THE GREEK TRAGEDY

Living Beyond Means

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The recent crisis in Greece is the new addition to the long list of casualties of the global financial and economic crisis that started in 2007. It has called into question financial institutions as diverse as the public accounting system to the common currency policy of the Euro zone.

In October 2009, the newly-elected government of Greece revealed that the country's budget deficit was far higher than previously thought : more than 12% as opposed to less than 3%, as required for membership in the EU. Ever since, the deficit has been revised upwards and currently hovers around 13.6%. In addition, the sovereign debt of Greece is nearly 400 billion dollars, close to 120% of its GDP and it runs a current account deficit of nearly 14% in the Euro zone. These data together strongly imply that Greece has invested more than it saved (i.e., private and public sector savings taken together), supporting this extra investment by borrowing from the rest of the world. In short, Greece appears to have lived beyond its means. International finance has responded to this situation by downgrading its outlook of the public finances of Greece. The Credit Default Swap (CDS) spread on Greece government bonds (which gives the financial markets' perception of the possibility of default on its debt by the Greek government) has sharply increased in the recent past as the rating of these bonds was continuously degraded by agencies. In the past fortnight, the bonds were relegated by a rating agency to the status of ''junk'' bonds. In less than six months, the interest payable on these bonds has climbed from less than 4% to more than 15%. Greece certainly cannot afford to borrow at such prohibitive rates. Being a Euro zone country Greece doesn't have the choice of treating its internal and external crisis separately: Greece can't print currency for deficit financing at home and devalue its currency to attempt to regain export competitiveness. In these conditions, its only choice appears to be to appeal for a bail-out from the EU and/or IMF.

If the business press is to be believed, the only long term solution for Greece is almost crippling austerity. Greece must cut on public expenditure to pay debts, import less and export more, sharply reduce wages and other benefits such as pension, social security, and increase taxes like VAT. Almost by implication, the business press advocates further privatization of the economy, cutting taxes for businesses to spur investment, and to weaken the process of collective bargaining so as to allow businesses to gain the upper hand in the "hiring and firing" process, what is sometimes euphemistically called flexibility of labour markets. And this is being proposed at a time when the Greek economy is yet to recover from financial crisis of 2007 and its GDP is shrinking.

In a recent report published by *Research on Money and Finance*, a network of political economists working on financial issues, the authors trace the recent travails of Greece to the formation of the common currency Euro zone in 2001.

Greece, along with other countries like Portugal and Spain, entered the Euro zone with an over-valued currency, which compromised their export competitiveness. Ever since 2001, the export performance of these countries has worsened.

Germany, the most powerful country in the Euro zone, has gained at the expense of these countries. In the past 10 years, the German economy barely grew at 2% per annum, local investment and consumption remained flat and the productivity and real compensation of labour stagnated. On all these counts the countries of South Europe did much better. However, Germany improved its export performance with respect to these Southern countries. Since 2001, the average real compensation of a Greek worker increased nearly 25% more than in Germany. This means that Greek exports are expected to cost at least 25% more than German exports. The entire growth of German economy in this period is predicated on running large trade surpluses with the Euro zone countries. As German local investment or consumption hasn't increased, most of earned export surplus has been recycled to Euro zone countries either as investment or mostly as debt.

This picture is borne out by the current and financial accounts of the Euro zone: Germany's current account surplus roughly equals the combined deficits of Greece, Spain, Portugal, and Ireland. And its total bank lending in the region (a sum of FDI, portfolio investment and debt) explains the borrowing of these countries. Thus, it is clear that, to a large extent, the recent economic crisis in Greece (and the the European "periphery" in general) owes its existence to imbalances inherent in the common currency zone.

As noted above, the main purported reasons of the crisis in Greece are its excessive government debt and the budget deficit. Before going further, one should compare these numbers with other countries. The average EU government debt is roughly 80% of the GDP. The government debt of the UK exceeds 100%. Many countries are running budget deficit above 9%. Most of these liabilities were incurred to bail out the large banks and financial institutions in the aftermath of the financial crisis of 2007.

One of the topics singularly missing from the business press's drumming of Greek ineptitude is the extent of debt Greek government incurred to save its own banks. Even so, Greece is not doing too badly if compared to the rest of the EU. It should be borne in mind that the European Central Bank (ECB) also lent hundreds of billions of Euros to save these banks (euphemistically called "quantitative easing". It means that the ECB simply printed this money and loaned it to the bank). The bank bailout in the EU zone totalled at least a few trillion Euros. In comparison, Greece requires less than 20 billion Euros to meet its current debt obligations. One of the reasons offered, most notably by Greek politicians to their own people, to agreeing to a deal with the EU and the IMF is to save the common currency of the EU. Indeed, the Euro has weakened with respect to other currencies in the aftermath of the Greek crisis. Again the political underpinning of this seemingly innocuous market mechanism should be noted:

there was no such attack on Euro by international finance when the ECB was printing hundreds of billions of Euros to bail out banks. Somehow these financiers are more interested in a 20 billion Euro shortfall in Greek's debt repayment than the enormous amount lent as bank bailouts.

One of the features of all the Euro zone countries after 2001 is the fall in the share of wages (income of the working class) in GDP. In all the countries, the productivity of the labour has increased at a sharper rate than the real compensation. One of the favourite criticism of the business press of the Greek government is its inability to keep workers on leash. They point to the increase in the real wages of Greek workers as a source of the current problem. In fact, real wages have increased barely 30% since 2001, and the ratio of the wages to productivity remains largely unchanged. The bail-out of Greece by EU and the IMF will further aggravate this trend. The conditions of bail-out require Greece, inter alia, to drastically reduce government spending to bring down the budget deficit from nearly 13.5% to less than 3%. Since the 1930s, large government expenditures, accompanied by budget deficits, are known to be vital to the running of capitalist economies. This spending acts to keep aggregate demand at a level that makes private investment viable. This should be borne in mind while calculating the cost of cut-backs on government spending. Greek government expenditure is nearly 50% of the GDP. If the Greek government cuts its budget by 10%, it reduces the total spending by 5% of the GDP. Generally the direct spending by the government, as opposed to running deficits by tax breaks to businesses, generates larger secondary income in the economy. In other words, 5% of the GDP generates an income far exceeding the initial spending, depending on the pattern of consumption and saving in the economy. If this factor is assumed to be between 2 and 3, then a cut-back of 5% will contract aggregate income approaching about 10-15% of current GDP. This will increase the already high unemployment rate in Greece to unprecedented highs: by some calculations, the official unemployment rate will reach levels seen in the US during the Great Depression.

The main objection to this argument runs as follows: when government withdraws the private sector takes over. However, the austerity measures being imposed on Greece do not lack historic precedence. These measures were called Structural Adjustment Programs (SAP) barely 20 years ago. The SAPs were imposed by the IMF on nearly 100 developing countries through the last two decades of the 20th century, as part of the conditionality to obtain emergency funds to ward off their balance of payment crisis. There are hardly any cases where the professed aims of the SAPs were realized. In most cases, the crisis recurred and deepened. Even the few countries that managed a decent GDP growth achieved it at the cost of great income inequality, stagnant or falling wages, and mostly at the cost of some other country. If the recent history is any guide to the future, the working class in Greece faces a long and bleak future in the aftermath of the bail-out and hopefully will fight to stave it off. □□□

Background / Further Readings :

1. A report on the crisis in the Euro area prepared by Research on Money and Finance.

2. Economist and Nobel laureate Paul Krugman on the Euro crisis.
3. Economist Costas Lapavistas on the Euro crisis.
4. Martin Wolf, chief economics commentator at the Financial Times, on the Eurozone crisis.

[source : *www.sanhati.com*]