



# *Policy Note*

---

2012 / 11

## **GREECE'S BAILOUTS AND THE ECONOMICS OF SOCIAL DISASTER**

C. J. POLYCHRONIOU

The Greek economy has been shrinking for the past five years, largely because of a contraction in domestic demand that started prior to the eruption of the sovereign debt crisis in late 2009. By the end of this year, Greece's GDP will have contracted by more than 20 percent since the onset of the crisis. The domestic economy grew by 4 percent from 2003 to 2007, a rather impressive economic performance until one realizes that the most important contributor to Greek GDP growth was heavy private consumption, fuelled by a surge in credit growth and large-scale public consumption and investment in advance of the 2004 Olympic Games (Moschovis and Servera 2009).

Moreover, this "dynamic" growth took place against a background of large-scale asymmetries and pathologies in Greece's economic and public administrative structure: malfunctioning domestic markets, which, among other things, kept inflation close to 2 percentage points above the rest of the euro area; increases in nominal wages outpacing productivity gains; growing fiscal deficits and sky-high debt-to-GDP ratios; astonishing levels of corruption and waste; minimal funding for R&D; and negative developments in tax revenue receipts. Thus, when the global crisis reached Europe's shores, all of the structural weaknesses of the Greek economy exploded to the surface, causing a crisis of immense proportions (Polychroniou 2011). Markets retaliated by pushing Greek bond yields to stratospheric levels, and Greece ended up being wholly dependent on the European Union (EU) and the International Monetary Fund (IMF) for its borrowing needs. But

---

C. J. POLYCHRONIOU is a research associate and policy fellow at the Levy Economics Institute of Bard College.

The Levy Economics Institute is publishing this research with the conviction that it is a constructive and positive contribution to the discussion on relevant policy issues. Neither the Institute's Board of Governors nor its advisers necessarily endorse any proposal made by the author.

this was only the beginning of a crisis that now threatens the very survival of the euro project. The Greek debt crisis soon spread like a virus to the outer periphery of the eurozone (Ireland and Portugal), then to the two largest economies of the south (Spain and Italy), and now bank runs have been added to the growing pressures on the eurozone.

The spread of the sovereign debt crisis from Greece to Ireland, Portugal, Spain, and Italy is a reflection of the flawed design of the euro system (Papadimitriou and Wray 2012) and of the dismal failure on the part of the current European leadership to contain a deepening crisis with fast, effective, and courageous political measures. In this context, Greece should not be seen as an isolated case but rather as part of the eurozone crisis. At the same time, however, Greece is a “special case.” Its economy is small, but with an amazing array of unique and rather persistent problems, most of which are directly related to the peculiarities of the domestic political environment and the overall political culture. For example, the country was already running a debt-to-GDP ratio above 100 percent back in 1992. And tax evasion remains an unchecked societal problem. The Financial Crimes Squad just recently reported that more than half of the business establishments operating in tourist resort areas were not issuing receipts, while on some of the most popular islands tax evasion rates were as high as 100 percent (*Athens News* 2012).

As the decline in Greek GDP should indicate, the economic situation in Greece today is catastrophic. The economy is in freefall, and the social consequences are being widely felt. The main reason for this awful situation is that the country has suffered for more than two years under a harsh austerity regime imposed by the EU and the IMF. The bailouts have proven to be a curse. The nation is literally under economic occupation and sinking deeper into the abyss, and there is very little reason to expect a turnaround in the foreseeable future.

The story of the Greek crisis has to begin with the inexcusably slow reaction on the part of the EU authorities. Many precious months were wasted before it dawned on Brussels that steps needed to be taken on behalf of an EU member-state. But when Brussels finally did react, the intent was to inflict punishment on “profligate” Greeks (punishment for also having cooked the books in order to join the eurozone and hiding the actual deficit from EU authorities) rather than help a member-state and sort out what was essentially a European problem. In 2008, Greece’s fiscal deficit occupied first place among the EU’s 27

member-states (at 7.7 percent of GDP) and its public debt was the second highest. And Greek national statistical authorities were truly notorious for their lack of independence and integrity. So when the Greek authorities also revised the deficit ratio for 2009 (from 3.7 percent of GDP to 12.7 percent of GDP; see European Commission 2010a), Germany and the EU chiefs were determined to activate a plan that would cause lots of pain for Greece and signal to other eurozone member-states what fate awaited them if they failed to put their economic and fiscal houses in order.

In May 2010, after being completely shut out of the international credit markets, Greece accepted a massive bailout package from the EU and the IMF in order to avert a default. This was *not* an act of solidarity on the part of Greece’s EU partners and its financial backers. At stake were Europe’s banks, which were overexposed to Greek debt, and the stability of the euro. Even so, EU officials appeared quite confident in public that the bailout agreement would help Greece put its economy back on track in a relatively short time and allow it to return to the international credit markets by the end of 2011 or early 2012. As perverse as it may now seem, the mood was rather euphoric. In Greece, Prime Minister George Papandreou (who still portrays himself as a modern-day savior of the nation) hailed the decision as a “historic day” for Greece and Europe alike. Still, most economists across the ideological spectrum were not merely skeptical about the bailout deal but actually thought that the measures that came attached to the rescue funds would sink the Greek economy into deeper recession.

The bailout agreement covered three years and totaled 110 billion euros. Greece’s eurozone partners would be providing 80 billion euros and the IMF 30 billion euros. The bailout loan carried a usurious interest rate of 5 percent. As for the aims of the bailout plan, they were broad and ambitious, clearly reflecting the urgency of the situation, but also highly unrealistic and driven by a strong conviction in the ability of the neoliberal structural reform agenda to quickly spur troubled economies back into growth. Lowering the deficit (to 3 percent of GDP by 2013), restoring debt sustainability (Greece’s debt had reached nearly 120 percent by May 2010), achieving internal devaluation for the purpose of reducing domestic demand, improving competitiveness, and increasing investments and exports were identified as the plan’s primary objectives. The fiscal consolidation strategy aiming to lower the deficit and restore debt sustainability involved a package of measures that amounted to

11 percent of the country's GDP. With the corrections in place, the forecast called for the appearance of a primary surplus by 2012.

The measures required to realize the above goals were nothing more than the standard IMF structural adjustment policies that have been enforced in many Latin American, African, and former Eastern European communist-bloc nations over the last 35 years; namely, slashing the budget, trimming the public sector, eliminating social programs and workers' benefits, liberalizing labor markets, raising taxes, reforming the pension system, blanket privatizations, and so on. Currency devaluation was impossible in the case of Greece, since the euro is used throughout the eurozone, so internal devaluation (lowering salaries, wages, and pension payments) was seen as a natural substitute. According to IMF expectations, the implementation of the structural adjustment program would allow the economy to rather quickly regain some of its lost competitiveness due to high labor costs and, after a slow increase, the debt would start declining after 2013.

In the Memorandum of Understanding signed by Greece and its EU/IMF creditors, the Greek government was expected to carry out the required reforms with lightning speed, and the "troika"—the European Commission, IMF, and European Central Bank (ECB) officials responsible for the supervision of the Greek structural adjustment program—would review its progress on a quarterly basis in order to determine when the next installment of rescue funds (which were to be used exclusively for the country's debt obligations) should be released. This approach to dealing with a nation's economic woes is rather typical of IMF thinking, which has always envisioned a national economy being like a ship that can change course almost instantaneously at the command of its captain. As for the national culture, there was no reason why it could not be taken apart like a car engine and retooled in no time.

The idea that the IMF has changed its philosophy and the tactics it pursues is hogwash. Indeed, in spite of the much-parroted claims of various senior-level officials that the organization has learned from its past mistakes and has altered the way it approaches nations in need of economic guidance and assistance, the mentality of the IMF (and its neoliberal acolytes everywhere) is still stuck in the era of the Pinochet regime in Chile, when guns and torture were widely used as means to enforce fiscal discipline and a "free market" utopia on an otherwise unaccommodating nation. The IMF approach has failed everywhere it has been tried, in the process making a mockery

of economic science and shredding democratic ideals and values. From Latin America to Africa in the 1970s and 1980s, and from the former Soviet Union in the 1990s to Europe's periphery today, the unfolding of the neoliberal experiment has produced a social dystopia, leading to lower growth rates, rolling back social progress, and increasing inequalities.

As was to be expected, the bailout deal of May 2010 turned out to be an EU/IMF fiasco and a Greek tragedy. Greece's deficit shrunk, but so did everything else—and in much greater proportions: employment, tax revenues, investment, consumer demand, social and human services. The public debt increased substantially, and so did every index of economic misery and social malaise, including the spread of anti-immigrant extremism and waves of suicides related to economic hardship. But Greece's financial partners had no interest in the social and economic consequences of the fiscal consolidation hoax they had perpetrated. All that mattered was attaining fiscal balance—that is, ensuring that the banks would keep on receiving payments for the Greek sovereign bonds they held.

The austerity-based fiscal adjustment program began to show catastrophic effects within a few months. Small-size businesses were shutting down at record levels and unemployment had begun its upward spiral. In May 2010, the unemployment rate stood at 12 percent; by May 2011, it had jumped to 16.6 percent. The austerity measures were also having a major effect on tax revenues. In spite of repeated tax hikes—including across-the-board sales tax increases, a reduction in nontaxable income, and an emergency property tax on all homeowners—state revenues declined, with the pension and social insurance funds taking especially huge drops. According to the Greek Statistical Authority, state revenues for 2011 were lower than in 2009, "the year," as some commentators acutely observed, "of the absolute fiscal derailing" (Malkoutzis and Mouzakis 2012).

Media coverage of the bailout and the frequent criticism voiced by the EU and the IMF officials supervising the fiscal adjustment program have combined to paint the Greek authorities as reluctant, even unwilling, to commit themselves to meeting the conditions of the bailout agreement. This is a gross distortion of the truth and a pretext for concealing the blunt failure of the austerity measures. The Greek government complied with the Economic Adjustment Program to the letter (see European Commission 2010b; 2010c; 2011). Billions of euros were reduced from primary expenditures, major cuts were made in public wages, hospital operating expenses were lowered by 50

percent, and the education budget got smaller by several hundred million euros. But as the recession kept getting deeper and deeper, and Greek tax revenues kept falling short of target, the pressure on the government to institute even more austerity measures increased. This is a tactic employed by the “troika” from the start of the bailout deal, and one that continues today, with the second bailout plan.

Having said this, the Greek authorities are hardly blameless for the disaster that befell the nation. The old political establishment drove the country into the abyss with its irresponsible policies and corrupt practices, and then (the Papandreou government) accepted whatever plans and decisions the EU and the IMF came up with for Greece as a *fait accompli*. It failed to push forth with some necessary reforms yet implemented wholeheartedly the most vicious austerity measures in recent European economic history. Indeed, the irony of all ironies is that the same political establishment that bankrupted Greece was assigned the role of guiding the country out of the crisis.

The May 2010 bailout agreement was to be a one-time deal. Yet, even before the ink had dried, everyone (except the EU officials) could see that this was not going to be enough to help Greece overcome its crisis, and certainly not enough to stop the spread of contagion. Accordingly, Greek bond yields kept soaring to ever greater heights, freezing Greece out of the private financial markets for an indefinite period of time, and the bond vigilantes went on a safari for more fiscally wild “PIIGS.”

Nearing the end of the first two years of the bailout, eurozone finance ministers ended up approving a new rescue package deal for Greece worth 130 billion euros. Without the new bailout funds, the country would have defaulted. Interestingly enough, stocks fell when the announcement was made, as markets were quick to realize once again that the deal wasn’t going to solve the Greek crisis. By that time, Greece had already made the transition from crisis to catastrophe. Austerity was crushing the Greek economy and causing a slowdown in every peripheral eurozone economy that was implementing deep austerity measures in the midst of a major recession. But dogma is dogma and, as such, it has to be reinforced regardless of any empirical reality. Thus, the second bailout package included even more budget cuts across the board, the reduction of public employment by 150,000 by the end of 2015, and a massive privatization project—essentially an all-out neoliberal attack on public goods and all publicly owned enterprises in Greece. “A Nation for Sale” is how many Greek citizens have come to regard the

terms and conditions included in the second bailout agreement. This largely explains the phenomenal surge of the marginal radical left group SYRIZA (which received 4.6 percent of the popular vote in the 2009 national elections) into the second-largest party in Greece (it drew 26.89 percent of the popular vote in the June 2012 national elections, losing first to the conservative New Democracy party by less than 3 percentage points), as well as the rise of the neonazis and other “right-wing, nationalist” parties. On sale, among other highly valuable state assets, are the ports of Piraeus and Thessaloniki; the Greek telecom OTE; the national lottery; prime real estate; and the postal bank. Greece’s financial backers expect the privatization projects to raise 50 billion euros by 2015, but this scenario seems far-fetched given the state of the national economy, and yet another indication of how wildly out of touch with Greek reality the neoliberal economic quacks are.

For the first two years of the first bailout agreement, EU leaders and the Greek government alike also made a mockery of any suggestion that Greece’s unsustainable public debt be restructured, a move that should have been undertaken almost immediately after the crisis broke out. In May 2012, a debt restructuring deal was reached with most of the private investors, who, after Germany and the EU used some strong-arm tactics, agreed to swap their government bonds for new securities worth less than half the previous securities. Greek government bonds held by the ECB were excluded from the “haircut.” As it turned out, this was yet one more move on the part of EU leaders to buy time, since the restructuring deal still left Greece’s debt at unsustainable levels, while placing new Greek bond issues under British law (hence the Greek Parliament cannot pass legislation refusing payment).

According to most calculations, the “haircut” reduced Greece’s debt ratio to 132.4 percent (although the actual debt ratio could be higher, as there is still some uncertainty about the effectiveness of the swap deal). This means that another debt restructuring is simply a must if the country is to have a financial future beyond 2020, when, according to the IMF, the debt is expected to fall to 120 percent (which would be what the debt-to-GDP ratio was at the start of the crisis) but could still end up as high as 145 percent. Under these circumstances, can anyone believe that the financial future of Greece allows room for even the slightest optimism?

In the meantime, and while the country is both economically and socially at the breaking point, the “troika” is asking the

Greek government to come up with additional savings of 12 billion euros for the next two years. The unemployment rate stands now at over 22 percent, and could soon reach 25 percent. More than 25,000 Greeks, mostly young and well educated, have already left the country in order to seek work in Germany. If the economics of social disaster that the EU and the IMF have been imposing on Greece for the last two-and-a-half years continues much longer, Greece will soon be a nation inhabited primarily by low-educated, low-income workers, the elderly, and immigrants. This is a fate that no country, regardless of its past financial and economic sins, deserves—and the shame will be Europe’s alone.

## References

- Athens News*. 2012. “Record Rates of Tax Evasions on Islands.” July 26.
- European Commission. 2010a. *Report on Greek Government Deficit and Debt Statistics*. January.
- . 2010b. “The Economic Adjustment Programme for Greece: First Review—Summer 2010.” *European Economy, Occasional Papers*, No. 68. Brussels: Directorate-General for Economic and Financial Affairs. August.
- . 2010c. “The Economic Adjustment Programme for Greece: Second Review—Autumn 2010.” *European Economy, Occasional Papers*, No. 72. Brussels: Directorate-General for Economic and Financial Affairs. December.
- . 2011. “The Economic Adjustment Programme for Greece: Third Review—Winter 2011.” *European Economy, Occasional Papers*, No. 77. Brussels: Directorate-General for Economic and Financial Affairs. February.
- Malkoutzis, N., and Y. Mouzakis. 2012. “Greece, Spain, Portugal Stare into Abyss.” *Kathimerini* (English edition), July 21.
- Moschovis, G., and M. C. Servera. 2009. “External Imbalances of the Greek Economy: The Role of Fiscal and Structural Policies.” *ECFIN Country Focus* 6, no. 6 (July 10).
- Papadimitriou, D. B., and L. R. Wray. 2012. *Euroland’s Original Sin*. Policy Note 2012/8. Annandale-on-Hudson, N.Y.: Levy Economics Institute of Bard College.
- Polychroniou, C. J. 2011. “An Unblinking Glance at a National Catastrophe and the Potential Dissolution of the Eurozone: Greece’s Debt Crisis in Context.” Working Paper No. 688. Annandale-on-Hudson, N.Y.: Levy Economics Institute of Bard College.