What Greece Means

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So Greece has officially defaulted on its debt to private lenders. It was an "orderly" default, negotiated rather than simply announced, which I guess is a good thing. Still, the story is far from over. Even with this debt relief, Greece — like other European nations forced to impose austerity in a depressed economy — seems doomed to many more years of suffering.
Fred R. Conrad/The New York Times

And that's a tale that needs telling. For the past two years, the Greek story has, as one recent paper on economic policy put it, been "interpreted as a parable of the risks of fiscal profligacy." Not a day goes by without some politician or pundit intoning, with the air of a man conveying great wisdom, that we must slash government spending right away or find ourselves turning into Greece, Greece I tell you.

Just to take one recent example, when Mitch Daniels, the governor of Indiana, delivered the Republican reply to the State of the Union address, he insisted that "we're only a short distance behind Greece, Spain and other European countries now facing economic catastrophe." By the way, apparently nobody told him that Spain had low government debt and a budget surplus on the eve of the crisis; it's in trouble thanks to private-sector, not public-sector, excess.

But what Greek experience actually shows is that while running deficits in good times can get you in trouble — which is indeed the story for Greece, although not for Spain — trying to eliminate deficits once you're already in trouble is a recipe for depression.

These days, austerity-induced depressions are visible all around Europe's periphery. Greece is the worst case, with unemployment soaring to 20 percent even as public services, including health care, collapse. But Ireland, which has done everything the austerity crowd wanted, is in terrible shape too, with unemployment near 15 percent and real G.D.P. down by double digits. Portugal and Spain are in similarly dire straits.

And austerity in a slump doesn't just inflict vast suffering. There is growing evidence that it is self-defeating even in purely fiscal terms, as the combination of falling revenues due to a depressed economy and worsened long-term prospects actually reduces market confidence and makes the future debt burden harder to handle. You have to wonder how countries that are systematically denying a future to their young people — youth unemployment in Ireland, which used to be lower than in the United States, is now almost 30 percent, while it's near 50 percent in Greece — are supposed to achieve enough growth to service their debt.

This was not what was supposed to happen. Two years ago, as many policy makers and pundits began calling for a pivot from stimulus to austerity, they promised big gains in return for the pain. "The idea that austerity measures could trigger stagnation is incorrect," Jean-Claude Trichet, then the president of the European Central Bank, declared in June 2010. Instead, he insisted, fiscal discipline would inspire confidence, and this would lead to economic growth.

And every slight uptick in an austerity economy has been hailed as proof that the policy works. Irish austerity has been proclaimed a success story not once but twice, first in the summer of 2010, then again last fall; each time the supposed good news quickly evaporated.

You may ask what alternative countries like Greece and Ireland had, and the answer is that they had and have no good alternatives short of leaving the euro, an extreme step that, realistically, their leaders cannot take until all other options have failed — a state of affairs that, if you ask me, Greece is rapidly approaching.

Germany and the European Central Bank could take action to make that extreme step less necessary, both by demanding less austerity and doing more to boost the European economy as a whole. But the main point is that America does have an alternative: we have our own currency, and we can borrow long-term at historically low interest rates, so we don't need to enter a downward spiral of austerity and economic contraction.

So it is time to stop invoking Greece as a cautionary tale about the dangers of deficits; from an American point of view, Greece should instead be seen as a cautionary tale about the dangers of trying to reduce deficits too quickly, while the economy is still deeply depressed. (And yes, despite some better news lately, our economy is still deeply depressed.)

The truth is that if you want to know who is really trying to turn America into Greece, it's not those urging more stimulus for our still-depressed economy; it's the people demanding that we emulate Greek-style austerity even though we don't face Greek-style borrowing constraints, and thereby plunge ourselves into a Greek-style depression.

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Comment:

I am not sure that leaving the Euro will help Greece either. By doing so, they will create a massive deflation. That of course puts anyone who had debt into bankruptcy anyway. Deflation might give Greece an increase in tourism, and will make its products cheaper, but it will not pay its debt.

That puts Greece into the position of being unable to borrow or finance needed growth anyway you look at it. Greece has to find a way to pay its creditors and also pay the costs of its government. Property owners in Greece will mostly owe more than their property is worth, so even if foreign buyers come to take advantage of good deals, the seller will not have anything left anyway.

The government will not have any assets to tax and its revenue will not be able to keep up with its necessary expenditures. So there will be massive unemployment no matter what Greece does. We have seen this situation before and even have examples today such as in Zimbabwe.

The U.S. is fortunate that it is able to pay its debt, and has the resources to keep the revenue coming in. In the U.S. even with all the rancor among the parties, the more responsible politicians (Some doubt there is such a thing.), recognize the need to keep government revenue withing the financial limits, that allow continued revenue.

In Greece the population did not seem to care, as long as they got their share, and many did so by evading taxes among other means.