

## **A Lesson to be learned from the Greek situation**

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ALTHOUGH the global economy is evidently on course to recovery, the fiscal crisis in Greece has raised crucial concerns about potential instability in the recovery process, especially in Europe. Many fear that Greece may eventually default on its government bonds and create a hostile environment for other European economies that have high fiscal deficits and public debt, including Portugal, Ireland, Italy and Spain. Global sovereign risks rose as Greece's fiscal consolidation plans were deemed unachievable and any help coming from the euro area was unclear.

### **DEFICIT AND THE EURO BLAMED**

The Greek situation was driven by the global economic crisis, as a worse-than-expected economic contraction in 2009 prompted the deployment of a large government stimulus package to cushion the economy. However, this led to sharply worsening fiscal deficits and rising public debt.

Greece has been facing "twin deficits" in the current account and fiscal position since 1980.

Its current account has deteriorated, partly as a result of adopting the euro.

With the appreciation of the euro prior to the global crisis, a big government sector and lack of productivity improvement, competitiveness losses and high unit labour costs have led to higher current-account deficits and an unsustainable debt level.

The current major concern is about the need to repay debt of Euro13 billion by May and Euro28 billion by the end of this year.

After a period of difficulty in reaching an agreement and a period of witnessing the ineffectiveness of the joint EU-IMF support mechanism proposed on March 25, the euro area amended and provided more details about the package on April 11.

The euro area would offer Greece as much as Euro30 billion of three-year loans at below-market interest rates, while the IMF would contribute Euro15 billion.

It is expected that this rescue package would help shore up market confidence and lessen liquidity risks this year.

Notwithstanding the expected declining liquidity risks, uncertainties remain.

The important point is that insolvency risk will decline significantly only when the Greek government can cut public spending in line with the austerity plan endorsed by the European Commission.

This, in turn, crucially hinges on the prospects of government revenues, which depend on future economic recovery.

Even though the support mechanism should help limit contagion risks, it could also create moral hazards, as other members with fiscal problems would likely follow the Greek request when their situation deteriorates.

#### LESSONS FOR ASIA

Besides, this may expose the flaws of the European monetary union framework with one monetary policy, in contrast to the divergence of individual member's fiscal policy and staggered stages of economic development.

For Asia, it is important to watch for lessons to be learned from the euro area.

One lesson seems clear - if Asia embarks on monetary integration in the future, an effective mechanism to help align diverse fiscal positions is imperative.

Convergence of economic development should be set as one of the most important criteria for any move toward integration going forward.

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**(The views expressed are the author's own.)**

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