

## Trying to Gain Footing in Greece

Greece is best known for its contributions to civilization. But the images that emerged from Athens this week—protests and riots over spending cuts and increased taxes, blamed on government mismanagement—portray a country in a downward spiral, filled with barbaric citizens. Of course, that's a simplification. In fact, there's some good news to be found among the ruins.

The Greek parliament recently passed the first part of their austerity program and expects to pass the authorization to implement the plan in the near future. This will ensure Greece receives the next tranche of bailout money from the European Union. The pack is expected to give Greece about three years worth of liquidity in order to fund their debt payments and work through the fundamental changes needed for stronger economic footing.

Greece's problem is simple and familiar. They spent too much and didn't collect enough taxes to cover obligations. Public expenditures currently account for over 40% of Greece's GDP. This means that in order to balance their budgets and avoid debt, they need an impossible tax rate or drastic spending cuts on public services. The austerity program being passed drastically cuts spending and social programs and increases taxes, especially for the wealthy.

Why all this global concern for a country that only accounts for about 3% of European GDP?

Greece has over \$500 billion of debt outstanding, most of it held by European banks and investors. A default could cause another liquidity or capital crisis for the European banks. Since Greece shares a common currency (the Euro) with the majority of Europe, the effects of devaluation spread far beyond the country's borders. The good news is countries with the strong economies, such as Germany and France, are firmly behind the bailout so long as the austerity programs are fully implemented. (Thus, the importance of the recent vote.)

The chance of Greece defaulting on its debt is extremely low. It's not an impossible scenario, just a worst-case one. Could Europe survive? Our feeling is Europe is in far better shape to absorb such a blow than it was last year. Banks have significantly higher capital today and central banks would be quick to step in and help defer any possible backlash to the financial system.

Though Greece's economy is by far the weakest in the European Union, there are concerns that its crisis could be repeated in other struggling Euro countries. That makes this a critical test of the Union's ability to deal with future problems. Our view is, though painful, the steps being taken will allow Greece and Europe to work through the current issues and allow a recovering global economy to help propel a recovery. Hard choices need to be made in Europe, and around the globe, to put central governments back on a path toward better financial stability and management.