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Greece could decide fate of U.S. economy

 By Mark Zandi

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Will Greece exit the eurozone? Hard to believe, but the answer to this question could determine the fate of the U.S. economy this year. Global investors have been driving stock prices down, as odds rise that Greece will quit the European currency union.

Greece is at loggerheads with Germany, the dominant European economy that dominates policy decisions for the continent. German leaders want the Greeks to get their financial house in order; i.e, to stop borrowing money and ultimately to repay the hundreds of billions of euros they owe. Most of those euros are owed to Germany.

Greeks recognize they have big financial problems, but argue they can’t be fixed anytime soon. The government spending cuts and tax increases they have adopted have plunged Greece’s economy into a depression on the scale of our Depression in the 1930s. Over one-fourth of all Greeks are unemployed, and things are getting worse.

Their economic pain is so bad that Greeks are thinking seriously about quitting the eurozone. Some are looking at what Argentina did about a decade ago, when that Latin American country rejected a similar dose of fiscal austerity, prescribed by the International Monetary Fund. Argentina defaulted on its debt and dramatically devalued its currency, and while the Argentine economy suffered badly for a while, it eventually found its footing and was growing strongly a few years later. Couldn’t Greece follow the same path?

Probably not. Argentina sells meat, grain, and wine to the rest of the world. Its devalued currency made all of these products quite cheap, and thus in great demand. Greece has nice beaches, but there are only so many hotel rooms to fill. More important, Argentina’s economy is still on very shaky ground a decade later. It never made the fundamental changes necessary to grow more competitive. If Greece leaves the eurozone, it will no longer be counted among developed-world economies.

For its part, Germany is thinking seriously about letting Greece go. Germans worry that if they give in to Greek demands, other fiscally troubled nations such as Ireland, Italy, Portugal, and Spain will seek similar relief. And if these countries don’t make the tough decisions on government spending and taxes now they never will, ultimately leaving Germany on the hook for all their debts. Did the German people sign up for this when they created the eurozone?

In fact, they did. For the eurozone to succeed, the Germans must be all-in. The proof for this comes from U.S. history. After the Revolutionary War, the colonies were completely bust. They had borrowed heavily to finance the war effort, and with the economy in tatters afterward, debt repayment appeared impossible. Alexander Hamilton, our first Treasury secretary, understood that for the young nation to survive, the federal government would have to take responsibility for the colonies’ obligations. In exchange, the federal government gained the power to tax, and restrictions were put on the states’ ability to borrow.

Once done, there was no turning back. The United States survived and soon became a global economic powerhouse. The Europeans have a long way to go to get to this place, and if the Germans let Greece go they never will.

Given the enormous cost to Greece if it leaves, and the enormous lost opportunity to Germany if the Greeks go, odds are that the eurozone will hold together. But the chance that Europe will go down a much darker road is uncomfortably high. The tricky politics involved in keeping the eurozone together could trump the economics. It took deft political leadership and compromise by Hamilton and his antagonist Thomas Jefferson to bind the early United States together. There may be no Hamilton or Jefferson in today's Europe.

If not, and if the eurozone fractures, the U.S. economy will have a big problem. The fragile stock market will fall sharply and it will become much more difficult for U.S. firms to borrow. European government debt will be worth a lot less; European banks, which own a lot of that debt, will be under severe pressure to rein in lending, including to U.S. companies. American banks are in good shape, but they won't be able to fill the void.

U.S. trade with Europe will also slump, as will European tourism and investment. China and other emerging economies that export a lot to Europe will be hit hard; this, too, will ripple back on the United States. It is hard to see how the global economy will escape a new recession.

Even just worrying about all of this is damaging. U.S. businesses remain reticent to take risks or to hire more aggressively, for fear of getting caught out on a limb if Europe can't keep it together. It may be uncomfortable for the U.S. economy to depend so much on events across the Atlantic, but if the Greeks and Germans get it roughly right — and odds are they will — it will mean a much brighter economic future for all of us.

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