Time to End the Madness

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May brought home to the world evidence of the popular rejection of the irrational pursuit of austerity amidst recession in Europe and elsewhere. One telling signal was the victory of Francois Hollande in the French Presidential run-off, making this the first presidential victory for the Left since 1988 and only the second occasion when an incumbent French president has not been re-elected. Nicolas Sarkozy's defeat may partly be the result of his excessively flamboyant style and arrogance. But it is largely the consequence of his willingness to collaborate with German Chancellor Angela Merkel in pushing for fiscal consolidation across Europe and imposing austerity on countries whose public debt levels were arbitrarily declared as unsustainable.

The country that was the worst sufferer of this economic philosophy that lacks rationale in the midst of a crisis was Greece. Burdened with austerity ever since the first bail-out agreement in 2010, Greece has not only seen incomes and output shrink dramatically, but is also experiencing an unemployment rate of 22 per cent, with one in every two jobseekers under the age of 24 unemployed. The austerity measures were ostensibly aimed at reducing Athens' debt from 160 per cent of GDP to 120 by 2020, through cuts in wages, pensions, healthcare, public sector employment, and much else. But with the austerity slowing growth, revenues have been falling short as well, making it near impossible to meet staggered debt-reduction targets. The bailout has failed.

The bailout was actually designed to help private finance capital. Access to credit from Eurozone governments, the European Central Bank and the IMF prevented the repudiation of private debt and an exit of Greece from the euro. In 2010, before the first bailout agreement, Greece owed about 310 billion euros, almost wholly to the private sector. According to the Greek Debt Management Office's estimates, Greece now owes 266 billion euros, of which close to 75 per cent is owed to the European Central Bank, Eurozone governments and the IMF. While there is talk of a greater than 50 per cent haircut taken by private banks, the real outcome has been a huge swap of private debt for official debt.

The cruel cut was that this redistribution in favour of financiers who had lent to Greece without diligence had at its other pole severe austerity. That this would be unacceptable was known. Hence, when former Prime Minister George Papandreou announced on 31 October 2011 that the government would hold a referendum to assess popular support for the terms of the bailout agreement, the response from the counterparties to the bailout was aggressive. The move, which was seen as a means to scupper the bailout deal, was attacked both within and outside Greece. This led to its withdrawal and the resignation of Papandreou as Prime Minister ten days later. Clearly, democracy was not seen as a suitable environment for implementing the austerity presented as a prerequisite for restoring confidence and kick-starting growth.

Elections were also postponed for long so as to allow an unrepresentative "national government", in the form of an opportunistic coalition between the centre-right New Democracy and the PanHellenic Socialist Movement (Pasok), to obtain legislative sanction for the austerity measures. The intention was to accede to the demands of the German and French governments, the European Central Bank and the IMF, even though protestors clashed with police outside parliament while the details of the austerity package were being debated and made into law.

But the elections had to be finally held. And they have left the erstwhile ruling coalition short of a majority, with the New Democracy winning 19 per cent of the vote and 108 (out of 300) seats in parliament and Pasok garnering 13 per cent of the vote and 41 seats. What is remarkable is the showing of Syriza, the Coalition of the Radical Left, which came in second with 17 per cent of the vote and 52 seats. In the October 2009 polls, Syriza had won just 4.6 per cent of the vote and 13 seats. The vote was clearly a rejection of the two leading two parties that had come together to accept and implement the austerity agenda in return for bailout funding.

Anger against austerity has also led a good showing by the Ultra-right and neo-Nazi Golden Dawn Party that reportedly advocates forcing immigrants into work camps and planting landmines along the Turkish border. The party has won 6.9 per cent of the vote and 21 seats in the Greek Parliament.

But with two seats short of a majority the coalition led by New Democracy has little chance of forming the government, since it is committed to both staying with the euro and continuing with the bailout policies. The one party that could have helped form a new "national government", the Democratic Left, which has won 19 seats, is committed to the euro but campaigned for a reversal of austerity measures. Thus barely a day after he began his effort to forge a new coalition in favour of austerity and the euro, New Democracy leader Antonis Samaras, gave up his bid to form the government. The next to get the opportunity is Alexis Tsipras of Syriza, who needs to forge a left coalition. His declared objective is to scrap the austerity measures. In Tsipras' view, there cannot be a government of "national salvation" to implement austerity, since such austerity amounts not to salvation "but tragedy for the people and the place". "The parties that signed the memorandum now form a minority. Their signatures have been delegitimised by the people." Tsipras is reported to have said.

The political rejection of austerity is visible in France as well. Immediately after his election Hollande declared that his election signalled that "austerity does not have to be inevitable" for Europe. That is significant, especially since his campaign promises included higher taxes on business and the rich, employment subsidies, and a partial reversal of the rise in the retirement age to 62.

There is therefore some hope that the world would see a retreat from an unthinking commitment to fiscal conservatism. But the transition would be difficult and divisive. Merkel has already warned Athens, grappling with finding itself a government, that it would have to stick to the reforms and budget targets agreed with lenders in the bailout deal. But this is not good for Greece, for Europe or the rest of the world. The evidence is too clear to ignore. Four and a half years after the onset of the Great Recession, the expectation that the world economy is on the path to recovery is being belied. The signals are many. To start with, the GDP growth in the 27 countries of the European Union has fallen from 2.4 per cent in the first quarter of 2011 to 0.8 per cent in the last quarter, according to the OECD Secretariat. Moreover, 5 out of 33 OECD countries (excluding Greece) had recorded negative rates of GDP growth in the last quarter of 2011. These are: Italy, Japan, the Netherlands, Portugal and Slovenia. The United Kingdom too is faring poorly, recording GDP growth of 0.5 per cent in the last quarter of 2011 and zero per cent in the first quarter of 2012.

The problem does not end here. The expectation of a recovery had been bolstered by evidence that the recession in the United States had touched bottom and begun to reverse. Both GDP and employment were being quoted as evidence of this. But it now seems that the recovery may be losing steam. Though the first quarter of 2012 saw GDP growing at 2.1 per cent, as compared to 1.5-1.6 per cent in the previous three quarters, this was below the 2.2 per cent recorded in the first quarter of 2011 and way below analyst expectations of 2.7 per cent. On the employment front, the 115,000 jobs added in April were just adequate to keep pace with population. The unemployment rate has fallen to 8.1 per cent in the US only because less Americans are coming onto the job market being disillusioned by past failure to find employment.

Finally, it is not just US, the one bright spot in the OECD, which disappoints. Countries such as China and India that were seen as pulling up the world economy because of their rapid growth are also slowing. China's growth slowed to 8.1 per cent in the first quarter of 2012, according to the country's National Bureau of Statistics. This compares with the 8.9 per cent recorded in the last quarter of 2011, and is the slowest achieved in the last 11 quarters. The government has reportedly lowered its growth target for 2012 to 7.5 per cent, as compared with 9.2 per cent last year. In India too, the Central Statistical Organisation has estimated growth in GDP during 2011-12 at 6.9 per cent as compared to the 8.4 per cent recorded in 2010-11.

The reason for this prolonged and widespread slowdown and its intensification into a recession in certain segments of the world economy is the irrational fiscal conservatism that has overcome most governments. Having spent hugely to rescue finance from bankruptcy, these governments have turned wary about the state of their finances. So the argument doing the rounds, aided and abetted by the IMF, is that it is time now for fiscal consolidation in which governments must cut expenditure and reduce their deficits in order to bring down their public debt to GDP ratios.

The reason why spending cuts in the middle of a recession are seen as making good sense is flimsy to say the least. Improved fiscal positions and reduced government debt is expected to improve "investor" confidence, leading to more international investments and credit and a revival of demand and growth. However, the reason why investors should feel confident when economies are languishing in a recession is never made clear. And the evidence that they don't is ignored. Consider a country like Ireland, which has been a disciplined student of the "austerity for confidence" school. Having recorded a negative 0.4 per cent growth in GDP in 2012, Ireland grew by just 0.7 per cent in 2011. And growth in the last quarter of 2011 was just a little above half that in the second quarter. Other countries that have been experimenting with the contradictory austerity-induced revival strategy, such as Greece, Portugal, Spain, Italy and the UK have also been disappointed, as was to be expected. Nowhere is the turn to austerity as severe as in the peripheral countries of Europe. So the political backlash had to begin there. But with France showing the same tendency, the popular mood is difficult to dismiss. Hopefully this would restore some balance in economic policy making across the world.

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