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Commentary

THE BUFFIN FOUNDATION SOCIAL AND ECONOMIC DEVELOPMENT ISSUES

Greek Drama in Euroland

The history of Ancient Greece is remarkable in many ways; its great philosophers and literary figures are revered even today. Sophocles, recognized as perhaps the greatest Greek tragedian, has remained an acclaimed master of his craft for more than two thousand years. Greek drama and tragedy may be studied in the ancient works of Sophocles or in the workings of the modern Greek economy. Nobel Laureate economist Paul Krugman of Princeton University has recently written two eloquent articles in the New York Times relating to the dramatic events in Greece that resulted from the tragic failure of economic austerity policies. These policies, forced upon Greece by its creditors, failed to restore the country's economic and financial well-being following the global financial crisis and failed to achieve the benefits expected from its participation in the European Community and its adoption of the euro currency. The first article, published on January 23 with the title *Much Too Responsible* describes how the eighteen countries comprising the Eurozone "did almost everything wrong", implementing austerity policies, spending cuts, and even tax increases, but not committing to stimulus policies to encourage economic growth. On the monetary side, officials fought the imaginary menace of inflation, and took years to acknowledge the real threat of deflation. European austerity measures reflected willful misdiagnosis of the situation. Officials in Berlin and Brussels chose to ignore the evidence in favor of a narrative that placed all the blame on budget deficits and simultaneously rejected the evidence suggesting that trying to slash deficits in a depressed economy would deepen the depression. Europe's central bankers erroneously worried about inflation in 2011 and decided to raise interest rates. The challenge now is to fight off the broader deflationary forces set in motion by years of wrongheaded policy. Europe's economy was wrecked in the name of responsibility. In selecting policy measures for a depressed economy, it should have been obvious that a balanced-budget commitment and a hard-money obsession would inflict long-term harm, damaging the economy and driving it into a deflationary trap, as has been the tragic experience of Greece.

The second article, published on January 26 with the title *Ending Greece's Nightmare* describes the outcome of the Greek elections and the intentions of Alexis Tsipras, leader of the Syriza party, to challenge the austerity policies and undo the damage they caused to the Greek economy, particularly regarding increased unemployment, reduced public spending and the nightmare of economic recession with its substantial decline in economic output. Greece's 2010 standby arrangement with the International Monetary Fund, under which the troika of the IMF, the European Central Bank and the European Commission extended loans to the country in return for a combination of austerity and reform, only served to worsen Greece's economic difficulties. The economic projections that accompanied the IMF standby arrangement assumed that Greece could impose harsh austerity measures with little effect on growth and employment. Greece was already in recession in 2010 but the projections assumed that the downturn would soon end. What actually transpired was an economic nightmare, as the recession gathered momentum, turning into a full-fledged depression, with unemployment rising to 28 percent. The Greek debt problem became worse as government revenues plunged along with GDP, so that the ratio of debt to GDP rose to unsustainable levels. Ultimately, the Greek people exercised their rights to demand change through the ballot box.

The challenge for Greece is now more about politics than economics. Alexis Tsipras won the election campaign for Syriza by demanding a substantial reduction of Greece's debt burden and promising renewed spending for public policy, including re-hiring 12,000 public sector workers. Mr. Tsipras has signaled a desire for Greece to remain with the euro currency thus avoiding the turmoil that would follow from a Greek exit. It is clear that Europe's austerity program has been excessive and counter-productive. Now that the European Central Bank has belatedly agreed to implement a program of quantitative easing, it is also evident that the policy of austerity has failed and has brought about a crisis of deflation. Despite huge sacrifices by the Greek population, the outcome of the "responsible" policies of austerity imposed on Greece has pushed Greece's debt from around 109% of GDP to an unsustainable level of 175% of GDP. The question now is how to resolve the political impasse in a way that might be acceptable to both Greece and the rest of Europe, more specifically, Germany, Netherlands and Finland. An extension of the maturity of Greek debt and a program of partial debt forgiveness might be a first step in the right direction. However, Greece remains dependent on receiving further European and IMF loans that are contingent on its meeting the terms of its previous bailout agreement. Political gamesmanship will decide the outcome of this Greek tragedy.

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