothing of Greece's ability to rein in public expenditures and meet its target of a budget deficit of less than 3 percent of gross domestic product by 2012.

Mr. Papandreou, a political scion whose father and grandfather were also prime ministers, took office late last year. Since then, he has been sending mixed signals about his commitment to budget austerity. He and his finance minister, George Papaconstantinou, have called for unpopular sacrifices like a public-sector wage freeze, an increase in the price of gasoline, smaller bonuses for workers like Mr. Damianidis and a crackdown on tax evaders.

But other moves have demonstrated less fiscal restraint. Soon after the election last year, he signed off on a 1.6 billion euro "solidarity handout" to low-income Greek families. He has also said he will hire 2,000 new workers in the country's energy department. His government also approved a measure giving borrowers a 12-month grace period to pay overdue debts and mortgages.

Mr. Papandreou's disparate policies may be a result of having a wide range of advisers. He has sought counsel

from [Joseph Stiglitz](#), the economist who has written critically about International Monetary Fund-style policy demands like sharp spending cuts, and Gary D. Cohn, the president of [Goldman Sachs](#).

Mr. Cohn has positioned his firm to be the leading underwriter of Greek debt — a role that will require it to convince investors that Greece will institute the same budget-tightening measures criticized by Mr. Stiglitz.

“What we learned in Asia in 1997 was that the advice of cut, cut, cut made recessions worse,” said Mr. Stiglitz. He said he has advised Mr. Papandreou to look for ways to stimulate the economy, such as increasing credit to small businesses, and said he believes Europe should be more aggressive in coming to Greece’s aid.

Through a spokeswoman, Mr. Cohn declined to comment on his work with Greece.

SITTING in his art-bedecked office here in Athens last month, Mr. Papaconstantinou dismissed talk of bailouts and bankruptcy and argued that only a center-left administration like the ruling Socialist party would be able to reach a deal with Greece’s trade unions.

“We are not asking for blind trust; we just need a few months,” he said. Mr. Papaconstantinou said he would be making a trip next month to the United States and Asia, aiming to persuade investors outside of Europe to buy Greek debt. But he made clear that there was no commitment on the part of China or any other country to buy Greek bonds. Goldman Sachs has also said that it has not made a formal pitch to China.

Mr. Papaconstantinou conceded that the debacle over the underestimate of the budget deficit had been a huge blow to the country’s credibility. He said that the official in charge of the office that gave the wrong figures had been let go and that legislation would be passed to make the office independent. It is currently part of the finance ministry.

Timothy Allen, a spokesman for Eurostat, the European Union’s statistical agency, said that there was no evidence of any similar inaccuracies in other countries. Nevertheless, as a result of the Greek imbroglio, Eurostat will now be given new audit powers to examine data from other European Union members.

After the debacle, the three main rating agencies downgraded Greece’s debt. Critics of the agencies say they should have anticipated the problem, not reacted to it.

“They’ve been behind on absolutely everything: [Enron](#), WorldCom, mortgage debt and C.D.O.’s,” said Jonathan Tepper, a partner at Variant Perception, a research house based in London.

Ratings agencies defend their record, saying that throughout the last decade, Greece has been rated below all other euro zone members.

Greece’s government, meanwhile, has made bold promises to rein in spending, but the more than one million public workers may not accept that the state can no longer meet its commitments.

As he dispensed lunchtime glasses of Greek brandy to his colleagues after an organizational meeting in a small union hall here, Panagiotis Vavougios, the 80-year-old head of the powerful, 200,000-strong retired civil servants union, was not in the mood to compromise.

“It is not the workers that should be blamed for this; it is bankers and large capital,” Mr. Vavougios said. “We will take to the streets.”

Niki Kitsantonis contributed reporting.

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