

Greece: When history repeats itself

By [Jacques Le Cacheux](#)

The duration of the Greek crisis and the harshness of the series of austerity plans that have been imposed on it to straighten out its public finances and put it in a position to meet its obligations to its creditors have upset European public opinion and attracted great comment. The hard-fought agreement reached on Monday 13 July at the summit of the euro zone heads of state and government, along with the demands made prior to the Greek referendum on 5 July, which were rejected by a majority of voters, contain conditions that are so unusual and so contrary to State sovereignty as we are used to conceiving of it that they shocked many of Europe's citizens and strengthened the arguments of eurosceptics, who see all this as proof that European governance is being exercised contrary to democracy.

By requiring that the creditors be consulted on any bill affecting the management of the public finances and by requiring that the privatizations, with their lengthy list dictated by the creditors, be managed by a fund that is independent of the Greek government, the euro zone's leaders have in reality put Greece's public finances under supervision. Furthermore, the measures contained in the new austerity plan are likely to further depress the already depressed domestic demand, exacerbating the recession that has racked the Greek economy in 2015, following a brief slight upturn in 2014.

Impoverishment without adjustment

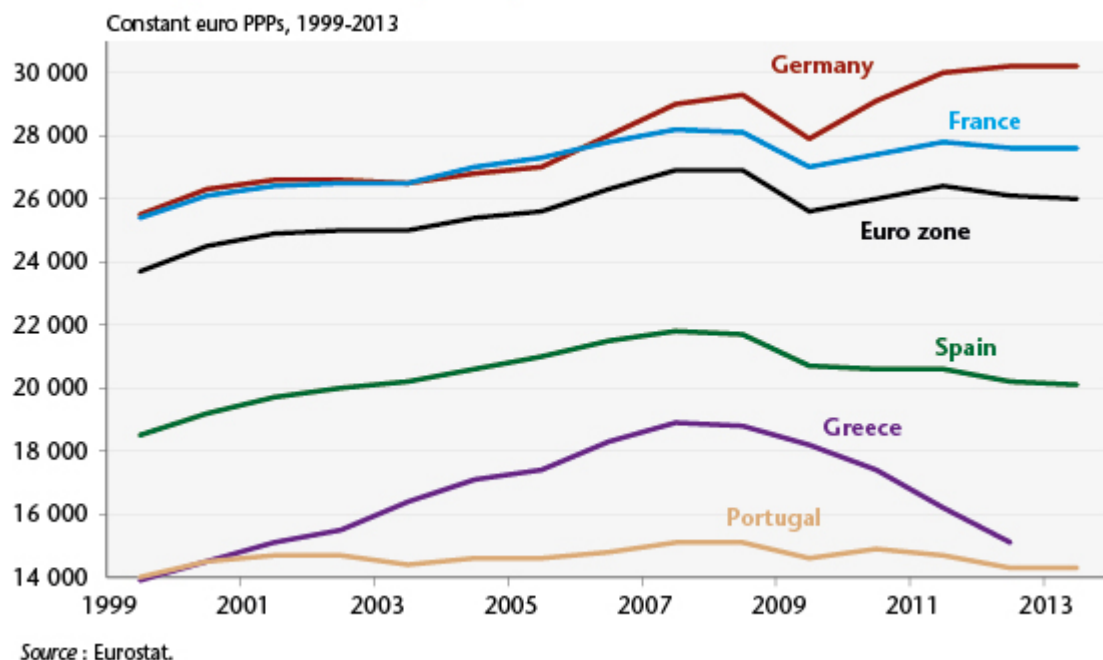
The Greek crisis, which in 2010 triggered the sovereign debt crisis in the euro zone, has seen prolonged agony punctuated

by European psycho dramas that always conclude in extremis by an agreement that is supposed to save Greece and the euro zone. From the beginning, it was clear that a method based on the administration of massive doses of austerity without any real support for the modernization of the Greek economy was doomed to failure [\[1\]](#), for reasons that are now well understood [\[2\]](#) but at the time were almost universally ignored by officialdom, whether from European governments, the European Commission or the IMF, the main guarantor and source of inspiration for the successive adjustment plans.

The results, which up to now have been catastrophic, are well known: despite the lengthy austerity cure, consisting of tax hikes, public spending cuts, lower wages and pensions, etc., the Greek economy, far from recovering, is now in a worse state, as is the sustainability of the country's public finances. Despite the agreement in 2012 of Europe's governments on a partial default, which reduced the debt to private creditors – relief denied by those same governments two years earlier – Greece's public debt now represents a larger percentage of GDP (almost 180%) than at the beginning of the crisis, and new relief – this time probably by rescheduling – seems unavoidable. The third bailout package – roughly 85 billion euros, on the heels of approximately 250 billion over the past five years – will be negotiated over the coming weeks and will be in large part devoted just to meeting debt repayments.

Meanwhile, the average living standard of Greeks has literally collapsed; the difference with the euro zone average, which had tended to decline during the decade before the crisis, has now widened dramatically (Figure 1): the country's GDP per capita is now a little less than half that in Germany. And GDP per capita still only poorly reflects the reality in an economy where inequality has increased and spending on social protection has been drastically reduced.

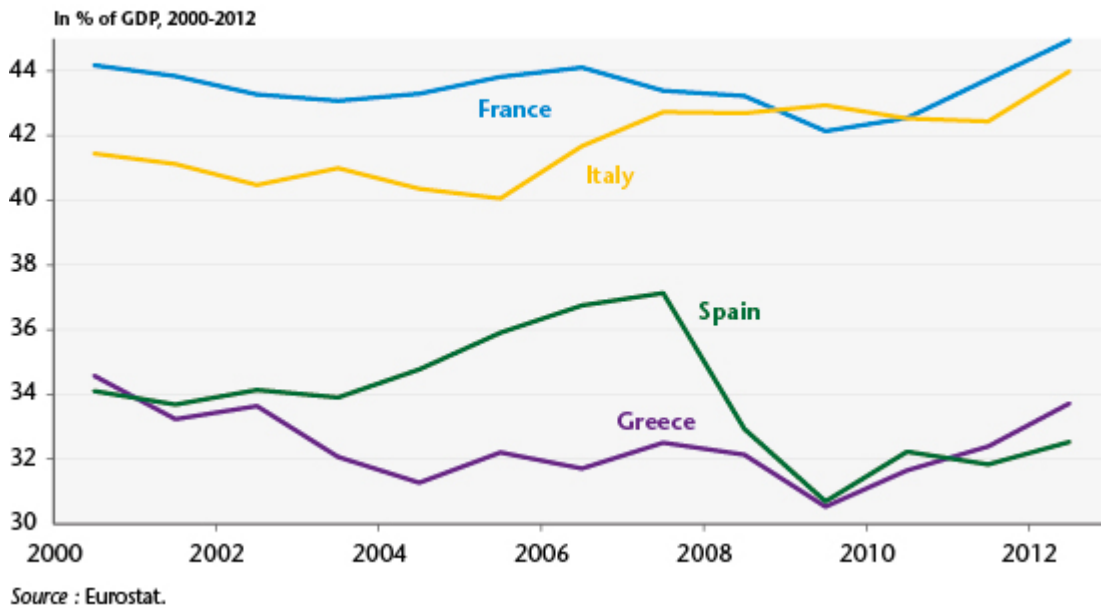
Figure 1. Real GDP per capita in several euro zone countries



The new austerity plan is similar to the previous ones: it combines tax hikes – in particular on VAT, with the normal rate of 23% being extended to the Islands and many sectors, including tourism, that were previously subject to the intermediate rate of 13% – with reduced public spending, and will result in budget savings of about 6.5 billion euros over a full year, which will depress domestic demand and exacerbate the current recession.

The previous adjustment plans also featured “structural” reforms, such as lowering the minimum wage and pensions, deregulation of the labour market, etc. But it is clear that the fiscal component of these plans did not have a very visible impact on government revenue: after having declined significantly until 2009, the Greek tax burden – measured by the ratio of total tax revenue to GDP – has definitely increased, but not much more than in France (Figure 2). This does not mean, of course, that an even stronger dose of the same medicine will lead to better healing.

**Figure 2. Level of overall fiscal pressure
in several euro zone countries**



Does history shed light on the future?

The ills afflicting the Greek economy are well known: weak industrial and export sectors – apart from tourism, which could undoubtedly do better, but performs honourably – numerous regulated sectors and rentier situations, overstaffed and inefficient administration and tax services, burdensome military expenditure, etc.

None of this is new, and no doubt it was the responsibility of the European authorities to sound the alarm sooner and help Greece to renovate, as was done for the Central and Eastern Europe countries in the early 2000s in the years before they joined the European Union. Will the way it has been decided to do this now, through a forced march with the Greek government under virtual guardianship, be more effective?

If we rely simply on history, the temptation is to say yes. There are many similarities between the situation today and a Greek default back in 1893. At that time Greece was a relatively new state, having won its independence from the Ottoman Empire in 1830 following a long struggle supported by the European powers (England and France), which put the

country under a Bavarian king. Greece was significantly poorer than the countries of Western Europe: despite an effort at modernization undertaken after independence that was led by the Bavarian officials assembled around the Greek King Otto, in 1890 the country's GDP per capita was, according to data assembled by Angus Maddison[\[3\]](#), about 50% of the level of France, and a little less than one-third that of the UK. The analysis of Greece at that time was little better than that today:

" ... Greece has been characterized throughout the 19th century by structurally weak finances, which has led it to default repeatedly on its public debt. According to the *Statesman's Yearbook*, in addition to significant military spending, Greece faces high expenditures on a disproportionately large number of officials for a small undeveloped state. Moreover, since part of Greece's debt is guaranteed by France and Great Britain, Greece could suspend debt service without the creditors having to suffer the consequences. The French and British budgets would be compelled to pay the coupons.

"By 1890, however, the situation had become critical. At the end of 1892, the Greek Government could continue paying interest only by resorting to new borrowing. In 1893, it obtained parliamentary approval for negotiating a rescheduling with its international creditors (British, German, French). Discussions were drawn out until 1898, with no real solution. It was Greece's defeat in the country's war with Turkey that served as a catalyst for resolving the public finances. The foreign powers intervened, including with support for raising the funds claimed by Turkey for the evacuation of Thessaly, and Greece's finances were put under supervision. A private company under international control was commissioned to collect taxes and to settle Greek spending based on a seniority rule designed to ensure the payment of a minimal interest. Fiscal surpluses were then allocated based on 60% to the creditors and 40% for the government." [\[4\]](#)

Between 1890 and 1900, Greek per capita income rose by 15% and went on to increase by 18% over the next decade; in 1913, it came to 46% of French per capita income and 30% of the British level, which was then at the height of its prosperity. So this was a success.

Of course, the context was very different then, and the conditions that favoured the guardianship and the recovery are not the same as today: there was no real democratic government in Greece; there was a monetary regime (the gold standard) in which suspensions of convertibility – the equivalent of a “temporary Grexit” – were relatively common and clearly perceived by creditors as temporary; and in particular there was a context of strong economic growth throughout Western Europe – what the French called the “Belle Epoque” – thanks to the second industrial revolution. One cannot help thinking, nevertheless, that the conditions dictated to Greece back then inspired the current decisions of Europe’s officials[5].

Will the new plan finally yield the desired results? Perhaps, if other conditions are met: substantial relief of the Greek public debt, as the IMF is now demanding, and financial support for the modernization of the Greek economy. A Marshall Plan for Greece, a “green new deal”? All this can succeed only if the rest of the euro zone is also experiencing sustained growth.

[1] See Eloi Laurent and Jacques Le Cacheux, “Zone euro: *no future?*”, *Lettre de l’OFCE*, no. 320, 14 June 2010, <http://www.ofce.sciences-po.fr/pdf/lettres/320.pdf> .

[2] See in particular the work of the OFCE on the recessionary effects of austerity policies: <http://www.ofce.sciences-po.fr/pdf/revue/si2014/si2014.pdf> . Recall that the IMF itself has acknowledged that the

adjustment plans imposed on the European economies experiencing public debt crises were excessive and poorly designed, and especially those imposed on Greece. This *mea culpa* has obviously left Europe's main leaders unmoved, and more than ever inclined to persevere in their error: *Errare humanum est, perseverare diabolicum!*

[3] See the data on the Maddison Project site: <http://www.ggdcd.net/maddison/maddison-project/home.htm> .

[4] Excerpt from the article by Marc Flandreau and Jacques Le Cacheux, "La convergence est-elle nécessaire à la création d'une zone monétaire ? Réflexions sur l'étalon-or 1880-1914" [Is convergence necessary for the creation of a monetary zone? Reflections on the gold standard 1880-1914], *Revue de l'OFCE*, no. 58, July 1996, <http://www.ofce.sciences-po.fr/pdf/revue/1-58.pdf> .

[5] An additional clue: the German Finance Minister Wolfgang Schäuble insisted that Greece temporarily suspend its participation in the euro zone; in the 1890s, it had had to suspend the convertibility into gold of its currency and conducted several devaluations.

The death throes of the "Confederation of Europe"?

By [Jacques Le Cacheux](#)

Will the institutions that the European Union has developed – from the Treaty of Maastricht in 1992, which created it and defined the roadmap that led to the launch of the euro in 1999, to the Treaty of Lisbon in 2009, which took up the main

articles of the constitutional treaty that the French and Dutch had refused to ratify in referendums in 2005 – be sufficient to resolve the crisis facing the EU today? After five years of economic stagnation and nearly four years of persistent pressure on national debts, it had seemed that fears about the sustainability of the European Monetary Union had been appeased by the determination shown in early autumn 2012 by Mario Draghi, President of the European Central Bank, to ensure the future of Europe's single currency at any cost. But the results of the recent general elections in Italy have once again unsettled the European sovereign debt markets and revived speculation, while the euro zone has plunged back into a recession even as the wounds of the previous one lay still unhealed.

How much longer will we be content with mere expedients? Would it not be better to make a real institutional revolution, like the one undertaken between 1788 and 1790 by the framers of the Constitution of the United States of America, as they faced an acute crisis in the public debt of the Confederation and the confederated states? In his Nobel Lecture, which the OFCE has just published in [French](#), Thomas Sargent invites us to consider this through an economic and financial reading of this critical episode in the institutional history of the United States, and through a parallel with the current situation of the euro zone that some may find audacious, but which is certainly enlightening.

There are of course many differences between the situation of the former British colonies ten years after independence and the Member States of the European Monetary Union. But how is it possible not to see certain similarities, such as the inability to find a collective solution to the national public debt crises or the inanity of the agreement in February 2012 on the future EU budget? *Mutatis mutandis*, it is a question of fiscal federalism, as well as political, in one case as in the other.

Long-term competitiveness based on an environmental tax

By [Jacques Le Cacheux](#)

“Shock” or “Pact”? The debate over the loss of France’s competitiveness has recently focused on how fast a switchover from employer payroll taxes to another type of financing is being implemented, implying that the principle of doing this has already been established. As France faces a combination of a deteriorating situation in employment and the trade balance, plus growing evidence that its companies are becoming less competitive compared to those of most of our partners [1] and that business margins are alarmingly low for the future, the need to reduce labour costs seems to be clear. But how and how fast are subject to debate. Should there be a rise in the CSG tax, VAT, or other charges, at the risk of reducing the purchasing power of households in an economic context that is already worse than bleak?

The economic situation has to be managed at the euro zone level

The value of switching a portion of charges on employers – a figure of 30 billion is often bandied about – over to another levy is often disputed by invoking the risks that such a strategy would pose to what is already sluggish growth: undermining consumption would further curtail business opportunities, hurting activity and thus employment and margins.

But France is in this depressed situation only because the European Union is committed to a forced march of fiscal adjustment that everyone – or almost everyone – now recognizes is counterproductive and doomed to failure: as the heartbreaking situation in Spain illustrates, the quest to reduce the budget deficit when the economy is in recession is futile, and “virtuous” efforts – repeatedly slashing public spending and increasing taxes – merely weaken the economy further and increase unemployment, since the fiscal multipliers are very high, as Keynes demonstrated over 70 years ago!

Fiscal support for economic activity is the only way out. But the experience of the early years of the first Socialist government is alive in all our memories: the failure was as great as were the illusions, and the “turn to austerity” made the government unpopular. An approach that failed in the context of the early 1980s, with a less open economy, an autonomous monetary policy and the possibility of adjusting the currency’s exchange rate, is all the less appropriate in the context of deeper integration and the single currency. Trying to maintain the purchasing power of French households while the rest of the euro zone is in recession and French companies are less competitive could only widen the deficit without boosting growth or employment.

We must therefore continue the fight in Europe: to slow down the pace of deficit reduction; to implement a more accommodative monetary policy in the euro zone, which would have the double advantage of reducing the cost of debt, public and private, thereby making them more sustainable, and of exerting downward pressure on the exchange rate of the euro, boosting external competitiveness at a time when the US and Japanese central banks are seeking to reduce the value of their own currencies, which would automatically push the euro up; and to jointly engage in a coordinated European policy to support growth, by funding research and investing in trans-

European transport and electricity and in education and training.

The national productive capacity must be supported and stimulated

The lack of competitiveness of French industry is not reducible to a problem of labour costs. And it is well known that a downward spiral of wage moderation and social dumping, which we can already see is wreaking havoc in Europe, can only lead the euro zone into a deflationary spiral, comparable to what these same countries vainly attempted in the 1930s in their "every man for himself" effort to escape the Great Depression.

Reducing social spending cannot therefore be an answer, while rising unemployment and the precarious situation of an increasing number of households, workers and retirees are pushing up the needs on all sides. Lowering wages, as some countries have done (Greece and Ireland in particular), either directly or through an increase in working hours without an increase in pay, is not a solution, as wage deflation will further depress demand and thereby feed yet another round of social dumping in Europe.

Improving cost competitiveness by reducing the charges on wages may be part of the solution. But this option does not necessarily send the right signals to businesses and will not necessarily lead to a decrease in their selling prices or an increase in hiring: windfall gains are inevitable, and the greatest affluence is likely to go to shareholders as much as to customers and employees. Reductions in social security contributions could be targeted for certain levels of pay, but they cannot be sectoral or conditional or else they would violate European rules on competition.

It is also necessary to encourage and assist French companies in modernizing their supply capacity. The new Public

Investment Bank [*Banque publique d'investissement* – BPI] can help by funding promising projects. But we can also make use of the taxation of corporate profits, including through incentives for investment and research that allow tax credits and depreciation rules: this is a way of more directly using incentives for businesses and conditioning public support on conduct that is likely to improve their competitiveness.

Environmental taxation: a lever for long-term competitiveness

Which charges should now bear the cost of these measures to boost business? Discussions on the respective advantages and disadvantages of VAT and the CSG tax abound. Suffice it to recall here that the VAT has been created to anticipate the reduction in tariff protection, which it replaces very effectively without discriminating on the domestic market between domestic products and imports but while exempting exports: an increase in VAT therefore differs little from a devaluation, with very similar pros and cons, especially with regard to its non-cooperative character within the euro zone. But also recall (see our post of July 2012) that consumption is now relatively less taxed in France than a few years ago, and less than in many of our European partners.

The recourse to a genuine environmental tax would, with regard to the other options for financing these concessions, have the great advantage of promoting sectors that are less polluting and less dependent on fossil fuels – while at the same time diminishing our problems with trade balances, which are partly due to our energy imports – and putting in place the right price and cost incentives for both businesses and consumers. In particular, taking a serious approach to the energy transition demands the introduction of an ambitious carbon tax that is better designed than the one that was censored by the *Conseil constitutionnel* in 2009. Its creation and its step-by-step implementation need to be accompanied by reforming both the direct levies on household income and the main means-tested benefits so that compensation is kept under good

control (cf. article in the [work “Réforme fiscale”, April 2012](#)).

A “competitiveness shock” therefore, but also a “sustainable competitiveness pact”, which encourages French companies to take the right paths by making good choices for the future.

[\[1\]](#) See in particular the [post of 20 July 2012](#).