MYTHS, MISINFORMATION AND TRUTHS ABOUT THE GREEK CRISIS:

Sciolism[1] in an era of specialization

*By Thanos Catsambas**

With the third bailout program in five years approved by Eurozone countries on August 20, 2015 to help Greece avoid bankruptcy and an inevitable disorderly exit from the Eurozone, one can reasonably wonder, "What will be different this time?" Without a dramatic change in Greece's political decision-making, the answer is "nothing," because the Greek political system is run by sciolist decision-makers supported by media that continue to feed myths and misinformation about the origin, developments and possible resolution of the Greek economic crisis. While the Greek crisis was triggered by the inability of the government to meet its obligations on international bonds in 2010, it was caused by long-standing structural weaknesses and the gradual loss of competiveness in the areas of textiles, light manufacturing, shipping repairs, and even an array of agricultural products and fisheries. The decline in Greece's competitiveness was, in turn, due to the inability of the country to respond effectively to globalization, and find alternative comparative advantages in the new global division of labor.

This much is well understood and accepted by serious analysts. But what followed in the five years after the outbreak of the crisis is a testimonial to how difficult it is, even for credible international commentators, to analyze an economy from a distance, without sufficient knowledge of the internal workings and true constraints of the economy in question. In my view, the Greek crisis has been frequently analyzed without due regard to two major factors: first, the rigid financing constraints faced by Greece as soon as it lost access to private capital markets; second, the multiple structural rigidities and distortions in Greece, which would be inconceivable in an advanced capitalist economy[2].

In this commentary, I shall highlight the most pervasive myths that have accompanied the first five years of the Greek crisis, offer an explanation of their persistence and

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[1] Sciolism: the superficial display of knowledge and learning

[2] A comprehensive analytical article that sets the record straight on many misconceptions is Hans-Werner Sinn, "The Greek Tragedy", CESifo Forum, Special Issue, June 2015.

conclude with what I believe is the only potentially viable solution. My analysis is a narrative about "myths", not only because of Greece's preeminent position in international mythology, but, more importantly, because of the decisive role they played in impeding progress and helping political parties with obsolete economic concepts gain and maintain power in Greek society.

MYTH I: There were painless alternatives to the adjustment path that Greece had to follow in 2010.

This myth has been a recurring theme of many domestic and international debates since 2010 and has been the archetypal myth promulgated by Syriza (both when it was in the opposition, and after it became the main party of the coalition that formed a new government in January 2015). Before its complete capitulation at the July 17 Eurozone summit, the present Greek government argued formally and informally that austerity was the cause of the crisis and that it must end. The reality, of course, is the reverse: the latent crisis in the years preceding 2010 was the cause of the subsequent austerity, because any economy that reaches the point of default must go through a period of adjustment to stabilize its faltering macroeconomic imbalances. Simply stated, a country that has been living beyond its means for decades, and for which the Day of Judgment has arrived, must go through a period of fiscal consolidation with a decline in its standard of living.

This simple truth was never explained in straightforward terms by any responsible decision maker, and reflects one of the biggest failures of the Papandreou, Papademos and Samaras governments in terms of their respective communication policies. There was never an attempt to explain the implications of the point that Greece had reached by the end of 2009, why the country had reached that point, where the country wanted to go in the future, and what was the (necessary and one-way) path that it would have to follow to achieve its future objectives.

Part of the blame must be attributed to the international partners (the former "Troika"), who also spoke in obscure terms ("internal devaluation" etc.) instead of simplifying the issue. The Greek people were led to believe that their government had the power to relieve them of the austerity measures, if only it could negotiate more effectively with its international partners. In fact, the only area where the government could and should have exercised control was to ensure a fair distribution of the burden of adjustment among its citizens. But there was no other option. Once a country has gone bankrupt, as Greece did in 2010, the standard of living that its citizens had enjoyed thanks to abundant and cheap borrowing from capital markets until then, must decline to a level compatible with the productive capacity of the country and its ability to repay its debts.

MYTH II: The Troika-supported program failed.

An extensive misinformation campaign, especially perpetuated by the Greek media, has focused on the axiom that the program "failed". There is little doubt that what commentators have in mind when they speak about "failure" is the decline in GDP, the rise in unemployment, the closing of several small businesses, the decline in property values and, more generally, the decline in the standard of living of the Greek population compared to what it was before 2010. But this interpretation reflects precisely the failure of Greek authorities to explain that a retrenchment was unavoidable and that the purpose of the program was to reset the economy on new, modern pillars that would ensure long-term viable growth.

The myth of the program failure is also linked with the assertion that bailout programs caused the serious austerity that the Greek economy experienced in the past five years. The traditional argument against a Fund-supported program fails to realize that austerity would have been more severe without a program[3]. The reason is that a country that essentially has gone bankrupt (and cannot tap capital markets anymore) will have to adjust its expenditures to available resources, which, in the absence of loans, will be only available domestic revenues, notably tax collections. In a collapsing economy with declining revenues there is no way that a government can finance the earlier level of expenditures. In the case of Greece, the 2009 budget deficit was 15.6% of GDP, or about

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[3] An interesting article that analyzes this question in some depth is Daniel Gros, "The Greek Austerity Myth", Project Syndicate, February 10, 2015.

€32 billion. Without the May 2010 loan from the then Troika, Greece would have had to reduce its spending by €32 billion immediately. Instead, Greece received the biggest loan in the history of the IMF and of the Eurozone (the first at the time), in the amount of €110 billion, which helped smooth out the adjustment process. Moreover, two years later, in 2012, Greece was granted the highest sovereign debt haircut in recorded world history, equivalent to 53% of nominal debt. Both the loan and the debt operation definitely helped Greece begin the adjustment at a much milder pace than it would have been possible without them.

Objectively speaking, one can argue that one part of the adjustment program fully succeeded while the other part succeeded only to a limited extent. The part of the program for which the IMF was primarily responsible, i.e. the fiscal adjustment, not only did not fail, but in fact was very successful, as a primary surplus of 0.8% of GDP was achieved one year earlier than programmed, namely in 2013 instead of 2014. And the fiscal adjustment was also "progressive", because most of the burden fell on the higher salary and pension earners.

The program, however, was not successful in terms of unleashing the productive capacity of the economy, because most of the mandated structural reforms were either not implemented or were implemented only partially or ineffectively. The European Commission, which was primarily responsible for the structural aspects of the program, was partly to blame, because it imposed too many requirements in too short a time, without taking into account the administrative capacity of the country: in other words, the problem with implementation was not so much a question of political will, as it was an issue of capability—at least until the middle of 2014.

MYTH III: Public expenditures in an economy under financial distress can always be set according to national priorities.

One of the major weaknesses in the reasoning of many Greek politicians and even academic economists is that they do not understand the importance of below-the-line accounts in the budget, namely the constraints imposed by available financing. Elementary economic theory (especially Keynesian theory) essentially assumes that there are no financing constraints and that movements in output and employment can be influenced by government intervention. Under normal circumstances, a government would submit to parliament a budget whose expenditures would be determined by projected revenues and whatever deficit would be estimated to be compatible with debt sustainability over the medium term. The deficit would then be financed by private capital markets—domestic or international.

But when a country is facing severe financing constraints (e.g. has gone bankrupt, like Greece), external financing is not available through the capital markets and is only provided by international official creditors. Under these circumstances, the government can only fulfill national priorities to the extent such funds are available. Public expenditures are a residual and are determined by domestic revenues and available official financing; in other words, while they can be prioritized, their total amount cannot be increased at the discretion of the government. This is a reality check that the current Greek government was unprepared to accept, and as late as June 2015 it decided to default on its obligations to the IMF, rather than reduce its expenditures.

If decision makers do not respect this simple arithmetic calculation and continue to retain (on paper) fictional obligations regardless of the financing constraints, then the economy moves into the realm of domestic arrears, where in reality employees and companies do not get paid. There are numerous receivables and payables on all sides and eventually the domestic economy is full of arrears from one economic agent to another, which results in a very messy situation that may take years to unwind. That was indeed the situation in the new CIS countries (the republics of the former Soviet Union), after the collapse of the latter in the early 1990s.

MYTH IV: The political cost impaired the implementation of reforms

For many years, analysts of the Greek economy and its travails have argued that the deterioration and eventual collapse of the Greek economy was due to government policies that ignored technocratic constraints, and that necessary "tough" decisions where delayed or never taken due to the proverbial "political cost".

This analysis is partially correct. Political considerations were (and shall always be) present in a representative democracy, but the case of Greece transcends pure politics and descends to lack of competence by both politicians and civil servants alike.

The months following the February 25, 2015 agreement, which extended the European program until June 30, 2015, were a surrealistic experience for all those involved in the negotiations between the new SYRIZA government and Greece's creditors. As a sign of respect to the outcome of the January elections, the creditors accepted a series of childish requests by the Greek government, notably the change of the term "troika" to "institutions" and the shifting of the locus of negotiations from Athens to Brussels (hence the name Brussels Group). The IMF has rarely accepted the conduct of discussions with authorities outside the capital city and normally only for reasons of security. The conduct of discussions outside a country's capital is not explicitly disallowed by the Fund's Articles of Agreement, but it is clearly a very inefficient process—as was shown in practice by many incidents during the Greek negotiations, for example, rotating counterparts, incomplete information, changing positions, and, at the end of the day, lack of authority by the Greek officials to negotiate in good faith. By the end of April, the IMF, the ECB, the European Commission and the US government (the latter had played an increasingly important role in the resolution of the Greek crisis behind the scenes) had all concluded that the Greek side was so inexperienced and ignorant about fundamental concepts of macroeconomic management, that further negotiations in good faith would be a waste of time. Therefore, they decided to present the Greek authorities with "take it or leave it" proposals, albeit in the beginning gradually and in a measured pace.

As a result of this process, the Greek government capitulated at the July 12 Summit of Eurozone Leaders after a 17-hour acrimonious session with Prime Minister Tsipras. The Summit Statement, which began with an unorthodox sentence about the "crucial need to rebuild trust" between Greece and its partners, included every point that the Greek government had sought to avoid until then, and in addition made a direct reference against the possibility of a nominal haircut of Greece's sovereign debt—a point the Greek government had desperately attempted to include. In short, <u>Greece lost on both inclusions and omissions in the Statement.</u> The new Memorandum of Understanding, signed between Greece and its creditors three weeks later and approved by the Eurogroup on August 14, was a more detailed version of the Summit statement.

CONCLUSION AND RECOMMENDATION

After six months of interactions between the new Greek government and the country's creditors, which the authorities had triumphantly called "negotiations leading to an honest compromise," Greece finds itself at square one: continued fiscal adjustment, further austerity and reforms, more supervision by the creditors (e.g. in the area of privatizations), stricter banking and NPL rules, and still unclear prospects about the extent and nature of the much-sought debt restructuring. What, then, did the Syriza government accomplish?

Sadly, the Syriza government succeeded only in convincing the European partners and the IMF that the fundamental problem with the Greek political landscape, particularly as reflected since January 2015, was not political choices but, simply, incompetence and disrespect for international rules. Part of that conclusion transcends the present government. Surely, the decision makers of Syriza (who, it is now revealed, were surrounded by inexperienced, ineffective, and well-paid "international advisors") showed an amazing unfamiliarity with applied macroeconomics while promulgating advanced theoretical concepts coupled with a contempt for down-to-earth arithmetic. But the opposition parties and the notoriously inept Greek media (gratefully with a handful of exceptions) demonstrated an equal detachment from common sense.

Where do recent developments leave Greece and what are its prospects for steady and sustainable growth? In the first paragraph of this analysis, I indicated that nothing will be different this time unless a dramatic change takes place in Greece's decision-making process. It is now time for me to define what I mean by "dramatic change."

I call for a two-pronged, concurrent approach: first, a government based on the broadest possible coalition, with an economic team comprising internationally recognized specialists (economists, businessmen, lawyers, tax accountants and privatization experts); second, a government granted legislative authority, which would enable it to decree laws with only broad parliamentary supervision until the end of the bailout program. Such extraordinary powers appear necessary to by-pass bureaucratic hurdles and parliamentary roadblocks during a period that timely decisions and implementation would be of the essence.

The stabilization, fiscal consolidation, and banking recapitalization aspects of the program would need to be a complemented by a conscious effort (in the form of a dedicated task force) to identify the new comparative advantages of Greece in the global division of labor and help advance a new mindset that will attract international investors and nurture domestic enterprises.

In my view, this radical strategy is a necessary condition for Greece to remain in the Eurozone. The upcoming general elections are the last hope for the implementation of such a strategy.

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