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Fiscal Sadism and the Farce of Deficit Reduction in Greece

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Unemployment in Greece has climbed to a new record of 27.9 percent, according to the latest figures released by the Greek Statistical Authority; the national output shrank by 5.6 percent year-on-year for the first quarter of 2013, but only by 3.8 percent in the second quarter (thanks to tourism); total consumer spending and gross fixed capital investment fell by 6.3 percent and 11.8 percent, respectively, in the second quarter of the year; and the country is headed toward a third bailout, as German finance minister Wolfgang Schaeuble bluntly predicted last month.

The Greek government, however, is not fazed by these grim realities. Thus, the Ministry of Finance insists that Greece is on the "right track" by pointing to the budget data of the central government, which shows a primary surplus of 2.6 billion euros for January–July. So what if this figure is the result of extraordinary accounting manipulation that involves, among other things, adding revenues that were received from the profits earned by eurozone central banks on Greek bonds, excluding projected spending for public investments, and withholding tax refunds? As a faithful and obedient servant to the "troika"—the European Commission (EC), International Monetary Fund (IMF), and European Central Bank (ECB)—that has run Greece the last three-and-a-half years, the government is using what few skills it possesses to complete a single task: reduce the budget deficit by any means necessary. After all, the troika believes that this is the most critical factor in order for Greece to return to international credit markets.

The obsession with reducing the budget deficit for its own sake is crippling the Greek economy for the simple reason that a national economy is not a household. Unfortunately, this rather simple idea seems to elude most European Union officials today, with Germany's chancellor and finance minister the high priests of fiscal discipline.

Extreme fiscal consolidation in the midst of a major depression can only have extreme effects on output, leading to mass closure of small- and medium-size businesses, greater unemployment, widening poverty, massive loss of faith in political and social institutions, social disarray, and the potential for political violence. In fact, this is precisely what has been taking place in Greece since 2010, as sadistic fiscal brutality is intensifying from one year to the next, with no apparent end in sight. Greece has all the right ingredients for another Weimar Republic.

Since 2008, Greece's GDP has experienced a real decline of over 20 percent, with the sharpest drop coming since the imposition of the fiscal austerity measures—the result of the international bailout agreements in May 2010 and June 2012. Wages and salaries have been cut by an average of 20–25 percent and retirement benefits slashed by as much as 40 percent. However, prices have been rising for most of the period during the crisis—thereby making a travesty of the so-called "internal devaluation" strategy—and tax increases designed to boost revenues for the troika have been taking place at a maddening pace. (Indeed, as further evidence of the dark, endless tunnel in which Greece is trapped, the IMF recently proposed an increase of 12.4 percent in direct taxes for 2014.)

It is estimated that, by the end of 2014, the purchasing power of Greek wage earners will be approximately half of what it was in 2009. Little wonder, then, why certain hedge funds have already reclassified Greece from a "developed economy" to an "emerging market."

Of course, the greatest victim of fiscal sadism has been employment. The unemployment rate jumped from 9.4 percent in 2009 to 16 percent in 2011 and today stands at 28 percent—and it is considered a sure bet that it will top the 30 percent mark by 2014.

In the meantime, the debt-to-GDP ratio has also exploded. From nearly 128 percent in 2009 it has grown to 180 percent, suggesting that Greece is beyond hope. At this stage, in order for Greece to be able to service its debt and recapture its lost GDP and employment levels, one would have to rely on an outrageously optimistic scenario of economic growth: probably somewhere in the range of a long-term nominal GDP growth rate of 7–8 percent.

While Greece may soon end up with wages comparable to those of China, the odds of its experiencing growth rates close to those of China are probably the same as achieving time travel.

Offering a bankrupt country like Greece yet another bailout package makes absolutely no sense. What it desperately needs in light of the ongoing catastrophe is a substantial debt "haircut" (probably around 60 percent) and a Marshall-type development plan—or, alternatively, a full exit from the euro, with all the nasty consequences, for Greece and the eurozone alike, that that would entail.

A more detailed discussion of the issues can be found at
http://www.levyinstitute.org/publications/?docid=1840.

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