usnews.com

The Never Ending Greek Tragedy

Greece has seen very little progress turning around its economy

By DALIBOR ROHAC

August 30, 2013

As fall draws nigh, Europe faces the Greek sovereign debt problem again. Both the German and Greek finance ministers, Wolfgang Schäuble and George Papaconstantinou, recently suggested that Greece might need yet another bailout to meet its financing needs.

This is disappointing for those who hoped that the deal agreed on in February last year, through which a significant haircut was imposed on bondholders, together with an injection of liquidity, was a lasting solution to the problem. However, in spite of the months of relative calm on the bond market and signs of timid recovery in the Eurozone, the recurrence of the problem is not surprising.

Greek debt problems have never gone away. Even after the restructuring last year, Greece has had the highest debt relative to the size of its economy in the Eurozone – 160.5 percent. And while the government is proudly running a primary surplus this year, 2013 is yet another *annus horribilis* for the Greek economy, which is expected to contract by 4 percent, thereby further increasing the relative size of the public debt.

Still worse, a contracting economy means that ordinary Greeks are getting poorer and poorer. The unemployment rate is at a staggering 27 percent, hitting young people, among whom the unemployment rate hovers above 64 percent, particularly hard. The full picture is even worse: out of 11 million Greeks, only 3.6 million are working. Since 2010, around 120 thousand professionals, including scientists and doctors, have left the country, and are unlikely to come back anytime soon.

The reason why the Greek economy is in such terrible shape has to do with the fact that the fiscal consolidation undertaken by the government of Prime Minister Antonis Samaras has been shambolic. Earlier this year, Greeks have increased the rate of their corporate income tax from 20 to 26 percent, and added new top rate of 42 percent rate on annual personal incomes above €42,000.

By relying heavily on increasing revenue, the government is effectively imposing a part of the burden of adjustment on the private sector. Moreover,evidence from other attempts at fiscal consolidation shows that adjustments that rely on revenue increases as opposed to spending cuts tend to be less durable and less effective.

Since 2009, government revenue as a proportion of GDP has increased from around 38 to 43 percent. While spending has declined, both in absolute and relative terms, the government has done very little to reduce the bloated public administration, and its attempts to squeeze more revenue from a shrinking economy are having a debilitating effect on the private sector – especially if unaided by structural reforms.

And on that front, Greece has seen very little progress. A recent report by the International Monetary Fund described the progress on privatization as "painfully slow, both in terms of asset preparation and financial results, raising concerns about the effectiveness of the privatization strategy."

Overall, the progress that the Greeks are making in stabilizing their public finances and opening up their economy to competition is completely inadequate to the magnitude of the economic problem they are trying to solve. When the financial crisis hit the Baltic states, the Latvian government fired one-third of its civil servants and proceeded with a fiscal contraction of over 11 per cent of GDP in just one year – most of it through spending cuts. In Sweden, following the financial crisis of 1991, public spending as a fraction of GDP fell by 20 percentage points, accompanied by an across the board liberalization of the economy. What is the likelihood of something similar happening in Greece after three years of half-hearted, and largely botched, reforms?

The real tragedy unfolding in Greece is not so much the waste of money of European taxpayers on successive bailouts, although that certainly animates the public debates in Germany and elsewhere. Instead, the more depressing story is the continuous failure of the Greek government to open up opportunities for economic success to its own citizens. And, unfortunately, the longer European leaders keep the funding spigot open for political reasons, the smaller the incentive will be for the Greek political elite to live within their means and to rethink the role that the Greek government is playing in the economy.