Lessons from the Greek Crisis

As the Greek economy descends into political and economic chaos, it's only natural for Americans to wonder how the United States can avoid such a catastrophe. Greece is descending into a debt vortex from borrowing too much, and can no longer keep up with domestic demands for social welfare payments.

The debt abyss is an economic reality already known to millions of American families who made risky bets on the housing market just before the economic crash, or racked up massive credit card debt. Those families know that the solution to restoring a sustainable and prosperous future is not to keep on spending wantonly, but to make painful lifestyle adjustments that cut spending drastically and begin to pay off the debt. A nation, like a family, that lives above its means for a time must eventually live beneath its means to pay off the debts.

Many of those American families also know that if they continue to try to live beyond their means after they get in economic trouble, creditors charge higher interest rates for additional loans. These loans eventually become unsustainable, and renegotiation of loans or outright default becomes inevitable.

This is where Greece is today. (To view the video, *Lessons from the Greek Crisis,* please scroll to bottom of page.)

Common sense says that Greek politicians should make drastic cuts in spending at least to the level of balancing the national budget, or perhaps even to the level of a surplus to begin paying off national debt. But America's liberal economists suggest the reverse course for Greece. Instead, Keynesian economists, such as Princeton University's Paul Krugman, think Greece should go big on government spending. The chairman of Princeton's economics department suggested in a March 12 *New York Times* column:

> 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.
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> 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.

Are Greece and Ireland victims of their own austerity programs? Krugman acknowledges that Greece should never have run up huge deficits during the good economic years of the 1990s and early 2000s, an assertion to which both the Keynesian and free-market Austrian school economists would agree. But Krugman and his fellow Keynesian economists say deficits in a recession are a solution to an economic crisis — even one like the current recession, which was built on too much government and privately held debt.

Krugman says that deep cuts in Greek government expenditures have worsened the economic recession. But while the Greek government has made some cuts in spending since 2010, it never passed any true austerity package that would balance the national budget. Not even close. The Greek government never even passed a budget plan that would cut its annual deficit in half. In other words, it never had a plan to stop the descent into its national-debt abyss. Despite an almost 20-percent reduction in spending in real dollar terms, Greece continued to spend wildly compared with the flat-lined level of government tax revenue.

So Greece never passed a true austerity package. All it did was apply the same kind of band-aid that some American families did during the last economic crisis. Many families were forced to make cuts in spending for luxuries, but didn't have the courage to bring cuts in living style to the level to make their budgets sustainable. In other words, they — for example — cut new credit card charges from $1,000 per month back to $500 per month. This did nothing but slightly delay the inevitable credit reckoning. Meanwhile, creditors charged ever-higher interest rates for ever-higher credit card spending balances that these families became less and less able to pay off. Bankruptcy loomed for millions of families because of these spending practices.

Had those families actually made the spending cuts and lived within their means early enough, they would have been able to avoid the higher interest rates, maintain good credit, and avoid bankruptcy. And making those choices early also would have made those cuts easier to live with, as compared with later when high debt and high interest rates ate into much of their cash income.

Krugman's idea that Greece should have gone big on spending is impractical, even if under rare circumstances it might work on a personal level. Consider a family that has taken on a considerable level of debt, but the father in the family decides to borrow more money to go back to school to get a master's degree and get a higher-paying job. That might work — if he gets a higher-paying job that more than compensates for the debt and interest costs taken on by the family. But the Greek government is already taking more than 40 percent of the national economy in taxes. There's no comparable higher-paying job available for Greek government to take on without killing the economy further. Even if public spending brings the Greek economy to full employment, the Greek government is still spending nearly 20 percent more than it gets from taxes. Growth in tax revenue from more spending will never bridge that deficit gap, despite Krugman's fantasies. The math not only isn't there, it isn't even close.

The Greek nation is already on the brink of bankruptcy, and is faced with the same decisions as a family facing bankruptcy: high debt levels, high interest on those debts, and only painful spending choices.

The Greek contagion is spreading across Europe, with nations such as Portugal, Italy, and Spain soon to follow. Even Ireland, the official "poster child" for the so-called austerity movement, is still running national budget deficits in excess of 10 percent of GDP. In other words, it's still near Greek-level deficits. There's no true austerity in Ireland. And, not surprisingly, Ireland just may require a second bailout from the European Union.

The U.S. government has followed the Greek example for the past decade, and is only three or four years behind the Greeks in the level of debt. Proportionately, the United States has about as much debt as Ireland and Italy, a little more than 100 percent of our GDP. Our more than $15 trillion national debt exceeds the entire Gross Domestic Product, the value of everything produced in the nation. When Greek debt hit 140 percent of GDP, creditors started to bolt from the nation. The United States has been adding almost 10 percent of our GDP to the debt every year under the Obama administration.

America has a choice to make as a nation. We can implement true austerity now and balance our national budget while we can still afford it, or follow the snake oil salesmen of academia who urge us to begin a slippery descent into the economic and political chaos that the Greeks have found.

Photo at top: AP Images