# Greece and boiling frogs

In recent weeks, I have thought a lot about the old Chinese story about boiling frogs. You will recall the story says that if you throw a frog into boiling water, it will leap out in shock. But if you drop the frog into cold water, then slowly boil the water, the frog dies without ever recognizing the danger.

For me, Europe's economies have for many years been frogs originally dropped in cold water. European friends have smiled smugly and dismissively as outsiders like me have talked about the impossible unsustainability of Europe's complacent, comfortable lifestyles. As the water has crept closer and closer to boiling point, so Europeans have continued to lounge, oblivious to the imminent threat of death.

Now, a European frog – Greece – has died. OK, it's a small frog, and it's not quite died – but put on life support to the tune of US$145 billion. Europe's other frogs seem inclined to dismiss this as a one-off. Greece is, after all, a peripheral economy as far as Europe is concerned. Greeks are stereotyped as cheerful, lazy, inefficient and disinclined to save. They are criticized for paying themselves too much, stuffing the country with Government jobs, and gifting themselves generous but unfundable pensions. Europe's other frogs seem still to be oblivious to the water dangerously seething around them.

But what makes Greece any different from other European states? The numbers ought to speak loudly for themselves. Greece's Government deficit has soared to 8.7% of GDP, with debt expected to hit 135% of GDP by next year. For the long term, debt levels have to stay below 60% of GDP to be sustainable, the IMF says.

France's deficit sits at an alarming 8.2% of GDP, while Portugal's is also 8.7%, with Spain at 10.4% and the UK at 11.4%. The IMF says Italy's national debt will reach 119% of GDP next year, with the UK and Belgium expected to pass 100%. The European average is expected to rise above 85%. By IMF reckoning, the EU is likely to have to fork out between US$700 billion and US$1.4 trillion to bail out the region's most vulnerable economies – Portugal, Italy, Ireland, Greece and Spain, the now infamous PIIGS. Hold onto your hat if the UK or Belgium needs a bailout.

Lest I am accused of Euro-bashing, I should emphasise that both the US and Japan are looking at similar scary numbers – the US with an 11% Government deficit, and debt imminently expected to pass 100% of GDP, and Japan with a 10% budget deficit and debt at a spectacular 227% of GDP.

Research by the economists Carmen Reinhard and Ken Rogoff on the history of debt crises says that defaults occur after rises amounting to 40% of GDP in a four year period. By this criterion, not only Greece, but also the UK and Japan can expect to default.

But let's stay with Europe for a moment. From an outsider's perspective, at least five, and perhaps seven of Europe's key member states appear to be on the rocks (honest numbers on the state of the UK's finances may begin to emerge once a new Government comes into office after yesterday's national election). They face huge – and politically unacceptable – austerities if their economies are to be brought back into equilibrium. Pensions and welfare benefits need to be cut. Government jobs need to be cut – adding to already-high unemployment levels.

And even then, there are real questions over whether their economies can recover fundamental competitiveness. In short, membership of the EU single currency region has forced uncompetitiveness on these economies and made the natural response – devaluation of the currency – impossible. In the words of Wolfgang Munchau, one of the Financial Times' leading European commentators; "A monetary union without political union has failed. The EU is thus about to confront a historic choice between integration and disintegration."

For many Hong Kong readers, it is fair to ask what possible relevance these European boiling frogs have for us in Asia. First, and most obvious, the seven most troubled EU economies (the PIIGS plus Belgium and the UK) account for one third of Asia's EU exports. Collapsing consumption in these markets is certain to depress Asia's exports to Europe.

Second, as already mentioned, the US is in as sorry a plight as the most troubled European economies, but sits in a unique category of its own – too important for the global economy to be allowed to fail. It is estimated that the US needs to move from its current fiscal deficit of 11% of GDP to a surplus of 4.5%, and keep the surplus in place for the next 15 years if it is to get back to debts at 60% of GDP. Can anyone really imagine what a reversal in spending of 15.5% of US GDP would look or feel like to an American family – a cool US$2.2 trillion cut in spending per year?

Third is that Japan's debt levels are mind-blowing, and completely unsustainable. Getting its debt back to around 60% of GDP would need spending cuts amounting to no less than 25% of GDP for the next 15 years – about US$1.3 trillion a year. Unlike Greece or Portugal, which rely heavily on foreign funds to service their debts and their deficits, Japan relies on its own people for 95% of its debt service. This has been a blessing until now, making Japan less vulnerable to fickle shifts in international investor confidence, but as the country's population ages, and more people move out of the workforce and into retirement, so reliance on Japanese people to fund debt must become less and less sustainable. There have to be real concerns over Japan's prospects going forward.

For Hong Kong, the stresses created in Europe by the EU's "one-size-fits-all" currency and interest rate regime strike a resonant chord. Policies suitable for core EU economies like Germany or France were clearly inappropriate for peripheral economies like Greece or Portugal, creating dangerous credit bubbles that they had no means of avoiding. So too Hong Kong's currency peg to the US dollar has over the past 28 years been a marvelous stabilizer, but has at the same time played an unhelpful role in inflating local bubbles, as our own monetary policy was required to mimic that of the US despite very different economic circumstances.

A final point of relevance is the issue of monetary union in Asia – often discussed since the 1998 Asian financial crisis. The lesson from Europe must surely be that the effort to impose a single monetary regime on an economically disparate group of countries is doomed. If disparities have been too large in Europe, then how much less manageable must disparities be across Asia? Information sharing, cooperation and coordination may still make sense, but anything more ambitious is obviously off the agenda.

Reviewing this landscape of dead and dying frogs, there is a perverse case for being thankful for the Asian financial crisis 12 years ago. It has left most Asian economies with modest and manageable deficits, negligible debt, and savings habits robust enough to provide a local buffer against external adversity. It has also purged the complacent sense of entitlement that still trickles through Europe's sclerotic veins, and left us more keenly aware of our competitive place in the world. This is indeed set to be Asia's century.

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