Available online at http://cadmusjournal.org/

Cadmus

Promoting Leadership in Thought that Leads to Action

Volume 2, Issue 5 - October 2015

The Greek Financial Crisis:
Theoretical Implications

Garry Jacobs
CEO, World Academy of Art & Science;
Vice President, The Mother's Service Society

Mark Swilling
Professor, Sustainable Development, School of Public Leadership of Stellenbosch University, South Africa; Project Leader, Centre for the Transdisciplinary Study of Sustainability and Complexity

Abstract

The world we live in is a product of the way we think. Our conception of reality determines what we see and what we achieve. The Greek crisis is not simply a case of high public debt, economic mismanagement or weak political will in Greece or the Eurozone. It is underpinned by economic premises, constructs and resulting practices that promote exactly the type of dilemma Greece faces today. Without addressing these conceptual issues, no lasting solution is possible. Rather it can be expected to repeat and spread to other countries and regions. This article is based on views presented by participants in a WAAS webinar examining the Greek financial crisis in the light of economic theory and practice. Wherever there are unmet social needs and underutilized social resources, such as high levels of unemployment, the potential exists to stimulate economic activity, enhance human welfare and promote resilience and sustainable entrepreneurship. Both conditions prevail in Greece today, but neither current nor anticipated policies are likely to result in near term benefits to the Greek people and the local economy nor for Europe and the world economy. It supports the view that a permanent and effective win-win solution can be found to the Greek crisis, compatible with the financial stability of the country and the welfare of its citizens within the framework of the Eurozone, but that such a solution will require a rethinking of fundamental theoretical issues and adoption of innovative policy instruments beyond those presently being contemplated.

For the past five years, the Greek financial crisis has loomed as a recurring threat to the integrity and future of the Eurozone, as a dire reminder of what might occur in other Eurozone countries, and as a powerful and persistent downward drag on employment, real incomes, public services and human welfare in Greece. Whatever the final outcome of the recent measures to prevent default and keep Greece within the Eurozone, none of the plans now on the table offer a permanent solution to the Greek problem, to the long-term viability of the Eurozone, and to the prospects for other successful currency unions in future. At best the current settlement will alleviate immediate pressure on the Greek financial system, while severely aggravating efforts to reignite the Greek economy, create jobs, raise incomes, and expand the Eurozone in future.

A real and permanent solution relevant specifically to Greece and in general to the Eurozone requires a deeper examination of fundamental premises on which the current international economy and European banking system are founded. It must include inquiry into the role and responsibilities of commercial banks, central banks and national governments in promoting both financial stability and human welfare. It must also consider the relationship between the prevailing financial system and the underlying social forces and productive potentials, which alone can ensure a continuous rise in living standards, job growth and economic welfare for people.

The World Academy of Art & Science is engaged in an in-depth inquiry into economic theory, institutions and public policies in order to evolve more effective theoretical and practical solutions to the challenges confronted by Greece and other nations. Following the highly successful XII International Economics Colloquium at the University of Florida this May, WAAS and World University Consortium constituted the NET (New Economic Theory) Working Group to engage a wide range of scholars, policy-makers and partner institutions in examination of the fundamental premises on which current economic theory is based, the urgent need for a new theoretical formulation, and identification of core principles and perspectives of NET. The project team presently includes nineteen institutional partners and more than forty individual scholars.

Our research supports the view that a permanent and effective win-win solution can be found to the Greek crisis, compatible with the financial stability of the country and the welfare of its citizens within the framework of the Eurozone, but that such a solution will require a rethinking of fundamental theoretical issues and adoption of innovative policy instruments beyond those presently being contemplated. Fresh thinking and innovative action are urgently required. On September 15, 2015, WAAS conducted a webinar exploring the theoretical and practical implications of the Greek Financial Crisis. The objective of the webinar was to examine the Greek Crisis for insights into fundamental deficiencies in current economic theory, to identify principles on which a more stable, resilient and equitable international financial system can be founded, and to explore potential solutions to the Greek crisis and related problems based on a wider political, economic and social perspective of European and global society in the 21st century.

The Greek crisis is not simply a case of high public debt, economic mismanagement or weak political will in Greece or the Eurozone. It is underpinned by economic premises, constructs and resulting practices that promote exactly the type of dilemma Greece faces today. Without addressing these conceptual issues, no lasting solution is possible. Rather they can be expected to repeat and spread. Indeed, many developing countries have experienced similar crises in recent decades after the same economic principles were applied via the IMF/World Bank structural adjustment programmes. One objective of the webinar was to identify and examine the theoretical premises that impede or obstruct effective solutions to the problem in Greece and similar problems elsewhere and formulate more valid theoretical perspectives.

Wherever there are unmet social needs and underutilized social resources, such as high levels of unemployment, the potential exists to stimulate economic activity, enhance human welfare and promote resilience and sustainable entrepreneurship. Both conditions prevail in Greece today, but neither current nor anticipated policies are likely to result in near term benefits to the Greek people and the local economy nor for Europe and the world economy. Therefore, the webinar also sought to identify key issues that need to be addressed in order to activate the economy by mobilizing the unemployed and other underutilized social resources to alleviate the downward momentum and hardship imposed on the Greek people.

1. An Inquiry into the Greek Crisis

The keynote address was delivered by Hungarian Economist Zoltan Pogatsa, author of *The Political Economy of the Greek Crisis,* who presented compelling evidence to debunk many of the common misconceptions regarding the real cause of the Greek crisis. His analysis shows that contrary to the view put forth by lenders, the Greeks are not lazy, prone to indebtedness, more corrupt or more heavily dependent on government subsidies than other European countries. On the contrary, the average Greek worked 30% more hours than his German counterpart and household debt in Greece from 2007-2009 was 20% lower than the European average. Greece scored comparably to South Korea, Czech Republic and Slovakia on transparency and significantly better than Poland. Social spending was considerably below the Eurozone average as a percent of GDP prior to 2008.

Pogatsa traces the roots of the debt crisis back three decades to the time when Greece entered the EU. From 1960 to 1980 the Greek economy grew considerably faster than the EU average. According to entry conditions, Greece was compelled to open up its vulnerable economy to European manufacturers and to give up essential tax revenues in exchange for massive subsidies to its small farmers whom it was very difficult to tax. Deceptive accounting practices by earlier governments with the aid of leading international investment banks disguised the debt problem for two decades leading up to 2008. The public debt problem arose not because of excessive wages or high expenditure on the welfare state, but due to the government's incapacity to collect sufficient taxes from a largely agrarian economy. Therefore, austerity programs designed to weaken labor and cut welfare expenses could never hope to solve the problem.

Pogatsa concludes by pointing out inherent weaknesses in the Eurozone, which is not an optimal currency area. Marked differences in economic cycles between its northern and southern members make it impossible to adapt a uniform economic policy suited to the needs of all its members at any given time. The inability of Greece to allow its own currency to depreciate relative to the rest of Europe prevented wages from reaching competitive levels after the 2008 crisis. Its inability to erect tariff barriers to protect its highly vulnerable, but very large small business sector, resulted in a massive hollowing out of domestic industry and increasing dependence on imported goods.

The remedy adopted by the European Bank, IMF and lending banks consisted of massive interest payments to bail out the four biggest banks, without penalty for their reckless lending. At the same time it nearly doubled Greece's debt to GDP level. The demand for new taxes will only further suppress the growth of the Greek economy and severely undermine social welfare. It will further weaken the negotiating position of collective bargaining on wages, which is practiced by 12 EU member states.

Dimitrios Kyriakou, Chief Economist, European Commission's Institute for Prospective Technological Studies, described the Greek crisis as a perfect storm. Greece was lured into the crisis by the promise of rising levels of prosperity through liberalization. Entry into the Eurozone meant sacrificing the exchange rate instrument and monetary policy instrument. From a very low debt level until the mid-1970s, it resulted in rising levels of debt in the 1980s when it reached 68% of GDP. Four years later it crossed 100%.

Recent experience with bubble-driven growth raises serious doubts about the sustainability of ever-higher indebtedness driving decreasing rates of growth. Sluggish growth combined with rising inequality calls into question the role of financial markets as well as the validity of the traditional trade-off between equality and growth. We have reached a point where the two need to move in tandem. The trap which Greece fell into was easy borrowing and cheap credit coupled with a Greenspanesque belief in a brave new Goldilocks economy, where hard landings were a thing of the past, and where, as a consequence, heavy borrowing was condoned, if not outright encouraged. The agreement reached includes tough fiscal measures, along the lines of the previous IMF-inspired loan packages since 2010. However this one includes two potential countervailing elements, which may justify a modicum of optimism, provided they are upheld in practice: a large investment package from EU sources and a debt restructuring deal over the next few months. Finally, it is noteworthy that the negotiations for this new loan package were carried out at the highest political level with the other Eurozone member states within the context of the Euro Group (composed of Eurozone countries finance ministers), and summits of heads of governments. Of course, the IMF, European Central Bank, European Commission, European Stability Mechanism played a key role in implementation issues.

Aldo Martinez, Professor at St. Peter's University and former Vice President of Market Surveillance at the New York Stock Exchange, emphasized that current international efforts seek only to address the symptoms rather than the real source of the problem in Greece. He argued that the Greek economy has lost its national autonomy and has become subject to the dictates of international financial forces. He also concluded that the strong dealings with Greece, which is a very small economy, may be intended as an example to other countries that consider rebelling against the dictates of the unbridled application of prevailing neoliberal economic dogma. Governments and financial institutions should be careful to ensure that the prescribed medication dosage addresses the cause of the illness to restore health without killing the patient in the process.

Hazel Henderson, founder of Ethical Markets, called for a concerted effort to downsize the unbridled financial markets that are skimming off all the rewards of labor productivity into the capital and banking sector. She referred to the implications of the adoption by the UN of the Sustainable Development Goals that call explicitly for a "transformed world". By recognizing the need for what the SDG documents refers to the "people-prosperity-planet-peace-partnership" approach, the SDGs are effectively a rallying call to develop a new economic theory that does not prioritize prosperity over people, planet and peace.

As Robert Hoffman stressed, the Greek crisis represents an egregious failure of conventional economic theory and the prescriptions of austerity, deregulation, and the sell-off of state-owned assets. The sell-off of state-owned assets will lead to flows of income to oligarchs and international financial institutions to the detriment of the well-being of Greek citizens. As was the case with the crisis of 2007-08, macro-economic theory, with its focus on equilibrium and flows of purchasing power, was blind to financial bubbles associated with asset stocks and prices. Because of membership in the Eurozone and the policies of the European Central Bank, the instrument of quantitative easing available to the US government (though misused in that case) was not available to the Greek government. The current crisis is the practical outcome of a bankrupt theory applied in a manner that is fatal to the patient. We need a new paradigmatic framework of thinking in transdisciplinary terms about the economy, which means treating people as an integral component of the earth system. The Greek crisis represents in a profound way the bankruptcy of a particular paradigm.

"The Greek crisis represents in a profound way the bankruptcy of a particular paradigm."

2. Theoretical Perspectives

The webinar illustrated and reinforced several fundamental perspectives that have emerged from the work of the New Economic Theory Project thus far:

1. *Resurgence of Neo-liberalism following the End of the Cold War:* The present crisis in Greece and the global recessionary trends that have spread to China, Brazil and other nations cannot be viewed in isolation. They are only the most recent consequences of a fundamental shift in economic theory and policy that gained dominance following the end of the Cold War, but originating in the rise of the neo-conservative movement in the USA during 1970s inspired by the theories of Hayek and Friedman. The orthodoxy of extreme free-market liberalism prevalent in the 1920s and largely displaced by the rise of public intervention in the economy during and following the New Deal gained a new lease of life during the period of rapid globalization that followed the Fall of the Berlin Wall, the founding of the WTO and the global spread of the Internet. The dismantling of tariff barriers facilitated a tripling of world trade in current dollar terms from 1990 to 2008. During the same period daily financial transactions multiplied more than six-fold. In the absence of effective international regulation, a virtual Wild West of global finance emerged. Under the pressure of increasing international competition, financial institutions in the USA, Europe and elsewhere lobbied for the dismantling of domestic regulatory constraints which had effectively insulated commercial banks from the speculative financial markets for seven decades. Unconstrained global financial markets coupled with computerized trading led in turn to growing instability, precipitating the Argentine crisis of 1989, the structural collapse of most African economies during the 1990s, the East Asian financial crisis in 1998 and the much broader global crisis in 2008. Effectively addressing the problem at the national level necessitates urgent efforts to stringently regulate the rapid movement of short term, speculative investments at the international level.

2. *Divorce of Financial Markets from the Real Economy:* A recurring theme of the Academy's work resurfaced during the webinar. Financial markets, which originally evolved as a means to pool the resources needed for large industrial investments and commercial enterprises in previous centuries, have now become a world apart and are increasingly divorced from the real economy they are, in theory, intended to serve. Public policies designed to attract and retain high-frequency speculative funds have been a major source of instability, undermining the environment for medium and longer term investments in real productive assets and inflating nominal GDP, while contributing only nominally or negatively to human welfare. Financial markets must be reoriented and incentivized to serve the real economy and society. Re-embedding the market within society is the single-most important policy measure needed to revive growth of employment, reduce inequality and promote ecologically sound investments.

"Society is the true source of wealth creation, not the liquid flows of finance that get reported via the news bulletins of the world."

3. *Austerity and Wealth Creation:* The Greek crisis is only the most recent in a long list of compelling instances that demonstrate the poverty of current theory and the destructive impact of austerity programs. The only difference in this case is that even many key players within the Eurozone, the IMF and leading economists internationally are predicting that the latest round of austerity measures will prove as flawed and ineffective as the earlier ones. And yet they have not come with an alternative, because this would mean breaking from their own conceptual assumptions about the nature of the economy. The source of the problem lies not merely in the policy itself, but more deeply in the theoretical framework on which it is based. Society is the true source of wealth creation, not the liquid flows of finance that get reported via the news bulletins of the world. Creative relationships and organized interactions between people for invention, production, distribution and consumption generate real wealth and enhance human welfare. Austerity programs have the opposite effect of squeezing and stifling productive initiatives and reducing the entire economy and society to equilibrium at a lower level. Economics has become divorced from the society. Economic theory is divorced from the wider theory of society of which it is a subset.

4. *Development, Self-reliance and Political Will:* The rapid expansion of the EU and Eurozone has revived the mentality of dependence generated in Europe by the Marshall Plan after World War II and throughout the developing world during the heydays of foreign aid dependent development strategies prevalent during the lost development decades of the 20th century. Development is a human process. Real development is self-development. Foreign lending and investment can play a positive role when they come in response to domestic aspirations and commitment, never when they try to act as a substitute. The promise of instantaneous benefit has been an irresistible lure for the recent expansion of the EU and one of the reasons for the Ukraine crisis. Pogatsa documents the original entry of Greece into the European Economic Community came

at a time when it had the fastest growing economy in Europe. Kyriakou suggested that this was probably more strongly motivated by a desire for political integration than economic benefits. But the recent negotiations with the ECB were dominated by the aid mentality of both donors and recipient. The refusal of the government and people of Greece to go begging was an encouraging sign that Greece was recovering the sense of self-reliance and self-respect it demonstrated before joining the European Community. That and that alone can turn around the country. Anything less is doomed to failure.

The Eurozone prospered for a decade after its establishment by generating trust and confidence among smaller economies and facilitating more efficient large scale exchange and cooperation. It now suffers from the lack of political commitment to the welfare of its own members. The petty accusations and infighting have undermined precious social capital in the region. Restoring that trust, confidence and cooperative spirit should be the highest priority. The current crisis should be mobilized to develop the political will needed to assume responsibility for promoting the welfare of all members of the currency union, combined with a determination of each member country to exhaust the potentials for its own self-development. It is true that the Greek crisis can only be resolved by international cooperation. It is equally true that the starting point must be commitment to self-reliance at the national level. The two are complementary rather than contradictory elements of a solution.

5. *Economy, Governance and Society are inseparable:* Social aspiration and social capacity generate the potential for wealth creation and human welfare. Political institutions and political will generate the power for collective action. Economy provides the instrumentation to make them effective. It is time to restore the Political term to Political Economy and add the Social dimension without which neither the one nor the other can accomplish anything. A solution to the Greek crisis is plausible, possible and achievable. But it must begin with a change of thinking and a rejection of the outmoded ideas and policies which have failed in the past and offer no hope for the future.

6. *Towards greater resource efficiency and sustainability:* It is now widely recognized, as expressed now in the SDGs, that we live in a carbon- and resource-constrained world. This means that economic growth as we know it can no longer assume the unlimited availability of natural resources (especially metals, fossils), ecosystem services (such as soils, water, fisheries, bees/pollination) and carbon space. As the New Climate Economy Report of 2015 made clear, a fundamental structural transformation of the global economy is required. Even mainstream bodies like the OECD and World Economic Forum have echoed this view. What we mean by economic growth will need to be completely redefined. Austerity is regarded as a non-solution for Greece without a ready alternative because the pursuit of economic growth in an infinite world remains the yardstick for measuring progress. If GDP is replaced with a well-being indicator, the result will be policies that simultaneously protect the resources people depend on for their well-being and which prioritize human needs rather than speculative investments and shareholder profits. Resolving the Greek crisis by replacing austerity economics with another theory

of growth that ignores planetary boundaries will run into the same problems, especially given that Greece is not a resource-rich economy. African economies went through what Greece is going through now, but Chinese demand for African resources became the driver of growth, thus saving African economies from the Greek syndrome. Now that this demand is dropping, the fundamental structural weakness of African economies will be exposed. Ultimately, a new economics of well-being will have to be post-extractivist, resource efficient and sustainable.

"Unless an alternative economic theory is proposed as the basis for viable pragmatic policy alternatives, resistance may be heroic but it will remain quixotic."

3. Conclusion

The Greek Crisis is more than just another national economic crisis, following those that have come before in Latin America, Africa and Asia and since 2008 globally. It has, in effect, become a symbol of the failure of a particular economic theory and policy prescription. Its irresolvability on terms dictated by the ECB and IMF starkly exposes the bankruptcy of these policy frameworks. It also exposes how disrespectful of democratic autonomy the major debt holders of this world can really be. Today's extractive institutions are the powerful lenders of gigantic amounts of debt to those who everyone knows cannot possibly repay their loans. The result is increasing concentration of power in the hands of an unaccountable few with devastating consequences for the majority of the world's population. How the Greeks resist occupation of their lives by these powerful institutions will set an example for the rest of the world. However, resisting will not be enough. Unless an alternative economic theory is proposed as the basis for viable pragmatic policy alternatives, resistance may be heroic but it will remain quixotic. Those who have opposed neo-liberalism for so long now need to collaborate to ensure they have more to say than merely rejection of what clearly does not work. Another world *is* possible, but only if we do the hard work rather than assume it will emerge spontaneously from the ashes of the old.

Author Contact Information
Garry Jacobs *- Email: garryj29@gmail.com*
Mark Swilling *- Email: mark.swilling@spl.sun.ac.za*