



Episode 565: The Fiasco in Greece: Lessons for the US and the World

Guest: Aris Trantidis

WOOD: Very glad to have a chance to speak to you. I devoted one episode of my show to Greece, and I just couldn't tell, frankly, how interested my audience is in international issues, but they are begging me for another episode on Greece, on what's been going on, in particular, over the past year. But I think discussing the crisis, the nature of the crisis, lessons we can draw from it would also be useful for us to talk about.

Let me start off with a claim that we heard, at least in some sectors of the American media, and you tell me how much truth there is in it. Sometimes Americans were told the root of or at least one ingredient in the Greek crisis was that the Greek welfare state had accustomed much of the Greek population to getting by with less labor for a smaller fraction of their lives than Americans are accustomed to doing, and now they're reaping the consequences of that. But on the other hand, I've seen statistics showing that, if anything – perhaps they're not as productive as people in some other countries – if anything, the Greeks work more than the Germans or others who were criticizing them. What's the truth of that?

TRANTIDIS: Well, there is an element of truth. It's not particularly the welfare state, because the welfare state wasn't developed in Greece, completely on benefits back in the good old days. But it's about government in general, government spending and borrowing in general. You must know that Greece was a highly clientelistic state. What do I mean by clientelism is that the political powers tried to get votes by treating voters as clients, distributing benefits through the state, but very specific benefits. Not like the kind of general entitlements that you have in Sweden, but for instance, I will hire you, I will hire you in the public sector or I will give you a government contract as a business man.

This distributional system essentially was heavily dominated by the government, and it was what we call now crony capitalism, not the kind of capitalism in which the energy of entrepreneurs is directed into producing something that the world wants to consume, consumers, but surrounds the government and tries to extract rents from the government. And clientelism meaning that this system spends a lot of money in accommodating the demands of the trade unions to the public sector, to hiring new people in state agencies. So the state expands, and the state is very costly.

And one way to finance this system, this highly distributional system, is essentially to find an external source, because there are limits to taxation. You can't overtax the economy. Or if you try to overtax the economy, there's a lot of tax evasion, people will react. So Greece started to heavily borrow from abroad to finance this highly distributional system. Now, this led to a surge in the public debt in the '80s, and since the '80s different governments tried to tackle this problem through patchwork reforms, periods of austerity followed by the electoral cycle of spending a little bit more, and they also found the Euro as an anchor through which they can have credit worthiness that will allow the governments to carry on borrowing at lower interest rates.

Now, when the financial crisis happened in 2008 and the public deficit increased, skyrocketed in one year, investors, already nervous with the global financial crisis, realized that Greece shouldn't borrow at steep rates because it might not be able to pay back its debt given the weaknesses of the economy. What were they? Not just high debt, but the fact that the model was so distributional, it was an economy that didn't produce enough for the world, for private consumers. It was an economy surrounding the state, the distributional state. So we have a production basis problem and a debt problem, and that led to the big burst of the crisis. That's why I say it's a crisis of government, not necessarily for the welfare state, but with the nature of government as an entity that is very likely to be hijacked by politicians who want to distribute benefits to their supporters and their crony businessmen.

WOOD: Now, when you put it that way, of course I think there'll be Americans who think, well, we see at least some of that in the United States — maybe not on the same scale as Greece — and it seems to be the nature of the state, that it attracts this type of behavior, these type of policies, these type of people, this type of cronyism. So is it that Greece just had — did Greece have a system that is fundamentally, qualitatively different from what we see in other European countries, or they just took it to an extreme that ultimately forced them to make changes?

TRANTIDIS: I think that elements of government failure exist in any political system in which the state allocates resources, but Greece is the most extreme case because of its particular circumstances. Greece, for instance, was a democracy in the '70s when its industry faced the oil prices, and the result was, instead of allowing companies to go bust and have what we call creative adjustment, you know, when new investment goes into areas in which Greece can compete in the world and produce something that the world wants to buy, there was a lot of protectionism. People said you shouldn't allow workers to lose their jobs; we should subsidize these companies that were deficit running.

And what happened there was that protectionism was the dominant ideology, and under the pressure of voters the government decided to nationalize all the industry. Back in the '70s and in the '80s, not just the monopolists like of energy and of telecommunications were under the state control, but even toilet paper companies or textiles, companies producing T-shirts were under state control. And this is because there was the idea that the state should protect employment and not allow the

economy to balance itself through what we call creative destruction. If your company is not competitive, it should be allowed to go bust, because there will be new opportunities for investment based on your comparative advantage or competitive advantage, if you want.

So Greece was a much more extreme case because of this cycle, of political ideas and the wrong dominant ideas about the role of the state in the economy. But I see that there are similar elements and similar ideologies in other countries as well; it's just that Greece is a warning, essentially, for the rest of the world of what not to do. I've always said that Greece is an education not just in its ancient glory, but in its relative decline.

And I have a book coming up in six months' time; it's called *Clientelism and Economic Reform: The Case of Greece*, in which I explain that this system of patronistic corruption is not a cultural trait that happens in a developing country. Greece is an advanced country, and it is a rational response of politicians, voters, and businessmen. It is rational if you're a businessman to want to be protected from competition if the alternative is you give a little bit of rights, give a little bit of political support, and get a cheap loan from a state-owned bank and get protection and get privileges. It is rational if you're a voter to want to be employed in the public sector with all its safety. The system was not irrational. It was rational, but collectively it was a big failure. Collectively it was irrational.

And those elements exist — I can see them — in every single political system. They are checked because of our ideas, because the ideas changed in the '70s and because there are checks and balances in society and different political forces, the media, they are able in different countries to constrain this tendency of governments to grow. But Greece, I think, is a useful lesson for every economy, including the American economy, about what not to do.

WOOD: Are there some numbers that stand out to you that indicate the sheer scope of the Greek crisis, just how severe it is?

TRANTIDIS: It is very severe. It's almost catastrophic. Remember, the country's an advanced economy. It has some relatively good institutions. It's not the perfect country in the world, but it has experienced a 30% drop of its GDP, of its economy. That's a war-like figure. It hasn't been seen in peacetime anywhere else in the world since the Great Depression of the 1930s in America. The official record of unemployment is around 22%. Youth unemployment has reached 60%. There is an exodus of workforce, an emigration of workforce abroad, trying to find a job in England, in Germany, in northern Europe. There was a humanitarian crisis. The situation is really bad.

That leads me to a second point I'd like to make, is that once the economy's messed up and the crisis burst out, it is very difficult, even for the most benevolent political elite, the most benevolent government to find the right policy mix to fix this mess, to tackle this crisis, because every single policy measure comes with unintended

consequences. At this stage, you try to raise taxes to raise revenue, and all of a sudden many people, many businesses go bust. You try to implement cuts in spending, and all of a sudden some people lose their revenue, and they're not able to pay their loans, which are nominated in hard currency, in prices that they can't be able to afford anymore. You try to fix one issue, and you create another problem somewhere else, exactly because the economy's a complex system.

The economy's not like a machine, in which one part is wrong and then you have a spare part and you put it and the machine works again. It is rather like a human body, in which if the human body is really, really sick, you have to administer a medicine with a dose which can be fatal or it can produce very serious side effects somewhere else. So we've seen, for instance, the government raise taxes, and many businesses go bust or many businesses relocated to other countries to avoid paying these high taxes. We've seen, for instance, many people leaving the country, therefore no longer working in this country, contributing to its economy, no longer being part of the tax base. You raise taxes and you get less tax revenue. You implement spending cuts, but your debt as a percentage of a shrinking GDP goes up.

The lesson that we can draw from Greece is that economies should never be allowed to reach that messy situation, because economic reform faces a fundamental knowledge problem, just as the government doesn't know how to plan the economy in good times, it is very difficult for the experts, for the economy, for the ministry of finance and the economy to design a policy mix that is going to be effective. It's very difficult even for economists. They don't have the tools, econometric tools or economic mathematical modeling, to be able to calculate all the creative and adaptive responses of individuals in an economy.

WOOD: I want to take some time now to see what's been going on since the last time we talked about this subject, which was probably early 2015, at least in the United States there's a presidential election that's been taking over a lot of the news, the primary races and so on, and Greece is not the front page story anymore, and I bet some people think, well, I guess they worked that out somehow, so I'd like to talk about that. Let's pause just for a minute, though, for this message.

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All right, so let's talk about what exactly has been done, and are things getting better or worse or what are the politicians trying to do about it, what's been done. What happened in Greece in 2015 in response to the crisis?

TRANTIDIS: Well, two very important events happened in Greece. In February 2015, a left-wing party was elected, SYRIZA, to power and formed a coalition with a right-wing party promising to end austerity and to renegotiate the terms of the bailout agreement in a direction in which the fiscal adjustment of the economy, now how much taxes you should raise, how many cuts you should implement to reduce the deficit will be much smoother and prolonged over a longer period of time. And also the promise to renegotiate, to get into an agreement with Greece's credit holders, the

European Union, Eurozone countries, and the IMF, to restructure its debt, because they believe that this debt is not sustainable, that there's no way Greece can repay its debt under the current terms. And they failed badly to achieve these goals, essentially because what they were asking, although they were backed by prominent economists, what they were asking is that the European taxpayers will essentially give more loans over a longer period of time so that Greece will have the opportunity to adjust. And the European taxpayers and the European politicians were not willing to do that.

All the negotiations were not fruitful, and in the summer of 2015, the prime minister, Tsipras, was forced to actually sign a third bailout agreement with the same type of terms and conditions than the previous ones that he had challenged as a leader of the opposition. Essentially now he's trying to implement a program that he didn't believe and that I don't think he does believe, whether it's efficient or not, and it's a very strange situation that shows the limits of politics. When they elect the government and believing that the frugal actions, through a political agency, change can happen, the economy and the broader institutional network puts a very strong constraint on what the national government can do, especially if you rely on other people's money. It shows the limits of politics.

And it again confirms the view that once you have a crisis as severe as that of the Greek crisis, the citizens will feel powerless. They will feel that they are going to pay a price that they shouldn't be paying, because apparently they weren't there when the previous government took those decisions behind their back. I'd like to remind you that Greece was hiding debt from its own citizens and the European Union, essentially. And they feel that someone else has to pay for their society to get more time to adjust and grow again. On the other hand, there is another moral question: why should a Slovakian taxpayer pay more money so that Greece will get a smoother adjustment, when the pension in Slovakia is 100 Euros, and the pension in Greece, the average pension is 1,000 Euros.

Public debt creates a huge moral problem here. Those who are going to pay for reckless borrowing are the taxpayers, and one might say, well, Greeks are to blame for this, but the idea is that Greek citizens do not have all the information about what is going on in the Ministry of Finance or what was going on in the Ministry of Finance in the 2000s and the '90s. They have only one vote every four years. They are not well informed. It's actually rational not to be informed. And a lot of information was hidden from them and was hidden from experts in the European Commission and the Eurostat and the authorities that have the resources to be able to scrutinize a country's finance. How can we expect a butcher, a nurse, a doctor to be able to follow what's going on behind closed doors?

On the other hand, the proposed solution to this crisis is to shift the burden on another pool of taxpayers in a European country, in Germany, in Slovakia, in France, in Italy who are not responsible for the Greek crisis either. So this is a very difficult situation. It's a blame game, and it was dominated by economic nationalism by moralism, which makes no sense. I think if there's one single entity to be blamed, I think it's the reckless governments that were engaged in heavy borrowing and brought the country

into that situation, and the lesson we have to draw is that once the economy gets into the mess, those who are going to pay for the crisis are the ones who are least responsible for the crisis.

And the situation now in Greece is a little bit of that the country has given up, essentially, has given up hope. It's fatalistic. We have to undergo this process. I'm not sure whether the prime minister will still be as popular as he is today after a year of implementing this policy, but people are disillusioned with power and they're disillusioned with politics, because they understand the limits of politics.

WOOD: If you were in charge and you had, let's say, plenary power, and let's say we weren't concerned about separation of powers or anything like that, but you just knew what needed to be done, what would that be? What would your program be? I mean, realizing that this is an extraordinary situation and very difficult, what would it take?

TRANTIDIS: Well, as I said earlier, economic reforms, actually when they try to address a crisis of that scale faces a fundamental problem. There are no easy solutions to the typical question of what should be done. So my question is, and I'm not a politician but I am an expert in economic reforms and I've studied economic reforms quite extensively to be able to tell you that there is no optimal solution here. Of course structural reforms help the economy and, like, liberalizing markets and making workforce more flexible. It takes a lot of time for those structural reforms to actually produce results, especially if your production base had already been distorted. And even if you lower wages, there's no industry in the first place to be competitive, because most of the economic activity revolved around a consumption boom and domestic demand and government procurement. So you may say it'd be easiest to have structural reform, but it doesn't necessarily lead to a rise of exports straight away.

It's easy to say I'm going to attract investment, but with the specter of debt that's still in public discourse, who's going to invest in a country in Euros when they may end up having a devalued drachma later on? Stability is very important. The rule of law is also very important. Contracts, the justice system should be operational and better functioning. All those reforms take time to materialize any benefits.

The most difficult decision is how you're going to bring down the deficit and the debt. It's necessary to restructure the debt. Even the IMF acknowledges that the debt is unsustainable. There must be a way to restructure it, not necessarily writing it off, but extending its maturities over a prolonged time so it can be easier for Greece to pay back this debt over a longer period of time. But there are no magical solutions, essentially. Every single recipe has its side effect.

I wouldn't raise taxes, but that's not in my hand to do if you have the European Union telling you you have to reach your fiscal targets in one year, and the easiest thing to do is raise taxes. Now, taxes have unintended consequences. They tend to undermine economic activity, further undermine consumption, and further undermine investment.

I'm not a politician, but I am someone who studies political economy, so I'm not going to say how I would have run Greece; I'm going to say what kind of advice I'd give to the American audience. The government can mess up with economy in different ways. In Greece it was heavy borrowing, but in some other countries it can be playing with the money supply; it can be, you know, expansionary monetary policies that do create asset bubbles. It's better to prevent this from happening, because once a bubble is burst, any form of policy response is likely to have serious side effects, and it may trigger a vicious circle in which the country is strapped for many, many years.

WOOD: I have to ask you: we deal with an economist over here named Paul Krugman. You're probably familiar with him: Nobel Prize-winner, he writes for *The New York Times*, and I have a separate podcast, which, unlike this one, runs only once a week, called *Contra Krugman*, and every week we refute his *New York Times* column. Well, Krugman makes fun of people in the United States who think there might be lessons for the United States in the Greek crisis, because he says, every time — and so every time anybody is concerned about the government budget or the debt or the deficit, Krugman will pipe up and say, "It's Greece, I tell you, Greece." So he's contemptuous of his intellectual opponents, but should he be? Should he be laughing? Are there lessons that Americans should be drawing?

TRANTIDIS: Well, I have great respect for Krugman and all the prominent economists, but of course you may have the right to disagree and say that there are some weaknesses in their argument. I'm not going to take issue with Krugman; I'm going to take issue with the belief that economics has the tools, the right tools to predict the right path for recovery, and they don't. Whether you are in my field, whether you are in Chicago, you have certain methods, you have statistics and economic modeling trying to capture what has happened on trying on that basis to make some prediction for the future. And these tools are flawed, because the economy is a very complex system, and there are many unintended events that may happen on the adaptive, creative response of economic actors in a given country.

I told you the example of taxation and side effects, asset bubbles being created by monetary expansion, artificially low interest rates, may give the wrong signals to individuals. You also have the things that through network effects will create new bubbles actually, and once a bubble burst, again, you have this network effect of herd instincts and domino reactions that lead to fiscal crisis. It's very hard to predict with accuracy and to say that this is the right path and this is the wrong path, because the tools of economics are flawed — not just economics, but in general social science. We should not have this hubris of saying that this is what should be done. We do not have the tools to predict everything; we do not have the tools to calculate how the system is going to work. Things are not linear; things are very unpredictable.

Therefore, my critique is we can draw different lessons from Greece, but you should be careful about predicting or dictating what should be done, because we do not have the right methodologies. We will never get the right methodologies to be able to capture the complexity of economic and, in general, human phenomena.

WOOD: Can you tell us a brief word about the book that you have forthcoming later this year, 2016?

TRANTIDIS: Yeah, the book is going to be called *Clientelism and Economic Policy: The Case of Greece*. And the term "clientelism" describes a relationship between politicians and their voters, or rather their social actors or social groups, which is based on the exchange of benefits: I'll give you a special benefit, because I run the economy. I can give you a license to operate your business, or I can give you a job, I can give you a promotion in return for your political loyalty and support. And what the book says, drawing on the case of Greece, is that clientelism is the default position of politics. It is rational for politicians and voters to engage in this practice, potentially because the benefits they get are very tangible and individual-based. However, this system of exchange on the macro level is very costly, essentially, because it diverts investment and energy from productive activities into rent-seeking and the pursuit of special benefits.

And in the case of Greece, that led to a debt crisis, because the way to finance this system was through borrowing, predominantly external borrowing. And of course there was community funding, as well, that helped sustain this distributional system. But it can take any other form. Governments can use other tools to sustain a distributional system, but in the end it leads to a permanent crisis, that governments have to manage how they're going to keep running this system despite the crisis. In Greece they tried to implement some reforms; they tried to draw credit worthiness by joining the Euro and a surge in the stock in 2008 exposed the weaknesses of this economy and led to the Greek crisis. However, I'm using game theory, so I'm using a rational argument to show that what happened in Greece is not country-specific; it's not a cultural phenomenon in the Mediterranean or in Latin America, but it's actually, as I said, the default position of politics, and different countries, different institutional environments must develop their own formal or informal checks and balances to keep this tendency at bay before it's too late.

WOOD: Well, I appreciate this important analysis. I'm going to link to, let's see, anything that you send me that you think our audience should read, anything that you do. I'm going to link to your faculty page. This will all be at — let's see what episode number this is. This is TomWoods.com/565, because this is Episode 565, so that will be the show notes page for today. Well, Aris, I appreciate your time today, and when your book comes up maybe we'll talk to you again.

TRANTIDIS: Thank you very much, Thomas. Much appreciated.