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GREECE: CAUGHT FAST IN THE TROIKA'S AUSTERITY TRAP

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On November 27, 2012, the Eurogroup reached a new "Greek deal" that once more discloses that there is no political will to address Greece's debt crisis, or the country's economic and social catastrophe. This fact increasingly makes Greeks think that the sovereign debt crisis incorporates significant geoeconomic and geopolitical interests at the expense of national sovereignty. Nonetheless, in the purely economic domain, there are two main aspects of the new agreement. The first is the condition imposed by the European Union (EU), European Central Bank, and International Monetary Fund—the "troika"—that Greece must adopt and apply a fiscal correction mechanism to "safeguard the achievement" of irrational and unrealistic fiscal growth and privatization targets. This mechanism will institutionalize economic austerity and the impoverishment of Greek workers in the private and public sectors, and squeeze to zero the degree of freedom for national economic policymaking.

The second aspect is the restructuring of creditors' debt claims as a means for Greece to reduce its financing gap and borrowing needs. This decision, in conjunction with Greece's public debt tender purchases, is hypothesized to put Greece's public debt back on a sustainable path by 2020–22, which will facilitate the gradual return to market financing. The new agreement between Greece and the troika is characterized by much fantasy, but little realism. The economic, social, and political environment in Greece remains fluid, since uncertainty and a lack of credibility continue to surround the course of economic policymaking in Greece and elsewhere in the eurozone.

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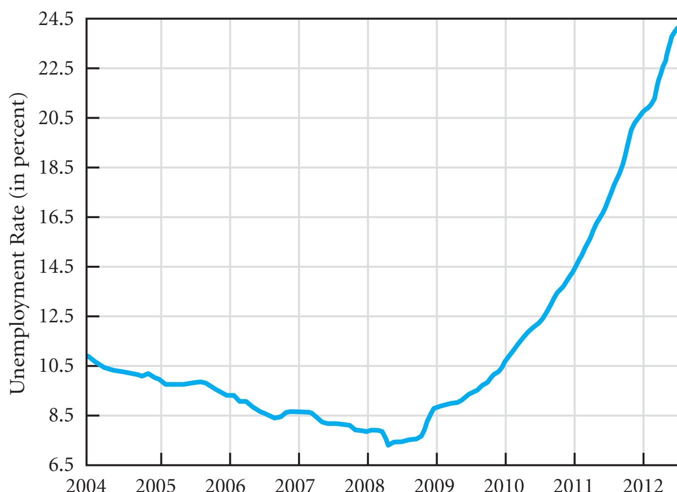
In the last 20 years or so, the Greek economy has been transformed into a consumption/demand-driven growth economy heavily reliant on debt accumulation, with significant structural deficits in the production system that steadily undermined the country's competitiveness and external position. This economic model, which does not incorporate an endogenous mechanism of sustainable income creation, is perceived by investors to have high credit risk, especially within the current architecture of the eurozone, which lacks a "lender of last resort" institution.

Initially, the global financial crisis, and then the sovereign debt crisis, induced Greece to pass through a process of deleveraging, which caused negative demand and growth effects, reducing the country's credibility and solvency in the private bond markets. Furthermore, the troika's austerity trap, which has been enforced by the bailout agreements, has caused a considerable reduction in domestic demand, deepening the recession and minimizing any possibility for restoring the country's credibility and solvency. Figure 1 shows the sharp increase in the unemployment rate, and reflects the economic and social catastrophe that has taken place in Greece due to the troika's first two Memoranda of Understanding.

Furthermore, the debt structure of the Greek public sector was not sustainable before, did not become sustainable after the "haircut" in March 2012, and will not become sustainable as a result of the Eurogroup's decision in November. As long as the public debt is considered unsustainable, liquidity and solvency problems will arise, rapidly multiply, and spread to the entire economy, which will continue to evolve through a "debt deflation" process, with catastrophic employment, growth, and wealth effects, leading the country to an impasse. The current situation in Greece involves a self-defeating cycle of extremely tight fiscal and wage policies followed by recession—a cycle that subverts the country's ability to meet its debt obligations. This cycle, combined with the troika's obsession with tax increases and expenditure reductions while the economy is already deeply depressed, keeps Greece in a "default trap" that increases the country's currency risk as well as the fragility and instability of the Greek banking system.

Figure 1 **The Evolution of the Unemployement Rate in Greece, 2004–12**



Source: Hellenic Statistical Authority, Labour Force Survey, July 2012

The abovementioned factors lead to the conclusion that Greece urgently needs a new strategy. The economic rationale for this strategy must differ completely from the one embodied in the troika's Memoranda, which were determined by Germany's illusions, economic interests, and federal political cycle. This new strategy must be implemented consistently, and without delay, in order for Greece to gear toward growth and debt sustainability and resolve its economic, social, and financial crisis. Given the current architecture of the Economic and Monetary Union, this strategy must rely on three major pivots.

In order to restore Greece's solvency and credibility, it is fundamental to create expectations that the Greek economy can generate primary surpluses that can fulfill a great deal, if not all, of its annual debt obligations. For this to happen, a new restructuring of the country's public debt is necessary. This restructuring should incorporate a substantial "haircut" of its nominal stock of debt, a near-zero interest rate, and a considerable extension of the period in which Greece must make its interest and principal payments. Greece's economic survival presupposes that its annual debt obligations fall to economically and socially affordable levels. Furthermore, the sustainability of primary surpluses depends heavily on economic growth. Any attempt to create a primary surplus in a depressed economy through economic austerity is determined to fail, with detrimental economic and social effects and without resolving the problems of solvency and credibility.

In addition, economic austerity delays Greece's fiscal adjustment and the implementation of vital structural reforms in the production system. The reason is that austerity creates recession, which negatively affects market expectations that the economy will exit from the "default trap," discouraging potential

domestic and foreign investors. As long as the vicious austerity-recession cycle continues, Greece's prospects for meeting its deficit and debt targets will weaken, thus refueling negative expectations. Nonetheless, the current recession and the economy's liquidity and solvency constraints make any shift to more expansionary fiscal and wage policies unfeasible. Consequently, is there any institution that can stabilize both the macroeconomic system and the financial system in the short term and create the conditions for Greece to generate the primary surpluses needed to meet its debt obligations?

The answer is yes, and this institution is Hyman Minsky's proposed "employer of last resort," or ELR (e.g., see Minsky 1986, Papadimitriou and Minsky 1994), a unique, countercyclical government initiative that has shown evidence of spurring growth and alleviating poverty. Direct employment creation is a macro-social policy response that is preferable to the troika's blind faith in the hypothetical employment effect of labor market flexibility and the gradual abolition of the minimum wage. This policy response could be promptly promoted in the form of "employment guarantee programs" (EGPs) aimed at channeling resources to targeted groups (e.g., youths and women) as well as particular regions, creating jobs in social care and child development, environmental clean-up and restoration, fire protection, and health services, which offer higher economic multipliers than traditional public infrastructure jobs (see Antonopoulos et al. 2011). However, financing EGPs requires the creation of an ELR fund. Practical funding sources are revenues from tax evasion, the utilization of public property, a percentage of the primary surplus and Treasury's cash buffer, and EU structural funds. The scale of the EGPs will depend on the size of the ELR fund.

EGPs can operate as a liquidity mechanism that will cause positive macroeconomic effects, to the extent that they will create income flows and domestic demand. In this sense, EGPs can be the missing link in Greece's exit from recession (by creating the conditions for positive growth rates and sustainable primary surpluses, and by improving social stability and cohesion through increased employment) and from the "default trap" (by reducing the currency risk). In addition, the ratio of public debt to GDP will fall, as will the nonperforming loans of unemployed households and the bankrupt firms in the banking system, increasing the country's financial stability, solvency, and credibility.

Apart from institutionally determined fiscal changes with immediate expansionary results, Greece also needs a new growth model. A long-term growth policy must strive for reforms to foster the transition to a new, export-oriented economy with higher structural competitiveness. These reforms must focus on changing the structure of production and reallocating resources to modern industries (e.g., green energy and organic agriculture), as well as to import-substitution industries. Nevertheless, the most important developmental task for Greece is to change the dominant culture of entrepreneurship. The latter must pursue profits by investing in R&D, expanding production and market share, and shifting toward export-orientated activities targeting higher rates of capital accumulation—instead of making profits through redistributive mechanisms such as tax evasion and the absorption of EU structural resources financing conspicuous consumption.

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