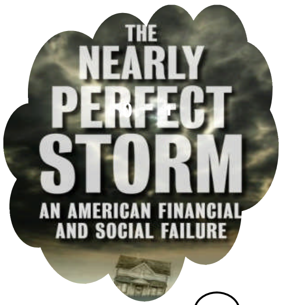

Your on the Street Reporter

Uyless Black

Epilogue II to *The Nearly Perfect Storm*

Deadbeat States

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Preface

My intent in writing *The Nearly Perfect Storm: An American Financial and Social Failure,* and these epilogues is to spark your ire. I am not one to compose inflammatory compositions. I began my studies of the 2008 financial crisis with a neutral view of the subject, perhaps even skewed toward the financial world (specifically, the investment banking industry), reflecting my former employment at the Federal Reserve.

No longer. The more I learned about the institutions and individuals who were involved in the meltdown, the more disgusted I became. I wish this turn of events had not come about. I wish I had found the Great Recession occurred because of a downturn in a conventional business cycle. It did not.

Do not expect this series to be light-hearted, although I will attempt some gallows humor to lighten the load.

The Nearly Perfect Storm: An American Financial and Social Failure
Epilogue II: Deadbeat States[1]

Quote from *The Nearly Perfect Storm* about the issue.

Page *xii*:
As poorly as some sectors (and people) in America's economy behave, we should be thankful the United States has not become a southern [Southern] Europe-like nanny state. Many of my critiques in this book are attempts to caution about the dangers of both corporate and personal welfare, as well as national welfare, such as that found in several countries in Europe.

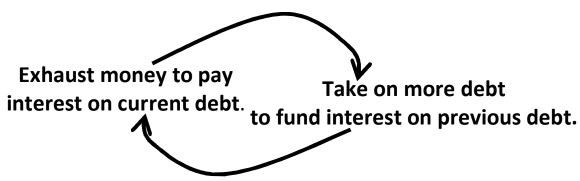
Page 303:
…measures can be put in place to avoid the contagion that came about (partially) because of the interdependence of financial institutions.

These epilogues are written on occasion as follow ups to *The Nearly Perfect Storm: An American Financial and Social Failure*, available at Amazon, Barnes & Noble, and other book stores. Epilogue II uses the current financial crisis in Europe as the focus of the discussion.

November 24, 2012 and January 28, 2015
Why should non-Europeans care about the failure of a bank or even a country in Europe? Because, as stated in the second quote above, the interdependence of, say, America on any set of financial institutions can infect America. Here's why:

Countries borrow money to finance their programs, including the maintaining of their physical infrastructure, medical plans, and retirement funds for their citizens. The borrowing depends a great deal on how well a country *manages* the money it gains from taxes and from the money it borrows.

The borrowings are supported by a government issuing bonds, which is a promise to pay-back the bonds' debt. The government must also pay interest on the bonds. If the government is considered responsible and sound, this interest is low. If the government is having problems, the interest the country must pay goes up. This situation can form a deadly cycle: a government must come up with more money to pay higher interest on these bonds. But it is having problems because its revenue has shrunk (unemployment, lack of innovation, etc.). So, it issues more bonds to stave-off the bill collectors, sinking deeper into debt:



[1] Graphics and figures in this report came from searching the Web with the keywords of "European Debt Crisis," and "Greek Debt Crisis" with Bing and Google searches. Specific sources, if available, are shown on part of these items, such as the journal from which the material came.

Government debt usually has been considered risk-free because a government can raise taxes or create additional money to redeem bonds when they mature. How do governments create more money? As just mentioned, unless they raise taxes, they issue bonds. Again, it can be a dangerous cycle.

Who buys these bonds? Anyone who wishes to do so, such as companies (for example, U.S. corporations), retirement funds (in the U.S., for instance), insurance companies (American International Group, as an illustration), banks (often, U.S. banks), international organizations (such as the International Monetary Fund and the European Central Bank,), even private citizens. After all, the bonds are IOUs, and most everyone likes to own debt so they can gain interest on it.

Paying off Debt

As stated above, banks often own government bonds. So, let's pose what might be considered a fanciful scenario: suppose a country is so inept and corrupt that it cannot honor its own debt? Fanciful? Not at all. Shortly I'll provide examples. For now, if a country does not honor the debt on its bonds, the institutions holding them could be in big trouble, including U.S. institutions. And if these institutions get into trouble, guess who will bail them out? The American taxpayer via Uncle Sam.

This debt is no different from the debt situation with you, me, and other citizens. Let's assume I am a government of a country, and you are a bank in this country. My cousin is a citizen of this country. My uncle is a U.S. bank. The other person in this story is my mother-in-law, played by Germany:

- I (government) borrow a thousand bucks from you (a bank), with the understanding that I will pay x interest until the loan matures. (In the context of this report, the bank buys government bonds.)
- I use the money to support my cousin (a citizen), as well as to keep my house fixed-up and buy some hot dogs to live on. Every month, I give my cousin some money to keep him going. Some of the money is also used to paint my house, repair the roof, and buy groceries.
- Periodically, you (the bank) come to me (the government) and enquire about my financial position. If it's sound, you are content to receive the same amount of interest.
- My cousin, who is not much more than a deadbeat, habitually blows his borrowed money on wild weekends in Juarez. He does not use any of it to save for a rainy day.
- In fact, he insists on receiving more money from me because his intake of tequila and consumption of ladies are costing him more money.
- I can't let my cousin down, so I plough more of the loan you gave me into supporting his lifestyle.
- Damn! I begin to run short of cash. I no longer have enough money to buy paint or wieners…or to support my cousin's degeneracy.
- So, I borrow a few hundred dollars from Uncle Jake (U.S. bank). My uncle was not born yesterday. He charges me interest.
- I have trouble paying the interest to Uncle Jake and you, because I have given most of the loan to my cousin. I desperately look for someone to get me out of the hole I am digging. I persuade my mother-in-law (Germany) to loan me some money. She does not like the

idea of taking away from her carefully crafted savings to bail out her son-in-law. But she cannot just stand by the sidelines and let her daughter become a street person. So, she lends me some money. These funds are used to pay the increased interest now being charged to me by Uncle Jake and you.

- Eventually, you (bank) become leery of my position and charge me (government) even more interest on the thousand bucks. Because my cousin (citizen) has strapped me so much, I cannot meet my obligation to you or my uncle…or my mother-in-law.
- To hell with it! I declare insolvency. Result: You (bank) receive no money. Nor does my uncle (U.S. bank). Nor does mom (Germany).
- Nor does my cousin (citizen) who raises a very big fuss (say a riot) because of *my* cutting him off from his slothful lifestyle.
- Nor does anyone else who had been doing business with any of these entities.
- Result? Financial deadlock.

A Look at the Past (written prior to Greece's crash)

Who started this mess, one that cascades (with a domino effect) into thousands of other entities (banks, countries, and citizens)? Easy answer: The culprits are my cousin (the citizens of a country) and me (the country's government). The others [you (a bank in this country), my uncle (a U.S. bank), and my mother-in-law (Germany)] are taken to the cleaners because of:

- The irresponsible habits of my cousin (the citizens of a country) who against all common sense runs himself into ruin.

- The ineptitude of me (the country's government), by not curtailing the insane profligacy of my cousin.

Let's substitute the players in our soap opera:

Me: The government of Greece.
You: A Greek bank, say the Hellenic Bank
Cousin: The Greek citizens.
Uncle: A U.S. bank, say Citibank.
Mother-in-law: As mentioned, Germany.

Here is what the Greek government and citizens are up to:[2]

- Jobs in Greece that are classified as "arduous" allow a man and woman to retire at age fifty-five and fifty respectively. As if this early age were not ridiculous enough, these professions have managed to be classified as arduous: hairdressers, radio announcers, waiters, and musicians. Over six hundred professions are classified as arduous.

- It is assumed anyone who works for the government is meant to be bribed.

[2] Michael Lewis, *Boomerang: Travels in the New Third World* (New York: W.W. Norton, 2011), 44-46. I use Mr. Lewis' findings as paraphrases or direct quotes. For ease of reading, I do not discern between the two. I hope Mr. Lewis will understand this shortcut and the plagiarist vigilantes will not hang me out to dry.

- People who go to public health clinics bribe doctors so the doctors will take proper care of them.

- People who spend their careers in public service end up owning multi-million dollar mansions and two or three country homes.

- The average government job pays almost three times the average private-sector job.

- The Greek public school system (one of the lowest ranking in Europe) employs four times as many teachers as Finland (the highest ranking in Europe).

- People who send their children to public schools assume they will need to also employ private tutors.

- The first thing a government does in an election year is to pull its tax collectors off the streets.

- The Ministry of Agriculture created 270 off-the-books jobs for people to digitize photographs of Greek public lands. Almost all these people knew nothing about digital photography, but some of them knew a lot about hair dressing and other taxing occupations. Excuse me. I meant other non-taxing occupations.

- Greece has no independent organization, such as the U.S. Congressional Budget Office, to tally accurate numbers about the Greek economy. The party in power gins up numbers as it chooses.

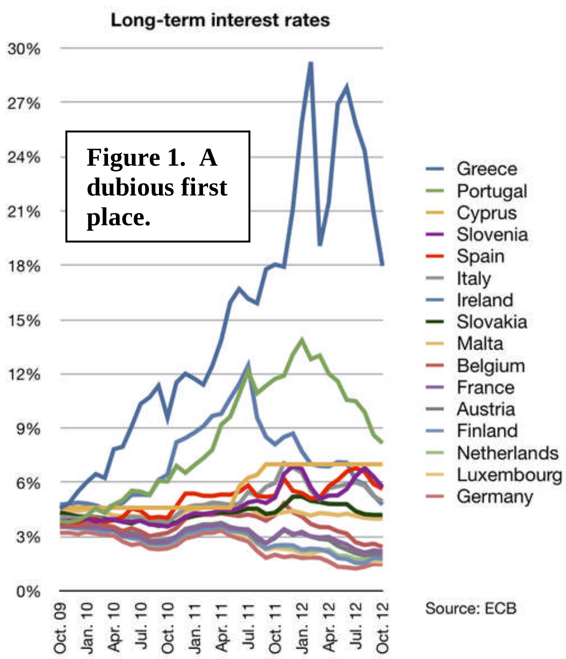


Figure 1. A dubious first place.

On and on; there are many more examples of this wretched excess. For now, take a look at Figure 1. It shows that for Greece, the interest chickens have come home to roost. The interest Greece pays on its debt resembles a loan shark operation.

The solution, technically speaking, is simple: the Greeks must curtail their reliance on their government. They must somehow modify their bribe-ridden culture with one that has at least a little bit to do with merit. They must expect to sacrifice in the short term if they are going to have long term security. So, what are they doing? As seen above, like our dissolute cousin, they are protesting that their government is at the heart of the problem. They

have taken to the streets to protest the prospect of their government cutting their pensions, raising retirement ages, and redefining "arduous" to possibly exclude manicurists.

They refuse to accept sacrifices that would eventually place their country and themselves on an even keel. They look upon their government as if it were a foreign country when they themselves created the government; a country in which the society "has endured something like a total moral collapse."[3]

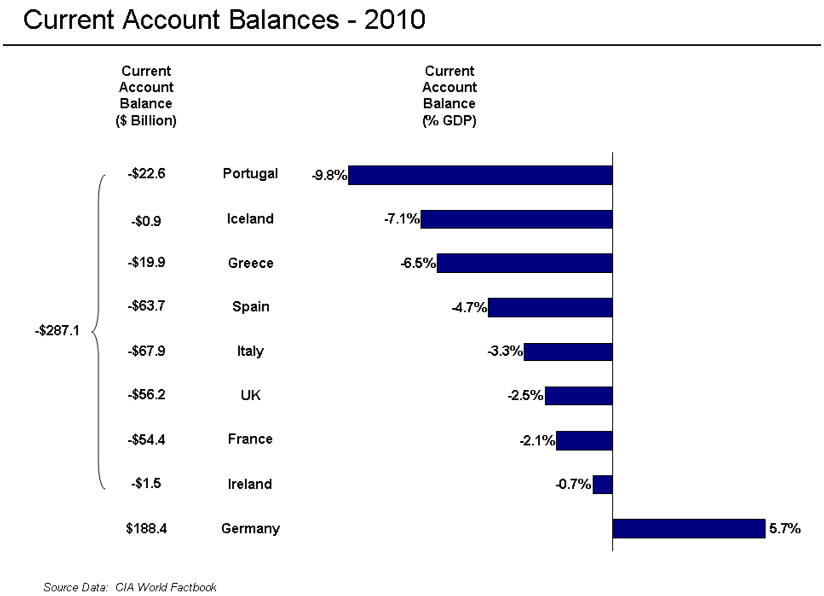


Figure 2. Brother, can you spare a (few billion) Euro(s)?

Meanwhile, our mother-in-law (Germany) has been keeping her house in order. As seen in Figure 2, she is the only household in Europe with a positive account balance.

And the citizens of Germany are growing tired of paying for the life styles of citizens from other countries. Especially when these people are in a state of denial about who is creating their problems. Who is? They need only look in the mirror.

Loaning Greece Money: The 2010 and 2012 Bailouts

With the backing from Germany, the European Commission, the European Central Bank, and the International Monetary Fund (IMF) lent Greece bailout money in 2010 and 2012. The *Wall Street Journal* calls these three institutions the troika, with this to say:

> Greeks believe, not unreasonably, that the conditions imposed by the troika have been disastrous. … the bailouts came with draconian fiscal tightening, in the typical IMF fashion, with too little attention to promoting pro-growth reforms. The result has been falling wages, with no growth in return for the pain.[4]

True. The arrangement to payoff this debt was based on the assumption that the bailout money would result in the illusion of a fast and fulfilling recovery of the Greek economy. As anyone with a dose of common sense would know, that did not happen. Who is going to be the first to get out bed, when everyone is sleeping between silk sheets? The *Wall Street Journal* blames the failed recovery attempt on the troika. Partially true, but how about the Greeks themselves,

[3] Ibid., 65.
[4] "The Greek Warning," *The Wall Street Journal*, January 26, 2015, A14.

including its citizens, and a government that was unable to change the financially degenerative culture?

The list above detailing the corruption and profligacy of the culture cannot be changed overnight, over months, even over decades. Habits die hard. Some never die. If you were a Greek citizen and were accustomed to the state-sponsored amenities described so far in this article, would you willingly give them up?

To 2015

Newscasts from BBC report that Syriza, the left-wing party that came to power last week, has promised to ditch austerity and renegotiate the country's $270 billion bailout with the [troika] and other measures, some are listed below:[5]

- An increase in the minimum monthly wage, from $658 to $853, close to a 30% increase.

- The creation of 300,000 new jobs.

- Bringing back the "Christmas bonus" payment, known as the 13th month.

- Eliminating the tax on heating fuel.

- Providing free medical care for those without jobs and medical insurance.

- A promise to write off some of Greece's (overall) $363 billion debt, which is 175 percent of its gross domestic product (GDP). (If not a write off, then a negotiation with better terms, which is a good idea.)

- And others.

There is little debate among conservatives or liberals that the present arrangement is not working; that stimulus, not austerity, must be the approach.

The Moral Hazard Once Again Raises its Head

The moral hazard has been a lead actor in the financial meltdown saga: A party (person, institution, government, etc.) will not act responsibility (over the long run) if the party is not held accountable for its actions. Again, this idea is nothing more than common sense, but it continues to be ignored. Why? Because taking the irresponsible party to task, beneficial in the long run, would create short run problems. So, it is deemed better to kick the can down the road, and let subsequent generations deal with the problem.

The newly-to-be-formed Greek government is planning to reverse the unsuccessful bailout strategy. Discounting some of this regime's ill-founded intentions, such as reneging on billions of dollars of debt, it is the only alternative. But the Greek government's biggest problem is not the short range issues of debt and budget deficits, it is finding a way to migrate its culture toward one of less corruption, fewer business regulations, and fewer handouts. As well as an aggressive

[5] "BBC and Greece reports." Material is sourced from several BBC reports.

education program to move its citizenry to be more competitive in the world market, not just on a town square in Greece.

Across the Pond

Most Americans know the United States is moving into a trouble bubble because of its debt and entitlements. The list below was compiled from several Google and Bing searches. I cannot substantiate each of these claims, but I have seen similar statistics from other sources that support these suppositions.

- The U.S. national debt us just over $18,000,000,000,000. That amount is over $56.000 per citizen.[6]

- The United States government is responsible for more than a third of all the government debt in the world.

- Mandatory federal spending is going to surpass total federal revenue for the first time ever in this fiscal year. That was not supposed to happen until many years into the future.

- The U.S. national debt is rising just over 4 billion dollars per day. The U.S. government is borrowing about 2 million more dollars every minute. The government borrows an average of about 168 million dollars every hour.

- The combined debt of the major government sponsored enterprises (GSEs such as Fannie Mae, Freddie Mac, and Sallie Mae) has increased from $3.2 trillion in 2008 to $6.4 trillion in 2011. U.S. taxpayers are guaranteeing that debt. This is debt that is not included in the $14.3 trillion national debt figure.

- Some experts estimate that the unfunded liabilities of the U.S. government for programs such as Social Security and Medicare are in the neighborhood of 60 trillion dollars. Other experts claim that the total for federal government unfunded liabilities could be well over $100 trillion. But what almost everyone agrees on is that it is going to be impossible to come close to meeting all of those obligations.

- The U.S. government currently has to borrow approximately 41 cents of every dollar that it spends.

- In 1980, government transfer payments accounted for 11.7% of all income. Today, government transfer payments account for 18.4% of all income.

- 59 percent of all Americans now receive money from the federal government in one form or another.

- Back in 1965, one out of every 50 Americans was on Medicaid. Today, one out of every 6 Americans is on Medicaid.

[6] http://www.usdebtclock.org/.

- Back in 1950, each retiree's Social Security benefit was paid for by approximately 16 workers. Today, each retiree's Social Security benefit is paid for by approximately 3.3 workers. By 2025 it is projected that there will be approximately two workers for each retiree. The population is getting older.

- According to a U.S. government report, interest on the national debt and mandatory spending on entitlement programs will absorb approximately 92 cents of every dollar of federal revenue by the year 2019.

America is not foreordained to remain the powerful wealthy country it is at the present time. On the other hand, and at the risk of offending Zorba the Greek fans, we are far from the corrupt, noncompetitive culture of Greece.[7]

[Written in early 2012]
If this upcoming Congress and Presidential Administration will <u>compromise</u> to *reduce debt and raise revenue [to both government and citizens]*, cut down governmental paperwork and bureaucracy, encourage the emigration of talent, and fix our schools, America's vigor, innovation, and energy will take care of matters.

[Written in early 2015]
Regardless of one's opinion about the previous three years of presidential and congressional practice of their ideologies, their avows to compromise, and their commitments to form a bridge that the majority of Americans want has been a failure.

If America does not address the issues that confront other government-laden and debt-laden countries, such as Greece, it will reach a tipping point from which it will not easily recover.

[7] On a personal note, I have a great liking for the Greeks. In my youth, I was smitten by a young Greek lady, as well as the warm, accepting Greek nature she represented.