

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

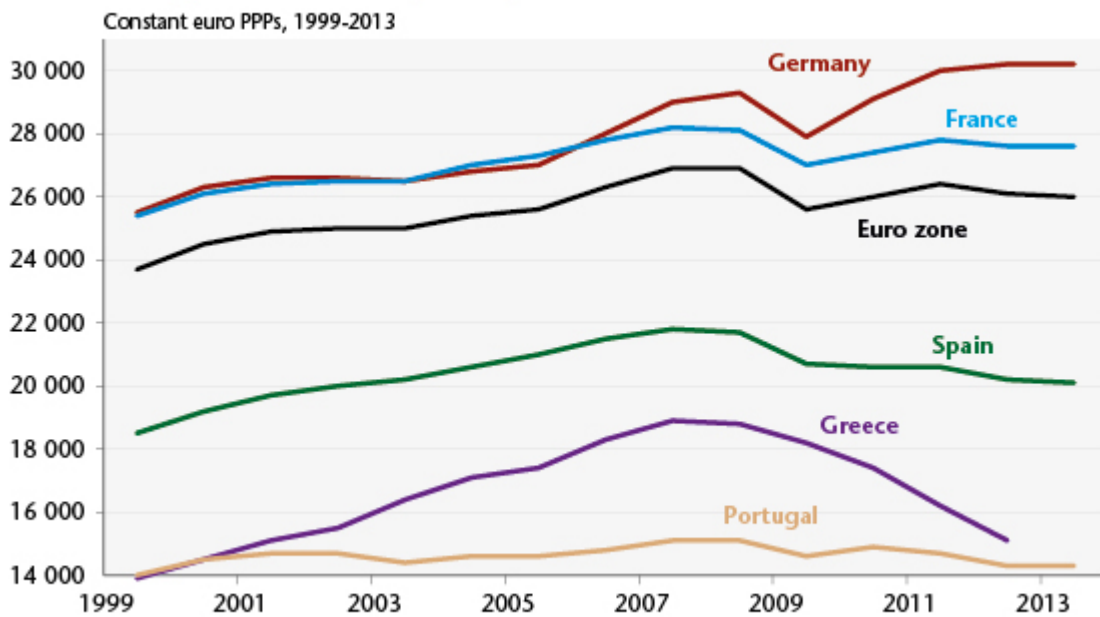
The Greek crisis, which in 2010 triggered the sovereign debt crisis in the euro zone, has seen prolonged agony punctuated

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

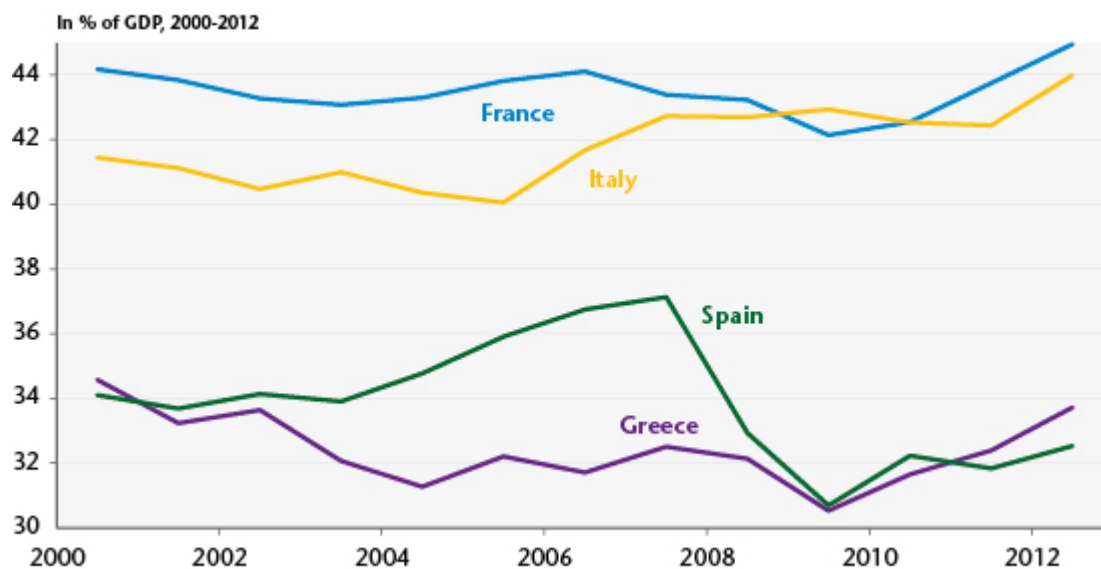


Source : Eurostat.

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**



Source : Eurostat.

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, overstuffed 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.ggdcc.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.

Argentina's experience of debt crisis

By [Augusto Hasman](#) and [Maurizio Iacopetta](#)

There is still a lot of uncertainty around the possible paths that Greece can follow in the near future. One possible path, which may be still averted by the current negotiation, is that Greece will default on the upcoming debt obligations (see

graphics [here](#) for a detailed list of the upcoming Greek debt deadlines), thus spiraling into a currency and credit crisis and possibly resulting in a “Grexit”[\[1\]](#).

The Greek debt crisis shares some similarity with the Latin American debt crisis of the 1990s and early 2000s. In both Greece and Latin America, debts are mostly bond debts or debts to international institutions. Similarly to Greece, many Latin American countries had become more and more open in the decades before the crisis. The series of financial crises started with Mexico’s December 1994 collapse. It was followed by Argentina’s \$95 billion default (the largest in history at that time, although later on Argentina resumed some of the payments), Brazil’s financial crisis (1998-2002) and Uruguay’s default (2002).

Argentina is viewed as benchmark for getting insights on the possible macroeconomic consequences of a Grexit, partly because it abandoned the peg with the dollar as a result of its mounting fiscal crisis. Nevertheless, some have pointed out at marked differences between the two economies, in terms of industry structure as well as trade composition (see [here](#) for instance).

Here, we review the different steps followed by Argentina during the crisis and propose some statistics related to developments of key economic indicators in Argentina before and after the crisis. For comparison purposes, we also provide key figures of the Greek’s economy.

Argentina and Greece at time of considerable stress

Greece entered the European and Monetary Union in 2001, meaning an irrevocably fixed exchange rate regime and the adoption of the Euro as legal tender. By *early 2010*, Greece risked defaulting on its public debt and had to call for a financial rescue to international institutions. On the other hand, at time of the crisis, Argentina had its currency, the

peso, 'immutably' fixed to the US dollar on a one-to-one basis. As today's Greek situation, when Argentina defaulted in late 2001, the country's economy and government were both experiencing considerable stress. 2001 was the third consecutive year of serious recession for Argentina, foreign direct investment had virtually stopped, and inflation, interest rates and the budget deficit all were soaring. The IMF had provided loans to keep the peso stable, on the condition that the government would adopt fiscal and monetary discipline. Argentina's economic problems became a serious crisis in December 2001, when the IMF denounced the government's inability to put its financial house in order and suspended its loans. This development was followed almost immediately by a banking crisis and violent public protests that produced a rapid succession of six presidents in two weeks. Figure (1) depicts the behavior of Argentinian key economic indicators before and after the 2001 devaluation. Figure (2) shows the Greek's indicators since 1998 [\[2\]](#). A quick inspection of the two figures reveals that:

- The magnitude of the decline of Greece's GDP during the crisis, counting from its highest point in 2008 is roughly the same as that observed in Argentina during a recessionary period before the devaluation: 25%.

- The rise in the unemployment rate has been much more severe in Greece than in Argentina. In Argentina, unemployment, rose from 12.4% in 1998 to 18.3% in 2001 whereas in Greece it went up from less than 10% in 2008 to over 25% to this day. Both in Argentina and in Greece the inflation had been relatively low before the debt crisis; in fact in Greece it has even been negative in recent years.

The recovery

What is somewhat surprising is what happened in Argentina after the crisis.

First, after a short period of turbulence, the Gross Domestic Product, in constant dollars, began to rise at an astonishing pace of almost 10 percent per year, until the 2007-08 financial crisis. Second, the unemployment rate declined from 18 percent to about 7 percent. Third, the poverty rate went down even below the level observed in the heyday of the pegged exchange rate. But financial indices deteriorated. First the difficulties in accessing external credits and the loss of credibility of the government pushed up the bond spreads from 4000 basis points before the crisis to ten times as much after the crisis. Second, the inflation rate seems to have stabilized at a double digit figure. According to some scholars (see for instance [Alberto Cavallo](#) "Online and official price indexes: Measuring Argentina's inflation" Journal of Monetary Economics, 2012) there has been a systematic attempt by government authorities to greatly underestimate or underreport the inflation rate. Therefore, the GDP gain may not be as high as the one showed in Figure 1. Although the Argentinian economy has gone into a sustained period of growth, it would be unwarranted to make an automatic link between the renaissance of the Argentinian economy and the dramatic conclusion of the crisis with the abandonment of the peg and the debt default.

Some have pointed out that the recovery period coincided with a boom in the price of primary commodities (soybeans), which notoriously account for an important part of Argentinian exports. Clearly the increase in commodity prices has been a windfall for Argentinian agricultural producers with possible trickling effects on the rest of the economy. Yet, the magnitude of the windfall itself can hardly account for the large GDP gains. In fact, soybean was sold in Iowa at an average price of \$4.57 per bushel in the year 2000 and at \$5.88 in the year 2005. Only since 2010 prices have gone up substantially more, but at that point, the Argentinian economy had already gone through almost a decade of economic boom. Furthermore, the high price of soybeans in the second half of

the 1990s (it was \$7.32 in 1997) does not seem to have been helpful to avoid the economic depression. The route to recovery in Argentina has been characterized by setbacks, but also by a number of inventiveness that may have played a role in defraying the shock of the crisis.

Bank runs

At the end of November 2001, rising worries about a peso devaluation and a deposit freeze, increased overnight interest rates sharply. Additionally, spreads between US Treasury bonds and Argentine government bonds increased by 5,000 basis points. In order to stop the effects of a bank run, the Minister of Economy Domingo Cavallo announced a freeze on bank deposits. As in Greece, this measure considerably reduced the capacity of depositors to withdraw and manage their bank deposits. The deposit freeze had even accentuated the feeling among the population that a crisis was going to explode, and a series of demonstrations surged along the country. Subsequently, the IMF announced a cut of its support to Argentina, as it had failed to meet the conditions tied to the rescue program and Argentina lost its last source of funding. With a total amount of almost USD 22bn in 2000 and 2001, Argentina was the largest debtor the IMF had at the time. In the protests and raiding that followed, 24 people died. President De La Rúa and his cabinet resigned soon after these events.

Claims after the currency devaluation

The government decided to 'pesofy' the loans at a rate of A\$1 (Argentinean peso) for each dollar (USD) owned by banks and A\$1.4 for each dollar deposited in a bank. Alternatively, people could get a government bond (Boden 2012), that paid A\$775.12 for a nominal of USD\$100, when the official dollar was 4.35A\$/USD. A less attractive bond was issued the following year: it paid A\$930 for a nominal of USD\$100 but could only be converted at 8.95A\$/USD.

Massive use of money-bonds

In 2001, different Argentinean provinces started to print their own quasi-currencies, several emergency bonds (technically called Treasury Bills for Debt Settlement) issued between 2001 and 2002. They were created as a way of alleviating the enormous financial and economic crisis that occurred in Argentina in 2001. These bonds were considered a “necessary evil” that initially allowed to cover the absence of money circulation. While at first the issuing of these quasi-currencies was controversial, it later gained acceptance partly because of the size of the issue and partly because of the magnitude of the crisis. These bonds circulated in parallel to the Argentinean peso. They could be used to pay some taxes, shopping and even salaries. As the pesos, they were denominated in different values 1, 2, 5, 10, 20, 50 and 100 to facilitate transactions (nominally equivalent to a Convertible Peso). The most popular bond was the Patacon that was issued in Buenos Aires. This bond had an interest rate of 7% and there were two series (Series A maturing in 2003, while the B in 2006). It is estimated that the total issue amount for the Patacons only reached 2.705 millions. Once the economic recovery of Argentina started in late 2003, the government honored 100% the principal of these outstanding bonds, and even the interests were eventually paid. Up to 13 quasi-currencies were issued by different provinces during that period.

Credit

Figure (1) shows that in Argentina the “Sovereign Bond Interest Rate Spreads, basis points over US Treasuries” has been growing for the last 18 years showing the difficulties Argentina has had in accessing to international credit market. The difficult access to foreign funding has pushed the Argentinean government to get financed internally through the central bank, retirement funds and the tax agency. The high inflation that resulted from this policy (close to 26%,

unofficial measures) has made the use of local credit extremely expensive for companies and households. However, as Argentina started posting large surpluses on the fiscal and current accounts after the default and large devaluation of the peso, access to foreign finance became less urgent. Argentina took a hardline approach against creditors. By 2010, 92% of the Argentine defaulted debt had been restructured. However, ongoing litigation by holdout creditors could lead to a new Argentine default in the near future.

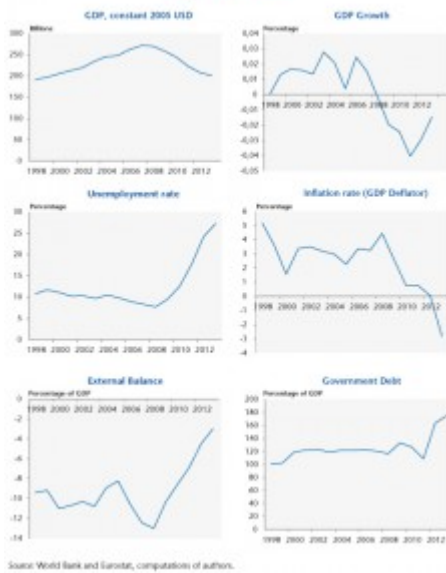
In conclusion, the Argentina exit from the debt crisis through a default did not have long lasting dramatic consequences on real activities as many had anticipated. The crisis meant a transfer of wealth from depositors to debt holders and promoted exports. After an abrupt decline, GDP quickly started its ascent and the country experienced high rates of growth in the 2000s, which reduced significantly unemployment.

Nevertheless the period right after the devaluation was characterized by political instability, large macroeconomic fluctuations and social revolts. The political stability that followed, might have played a role in sustaining growth, but the rate of inflation climbed at double-digit figures and the various price control mechanism introduced by the government have created a lot of frictions in the business sector. Finally, the increasing isolation of the government from the international political arena partly, due to the outstanding litigation with international lenders, could, in the long run, have negative repercussion on trade.

Figure 1. Argentina



Figure 2. Greece



[1] “Grexit” is a combination of “Greece” and “exit” and refers to the possibility of Greece leaving the Euro area.

[2] The plots are generated using World Bank data, except for the level of 2013 Greek debt/GDP ratio, which is taken from Eurostat.