Greek Tragedy in European Theatre:

the Economic Consequences of Depression Economics

Professor Ioannis Theodossiou

Centre for European Labour Market Research (CELMR)
University of Aberdeen Business School
University of Aberdeen
Scotland,
U.K.

February 2017

Greek Tragedy in European Theatre:
the Economic Consequences of Depression Economics[1]

By Professor Ioannis Theodossiou

[The author is grateful to PRIME's Ann Pettifor and Jeremy Smith for their valuable comments and suggestions. Any remaining errors or omissions are the author's responsibility.]

'*The liberty of a democracy is not safe if the people tolerated the growth of private power to a point where it becomes stronger than the democratic state itself. That in its essence is fascism: ownership of government by an individual, by a group, or any controlling power'*

Franklin D. Roosevelt *"Message to Congress on Curbing Monopolies.," April 29, 1938*

***Prologue**: Capitalism and Neoclassical Economics*

Robert Lucas, the high priest of the neo classical / neoliberal mantra has allegedly told to his students at the Chicago University that

'*we need to spend only ten minutes on Keynes; we know it does not work*'.

This is not an isolated opinion but the received wisdom that is religiously upheld in the neoclassical traditions that shapes the economic policy debate. For him and the neoclassical mantra the only economic set up that can deliver economic prosperity is that of the unhindered markets. Economists of my generation and after have become well trained in the 'wonders' of the free market economics and its ability to bring prosperity. Keynes' views and analysis has largely vanished from economics classrooms, economics discourse and economic policy debates.

But contrary to this belief, as Figure 1 [see end of article] clearly highlights, the effects of unhindered markets on the fortunes and welfare of the people is by no means conducive to stability and prosperity. It depicts the fluctuation of unemployment rates of four economies with different degrees of reliance on the efficiency of the market mechanisms. This pattern is similar in most of the main western economies. Apart from a relatively short period between 1945 and the 1970s marked by active government intervention and regulated markets, capitalism exhibits a profound instability over time as both the productive potential and the associated employment levels fluctuate greatly. It is noteworthy that every dip in the business cycle is associated with heightened unemployment, despair and poverty for a large number of people and the size of the dip reflects the volume of despair. Although the high priests of the neoclassical doctrine view this despair with the abstract indifference of neutral statistical numbers, unemployment has both economic and human costs. It costs in terms of the lost output that could potentially be produced if these people were productively employed and it costs as they end up to the dole. It costs the government lost tax receipts and employee contributions to pension funds. But this is scarcely all the waste. There is a far greater loss to the unemployed themselves. This is first, the financial cost represented by the difference between the dole and their potential full wage and, second, the loss of both psychological and physical health and the loss of morale.

However, contrary to Lucas' conviction that the '*central problem of depression prevention has been solved*'[2] when the economy collapsed in 2008-9, the unrestricted free market policies did not deliver the expected outcomes, as almost ten years after the catastrophic events of 2008 western economies - especially the European Union - are in a '*long dragging conditions of semi-slump, or at least subnormal prosperity*'[3] similar to that of the 1920's. Yet, the European political and economic establishment in line with the neoclassical mantra continues to pursue policies of austerity, otherwise known as policies of internal devaluation, in the EU and Greece as the road to macroeconomic recovery.

Austerity or internal devaluation: definitions

Internal devaluation policies amount to a policy of reducing prices and incomes of the citizens of a country relative to other countries so as to result in changing the real exchange rate *in terms of commodities*. In effect, internal devaluation reduces the ratio between the *volume* of the currency of the Eurozone country and its requirements of *purchasing power in the form of money*. This results in increasing the exchange values of this Eurozone country in terms of commodities relative to others. Thus, the belief is that the individual country's goods become more competitive relative to other Eurozone countries and relative to other countries of the world.

The deflationary policy agenda of internal devaluation is a programme of cutbacks in expenditures, a decrease in government's deficits and debts and wage and income restraint even during a period of recession. The proponents of such policies argue that economic pressure should generate a decline in money wages which in turn should reduce the cost of living. Thus, at the end of the process, real wages are expected to be restored.

This policy agenda is not new. It is the foundation of classical economics. When during the Great Depression, A. C. Pigou was asked to explain to the Macmillan Committee[4] why unemployment was so high his response revealed the strongly held beliefs that shape the austerity economic policies of today. This is how Pigou's response is recorded:

Chairman: *Would you necessarily create vacancies … by the reduction of wages?*

Pigou: *I think you would to some extent*.

Chairman: *If wages rates were reduced, you think there would be an increased demand for labour?*

Pigou: *Then, I think there would be an increased demand for labour*.

In general Pigou held egalitarian views and he was not a reactionary but the belief that wage reductions even in a depression are able to induce some industries to hire more and no industries will hire fewer workers was a strongly held view. It was the *sound economic opinion* of the day and it continues to be so today for those versed in the wonders of 'free market' economics.

Of course, one may react to this proposition as Keynes did by advancing the view that if one producer cuts wages, then, as long as no other producer does the same, he or she should be expected to produce more and seize more of the available trade. However, if wages are cut all round, the purchasing power of the community will be reduced by the same amount as the reduction of labour costs; and so no producer will face any increased demand for products.

Keynes also pointed out that even if Pigou's policy can be carried through and even if it finally succeeds one also would expect that it would also cause extensive injustice in the process as inequality would greatly increase as weaker groups and industries lose out in favour of stronger ones.

However, Keynes was convinced of the futility of these policies. His work was largely devoted to putting an end to the misleading 'classical' doctrine which held that competitive market economy would always ensure full use of potential resources. In effect, Keynes rejected the existence of self-correcting market mechanisms in competitive markets that are capable of eliminating any excess supply of labour and other productive resources. Importantly, Keynes did not argue that competitive market mechanisms do not work because of unwise government interventions such as the minimum wages or because of private actions and activities such as trade union power or industrial monopolies. Instead, he contests the misleading 'classical' orthodoxy on its belief that competition is able to adjust prices of products and factors of production so as to eradicate excess supplies in product and labour markets arguing not that the process of adjustment may take long time but that it does not work at all.

Parode: The Wonders of Neoclassical Economic Policies

In view of Keynes' intellectual heritage this essay highlights why one should expect that policies springing from the classical orthodoxy, such as internal devaluation, are futile and indeed counterproductive in restoring economic activity. But before this it will be instructive for the subsequent discussion to briefly review the current outcomes of the internal devaluation policy agenda in the EU and Greece almost a decade after the 2008 events.

Episode 1: *The European Theatre*

One would sum up the Eurozone's economic performance (the 13 pre-2007 EU countries) as at best unsatisfactory.

Europe's GDP is roughly where it was the 2007 and its per capita income adjusted for inflation has fallen. Even Germany, the power house of Europe, has exhibited growth of 6.8% since 2007 that is an anaemic 0.8% per annum noticeably weaker than Japan's a country that has suffered an almost 20 year recession. This weak economic performance in Germany came at the tail end of the severe internal devaluation policies implemented at the dawn of 21st century with severe cuts in Germany's safety net, stagnation of real wages and a transfer of income from the poor and middle income classes to the higher rungs of the income distribution[5].

Even though some Eurozone countries have seen a moderate increase in real wages since 2007, real wage growth in the EU is disappointing. Table 1 [at end] shows the total wage growth rates for 2007 to 2015 using the OECD calculated real wages[6]. For almost a decade for most countries real wages did not increase since real wages have either stagnated or have increased at most by 1% per year and in some countries have significantly declined (notably Greece, the UK and Portugal). Interestingly, as Tily (2016) has observed the neoclassical belief is that downward flexibility of wages always generate employment gains. However, Table 1 shows that this is evidently not the case. In the UK, in spite of the large fall in real wages which is in fact the longest and steepest decline in real wages the country has suffered since at least 1830 - there are remarkably smallish employment gains (in terms of the employment rate) and any real wage flexibility in Greece was completely in vain. Moreover the countries whose workers enjoyed the highest gains in real wages are also among those with the highest employment gains. In summary, throughout the EU real wage improvement is feeble and employment gains, if any, are weak at best. In addition this labour market performance is coupled with severe deterioration of employment conditions in and worker's rights, worsening terms of collective agreements, increased casualisation of employment and the rise of zero hours contracts throughout the EU and the Eurozone. The latter employment policies, known also as labour market Flexicurity, mainly involve a maximum of flexible labour with fast vanishing elements of labour market security.

In the face of such deteriorating conditions of employment, unemployment in the Eurozone has been unprecedented in modern history averaging 11% in 2015 whereas in crisis countries it has reached twice as much and in Greece it was over 25% for three years, peaking at almost 28% (and still 23% in late 2016). As a yardstick for comparison unemployment rate during the Great Depression was around 11% in the UK and around 20% in the US. In summary, Eurostat estimated that 20.973 million men and women in the EU-28, and 16.326 million in the euro area (EA-19) were unemployed in August 2016. Furthermore, 4.199 million young persons (under 25) were unemployed in the EU-28, and 2.927 million in the euro area[7]. This is a dismal performance.

Yet, nothing is more telling about the economic performance of the EU than the developments on the poverty front. Thus, more than 120 million people (24% of the EU population) are poor or live at risk of poverty or social exclusion and their numbers have increased compared to 2011. This includes 27% of all children in Europe and 20.5% of those over 65. Among the EU population 9% are working poor and 10% live in households where no one has a job[8]. The distribution of wealth is heavily tilted against low and the middle incomes. A recent Oxfam report reveals that the top 1% of the EU28 population owns the 31% of wealth and the top 10% owns 69% of wealth. However the bottom 40% of the population owns just the 1% of wealth[9].

In order for the public to retain some acceptable standard of living with incomes and wages and purchasing power supressed over time, it has resorted to borrowing. Indicatively the available data show that private sector debt (the stock of liabilities held by non-Financial corporations, households and non-profit institutions serving households) is 133% of the GDP in the EU[10]. But as internal devaluation takes its toll on the earnings capabilities of the public across the Eurozone, non-performing loans have been increasing at a rate of €50 billion a year and the problem is most severe in southern Europe.

Faced with the adverse effects of their favourite policy choices, the EU policymakers resorted to a cheap money policy otherwise known as to Quantitative Easing in order to stimulate the stagnant EU economy. Roughly nine years of Quantitative Easing has caused historically very low interest rates, often negative. Despite of the low interest rates and expansion of the monetary base, growth has been nearly non-existent. The European Central Bank has apparently lost traction as money printing and low interest rates have caused no economic growth – this is an era of the Keynesian '*Liquidity trap*'.

However, Quantitative Easing has also at least two deflationary effects. First, it puts significant pressure on pension funds as they rely on a good return on their financial investment for paying out of pensions and further it creates adverse expectations for future pensioners who naturally curtail their current consumption. Second, such low interest rates induce employers to borrow to finance labour-saving devices which under normal conditions would have been considered unviable thus increasing unemployment during a period of economic stagnation.

This policy of low interest rates has put the banks under pressure. Since the financial crisis, banks have invested in government bonds which are supposed to be 'low risk'. In 2007 a bank buying a government bond in the Eurozone could have received a 4.5% return. In 2016, such a government bond is expected to offer no return or even to offer a negative return. For instance, on 13 July 2016, the German government issued a 10-year bond with a yield of -0.05%. This is a major problem for banks since owning these bonds reduces their revenue. Yet, they cannot transfer these losses on to their customers as the latter are likely to withdraw their deposits seeing this their savings diminish they would prefer cash. Hence, banks worrying about their own liquidity they are unwilling to expand their lending. In view of this the European Central Bank has dropped its deposit rates to it to -0.4%, in order to discourage banks from hoarding money, and induce them to increase their lending. But since the economy is stagnant the demand for loans does not exist. The European Central Bank cannot raise interest rates either. The debt levels in the EU are too high to bear higher interest rates. Overall, €1 trillion in bond purchases by the European Central Bank has no appreciable benefit to the economy. It appears that the European Central Bank is facing the Keynesian 'liquidity trap'; the boundaries of quantitative easing (QE).

The only meaningful effect of the actions of the European Central Bank has been inflation in the financial markets. The expansion in the monetary base has financed overwhelmingly stock, bond, and real estate purchases which have driven up the prices of the financial asset but this has not made any significant contribution in the productive capacity of the EU countries. Indeed, using the Gross Fixed Capital Formation as a percentage of GDP (GFCF) as a proxy of the investment activity for the EU 13, Table 2 shows that it has almost uniformly fallen in the recent period. Looking at the countries hit most severely by the 2007 recession, the slowdown of the investment activity is even more pronounced. To gain some yardstick for comparison one should consider that the GFCF of China has been 25.7 in 1990, it increased in 2007 to 38.8 and in 2014 reached 44.3.

One could summarise the above dismal performance of European economies in similar spirit as Keynes summarised the state of affairs of the Europe of his day. Now as then this

> '*decadent international but individualistic capitalism, in the hands of which we found ourselves … is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous –and it does not deliver the goods. In short, we dislike it and we are beginning to despise it. But when we wonder what to put in its place, we are extremely perplexed'.*[11]

These are Keynes' thoughts about the failure of the political and economic establishment of his own day to counter the Great Depression. It applies equally to current events.

Episode 2: *The Greek Tragedy*

Since 2010 the European Commission, the IMF and the Greek and European political establishment have imposed a full blown internal devaluation programme that in Greece has caused a depression unlike any seen in Europe since WWII. The main drivers of the programmes have been an exaggerated and cruel implementation of the neoliberal policy agenda including cuts in wages and pensions, increases in taxation, total relaxation of any collective agreement, redundancies for public sector employees, the fire sale of public assets at fire prices and severe cuts in funding for an already underfunded health system. These deflationary policies have been lately reinforced with an even more outrageous policy prescription for an economy in severe depression namely the requirement of a Primary Surplus, that is, the attainment of excess of revenues over expenditures net of interest payments. Though this surplus is destined to pay the creditor countries one should expect that it would cause a further reduction of the purchasing power of the Greek citizens over and above the decline associated with the earlier battery of internal devaluation policies.

The European economic and political elite, in supporting these policy prescriptions, argued that since over the pre-2010 decades the Greek economy suffered low productivity, these policies would redress the balance by curtailing spending - private and public – and somehow promote market confidence. In turn, the increased confidence would increase investment and thus outweigh the contractionary effects of austerity.

Almost ten years of strict implementation of these policies has created only despair for the Greek nation. The Greek national debt – the reduction of which was supposed to be the reason for these policies in first place - has increased from around 109% in 2008 to almost 180% of GDP today[12]. Meanwhile the country's GDP has declined by more than 25% over the same period and the Gross Fixed Capital Formation as percentage of the GDP (GFCF) has uniformly fallen from 26.0 in 2007 to 11.7 in 2015.

The unemployment rate has increased from 11% to over 23% after reaching a peak of 28% and youth unemployment after reaching an extraordinary 60% is still around 44%. It is noteworthy that this recent minor decrease in the unemployment figures reflects first, a ruthless casualisation of labour earning miserable wages. Recent data released by the Labour Ministry shows that 126,956 employees in the private sector are paid a gross monthly salary of €100 and 343,760 employees, mainly employed in part-time or rotating work contracts, 2-3 days per week or even few hours per week, are paid monthly salaries between €100 and €400 gross. Second, it reflects a rapid increase of outflow of Greek nationals in a search of better living elsewhere in the EU and beyond. Indeed, a 2013 study has found that more than 120,000 professionals, including doctors, engineers and scientists, have left Greece since the start of the crisis in 2010[13].

A more recent European University Institute survey has found that of those who emigrated, nine in ten hold a university degree , more than 60% of those have a master's degree, and 11% hold a PhD. This is a calamity for the Greek economy. Not only has the Greek nation – either the parents or the State or both - has paid for the skill accumulation of those who left Greece but Greece now is unable to capture any returns from these human capital investments. The long run economic repercussions of this brain drain will be detrimental for the future social and economic prospects of the Greek nation[14].

The destruction of the Greek economy is best highlighted by the reports regarding rising inequality and poverty. Greece has the largest increase in income inequality (before taxes and transfers) in Europe since 2010 which is now the highest in the EU[15]. In 2014, over a third of the population was at risk of poverty or social exclusion (36.0 %) and one in five Greeks were experiencing severe material deprivation, a figure which nearly doubled since 2008. It is also noteworthy that in 2010, 27% of the Greek population was classified as poor or living at the risk of poverty but that figure currently stands at 56%. Furthermore, 44% of pensioners and almost 44% of children are living below the poverty line[16]. Finally, a study conducted by diaNEOsis, a non-government research and analysis organisation, shows that in 2009 only 2.2% of Greeks lived in extreme poverty which increased to 8.9% 2011 and 15% in 2015, that is 1,647,703 Greek citizens including 17.6% children and 24.4% of the youth aged 18-29. The group most at risk for falling into extreme poverty is the unemployed of whom 70-75% live in extreme poverty. In 2011 that figure was less than 50%[17].

The health consequences of this degradation of the welfare of the Greek population are enormous. The suicide rate has risen by 35% between 2010 and 2012[18] and an estimated 800,000 Greeks are without access to medical care due to lack of insurance or poverty[19]. A 2014 report in The Lancet medical journal has highlighted the devastating social and health consequences of the austerity policies due to the scale and speed of the changes imposed by the austerity policies which turned out to be detrimental to the capacity of the public health system to respond to the needs of the population.

But this Carthaginian destruction of the Greek economy has not distracted the European policymakers from their neoclassical focus. The new August 2015 agreement between the European creditors and the Greek government stipulated that if set fiscal targets are not met additional austerity measures will kick in automatically, thus further enhancing the contraction of the economy as the agreement institutes an automatic built-in destabiliser in the Greek economy.

The above state of affairs both in Greece in particular and the EU in general paint a bleak picture for European capitalism and a total negation of the extensively lauded and advertised European Social Contract which among other humans rights was supposed to guarantee positive rights and freedoms for such issues as health, labour rights, full employment, reduction of working hours, social security and social and legal protection from poverty and social exclusion and the like. In contrast the current actions of the European policymakers in their almost religious belief in the neoclassical doctrines of unrestricted market capitalism have created a situation that as in Keynes time

> '*on the one hand the labouring classes accepted from ignorance or powerlessness, or were compelled, persuaded, or cajoled by custom, convention, authority, and the well-established order of society into accepting, a situation in which they could call their own very little of the cake that they and nature and the capitalists were co-operating to produce. And on the other hand the capitalist classes were allowed to call the best part of the cake theirs and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice*'[20].

Most importantly, internal devaluation policies implemented on a stagnant economic environment show that

> '*today we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the workings of which we do not understand. The result is that our possibilities of wealth may run to waste for a time –perhaps for a long time*'[21].

As for Keynes in 1930, this *muddle* which has jammed the machine results from the economic consequences of the insistence of the economic and political European elite on policies dictated by the mistaken classical 'Orthodoxy'.

Stasimon*: The Economic Consequences of Internal Devaluation.*

To trace the economic consequences of internal devaluation this section aims to sketch Keynes' main analysis on the repercussions of deflation of wages, incomes and prices on economic activity.

The policy debate in Greece and the EU is subjugated first by the hysteria with the issue of budget deficit and public debt. The proposition is that the less the governments borrow the better and, therefore, the main policy has been to put pressure on the State to curtail as far as possible all capital expenditure, without concern on how productive and desirable that is in itself. The idea is that cuts in government expenditures are not to be used by the government to tax the general population less but to borrow less on the assumption that if the government borrows less the private sector necessarily borrows more, though taxing less the highest rungs of the income distribution might be desirable as it is considered as an incentive to investment. Second, led by the belief that the main thrust of policy should be the internal devaluation; a program of cutbacks in expenditures, decrease in deficits and debts and wage and income restraint is pursued even in a time of recession.

The idea is that if producers have reduced costs of production they will produce more and the prices of the produced goods will fall as much as wages. However, as Keynes pointed out that there is no reason to expect that any reduction of purchasing power will be offset by increases in other directions. Certainly, this reduction of purchasing power may cause a reduction of domestic expenditures on imports, which may improve the trade balance. It may also reduce savings, as public employees and others whose salaries are cut and those who lost their jobs may save less or draw on their passed savings to maintain their habitual standard of life. However, producers will find that the expenditures of consumers (public employees, pensioners, unemployed) are reduced. Consequently, they can only match this reduction of revenue by either cutting down their own expenditure or making redundant some of their employees or both. As a necessary consequence of reduced incomes and profits there should be an increase in unemployment and a decrease in government tax revenues.

Effects on Lenders and Borrowers

Importantly, as Keynes[22] noticed, deflation of wages, incomes and prices transfers wealth from the rest of the public to the rentiers and to those who hold titles to money. In effect, internal devaluation redistributes wealth as it transfers money from borrowers to lenders. The real assets in the country constitute the wealth of its citizens. Such real assets are buildings, stocks of commodities, goods in the process of production and the like. As is the usual practice, owners of these assets frequently purchase them by borrowing money. So to the number of borrowers there is always a corresponding number of lenders. The lenders own the money used by the borrowers - the asset owners - for the purchase of these assets. This money is usually obtained though the commercial banking system. Thus, in effect, the banks assure the depositors who lent the money to the bank that their money will be paid back on demand. This promise is given on the assumption that the borrowing customers will honour the terms of the loan and pay back the money used to buy their real assets.

However, a change in the value of money affects the relative position of those who possess claims to money and those who owe money. A decrease in prices and wages is equivalent to an increase in the value of claims on money. Hence real wealth is transferred from the debtors to the creditors since a larger proportion of the real assets is represented by the claims of the depositor (the lender) and a smaller proportion goes to the owner of the asset who has borrowed money to buy the real asset. In short, the real value of the loan increases for the creditor and the real burden of the debt increase for the borrower. Hence, debt service is a higher proportion of debtors' incomes, and there is a reduction or even elimination of the borrowers' margins of equity. This disqualifies them from further access to credit. Hence, debtor bankruptcies and defaults follow as a vicious circle sets in. This transmits the distress of debtors to their creditors which threatens the solvency and liquidity of the lenders and financial institutions.

Effects on the Banking Sector

The above is only the first round effect of deflation of prices and wages. The second round effect comes from the position of the commercial banks between the borrower and the lender as they owe money to their depositors whose money is lent to the borrowers. Banks give a guarantee to their depositors of getting back the money on demand but without any concern on the worth of money. Indeed, small downward fluctuations in the value of money have no repercussions for the banks as it is a common practice for them to allow for small decreases in the price of real assets by financing only a part of the initial purchasing price of the asset. This 'margin' protects the bank in ordinary circumstances where the downward change in the money value of the assets is within conventional limits. But this guarantee to the lender can be honoured only if the money value of the asset that the borrower has purchased remains constant or fluctuates within narrow limits over a significant period of the loan. When in a brief period of time the money value of the asset declines excessively in a way that exceeds the set margin the bank is unprotected. A severe decline in the money value of the real assets, as this experienced the recent years in Greece and elsewhere in the EU, jeopardises the whole banking structure. There is a degree of deflation in the price of real assets which cannot be endured by any bank and the Greek banks are a case in point.

Effects on expectations

As devaluation of wages and prices takes its course and there is a gradual rise in the value of the country's money in terms of the goods it announces to every producer that in the future any stock held in goods or raw materials will steadily depreciate and to everyone who has borrowed to finance the business that the real value of the loan will steadily increase. In view of this any sensible producer will postpone any orders as long as possible and any sensible borrower will prefer to go out of business rather than borrow. Furthermore any sensible citizen will turn any asset in his or her possession into cash and wait for the appreciation of its value. Thus, as pessimism sets in the circulation of money is expected to fall which will further intensify the slowing down of the economic activity. As Keynes put it '*a probable expectation of deflation is bad enough; a certain expectation is disastrous*'. Indeed, the whole economic activity can be brought to a standstill as it is the case in Greece although the rest of the EU suffers from the same disease.

Say's law: When doctrines defy logic

The classical tradition proposes that internal devaluation policies benefit the community as a whole by reducing the cost of production which in turn induces the producers to increase the volume of production and hence employment. This is because the costs are what the producer pays the employed labour for the production and the produced product prices determine the producer's income when the products are sold. For the community as a whole, the producers get back as sales proceeds the same amount that they have paid out to the employed labour in the course of production since this is the income of the public which they use to buy the products produced. Thus, *supply creates its own demand*.

This Keynes denied. He argued that it is not true that what producers pay out as costs of production necessarily returns back to them as the sales proceeds of what they produce.

> '*It is a delusion to suppose that they [*producers*] can necessarily restore equilibrium by reducing the total costs whether it be by restricting output or cutting rates of remuneration*;… *For the reduction of their outgoings may, by reducing the purchasing power of the earners who are also their customers, diminish their sale –proceeds by a nearly equal amount*'[23].

Why then does the total cost of production fall short of the total sale proceeds? To answer this it is instructive to briefly outline Keynes' explanations as they appear in his '*Treatise of Money*' which precedes his masterpiece, The *General Theory*.

Keynes starts from the premise that the total costs of production – *which is also the total earnings of the community* - are divided in some proportion between the cost of production of consumer goods and the cost of production of capital goods. The incomes of the public (the total earnings) are also divided in some proportion between the expenditures on consumer goods and on savings. Overall, if the proportion of the cost of production on consumer goods is larger than the proportion used by the public to purchase consumption goods then the producers of consumption goods will receive less sale proceeds than their production outlays. Hence they incur losses.

However, the profits of the producers of consumption goods will be reinstated only if the proportion of the income that the public spends on consumption goods increases (i.e. the public saves less) or if a larger proportion of production is dedicated to capital goods (since this reduces the proportion of production devoted to consumption goods). However, capital goods cannot be produced in a higher proportion unless the producers of such goods foresee that are going to make a profit. Hence, the issue lies in identifying the determinants of the profits of the producers of capital goods. Clearly, they depend on whether the public prefers to keep their savings as cash or use them to buy capital goods. If the public does not buy capital goods then the producers of capital goods are set to make a loss. Hence less capital goods will be produced. If so then the producers of consumption goods will make a loss. In the end, all producers will make a loss. This will cause a rise in unemployment and a vicious circle will start. This simplified picture of the production–expenditure process highlights the essential variable in Keynes' analysis of new capital investment. The fundamental cause of the recession or slump is the insufficient output of new capital investment.

So in view of this, why is there an insufficient output of new capital goods today? In my view this is due to a number of combined circumstances. First, the fall in incomes and prices has been catastrophic to those who have borrowed and anyone who has postponed new capital investment and business initiatives has gained by the postponement. Second, the lack of sufficient demand generated by the austerity policies exacerbated the reluctance of the producers of capital goods to borrow. Third, both the European Central Bank policy of cheap money and the shift of wealth from the low and middle incomes to the top have affected the preferences of the lenders towards speculative use of funds and encourage them to take part in Stock Exchange speculation. Fourth, in view of the borrowers' reluctance to borrow, instead of financing new investment the savings of the lenders are being used up either on occasion to finance business losses and distress borrowers to meet losses which they have incurred through the fall in prices thus extracting exploitative rates of return or to finance labour saving devices which under normal conditions would have been considered unviable. This exacerbated unemployment and lack of demand.

*Is there an **Exode** in this Greek Tragedy and the European Stagnation?*

Any recovery is inseparably tied up with the re-establishment of both the purchasing power of the public and the restoration of demand at higher levels and importantly with establishing a higher volume of new capital investment. This should involve first, maintaining low interest rates and second, the return of confidence to the business world so inducing favourable expectations for the future so they are confident in investing in new capital. However, confidence cannot return without the experience of improvement in business profits; but business profits cannot return without the increase in new investment relative to savings.

An increase in investment relative to savings can only take place first, when there is a rise in prices thus improving the ability of reducing the monetary indebtedness as the alleviation of the debts or at least the writing down of debts to match the market value of the assets can go a long way to restoring confidence and second, when favourable expectations to the businessman are built up regarding the future yield of a unit of new capital asset compared to the current production cost of this unit of capital asset, that is an improvement of the Marginal Efficiency of Capital. The question then becomes what methods can be implemented to increase the volume of investment which is the expenditure of money on the output of *new capital goods*. In the current state of affairs there are two ways to this end: The first is the restoration of confidence in business prospects so that businessmen have a reasonable prospect of earning sufficient return from a new capital investment. However, restoration of confidence cannot be based on unclear hopes and rhetoric but on real improvement in the demand for goods and services. This result can be achieved only along a second scheme.

This scheme consists of a total reversal of the current policies and a drive for new public capital investment under the direct auspices of the State or other public authorities.

To be clear at this point; new capital goods investment does not mean raising revenues by the government selling state assets through privatisations. Classical thinkers such as John Steward Mill viewed State assets such as port, water, electricity, railway companies, the hospitals and the universities as entities which are not supposed to operate for profit but rather to establish an infrastructure in the country conducive to providing a stable and low cost environment for all citizens and the business world within which they could pursue their interests. Privatisation not only negates this vital purpose but in addition introduces monopoly power in the market since most of State assets are to an important degree natural monopolies and it is well known that private monopolies are detrimental to market functioning. Second, when a country sells its assets, its net worth is decreased with long term consequences. Importantly the country not only does not own the asset but it also forgoes any yields arising from its ownership and it furthermore it results in increases in its costs outlays when buys back the services or goods that the forgone asset provided. This is counterproductive to the road to recovery.

Should government forsake active intervention?

The government should take active role in establishing new capital investment. Contrary to the current policy prescriptions the government should set up an authority whose business should be to make sure that detailed plans are prepared for new capital investment to be undertaken directly by the State. Thus the port, water, electricity, railway companies, the local authorities, the hospitals and the universities and other entities should be asked to investigate and then detail the projects that could be usefully undertaken if capital were available so projects can be launched. This was Keynes' advice for the road to prosperity during the 1930s and his advice is fully applicable today. It is also noteworthy that investments in health and education are the most valuable and effective part of the public investment programme as they lead to a more efficient and dynamic economy.

Importantly, new capital investment can be further encouraged if the government enacts legislation to facilitate the establishment of worker cooperatives backed up by access to favourable credit facilities to establish new business or to turnaround indebted private companies. The establishment of worker cooperatives give an alternative to the capitalist enterprise and provide an alternative model of economic regeneration where workers and their communities can decide what to produce, where to produce, how to produce and what do with the profits. MONDRAGON Corporation, the co-operative corporation in the Basque Country and other similar worker cooperatives are models to aspire in this respect[24].

The government revenues required for this extensive government intervention can be secured by fair and strictly progressive taxation. The extraordinary increase in the degree of inequality is an outcome of government policy in terms of what it does and what it does not do. Much of the income accumulated at the top end of the income distribution is not one based on individuals' contributions to society but is instead rents captured by the inappropriate rules including tax breaks and tax exemptions, exploitation and monopoly power –notwithstanding corruption. This has transferred income from the bottom and the middle to the top over several of the past decades. This trend should be reversed[25]. Indeed, if there is an

> '*undue concentration of incomes and probably a resulting tendency to over-saving' if a more equal distribution 'were achieved mainly at the expense of reducing a volume of savings so swollen that a considerable part of it goes to waste, the change would be very nearly a clear gain*'. (J. M Clark, 1934).

Progressive taxation will mobilise inactive savings and reverse the trend of transferring income from the bottom and the middle to the top, providing revenues for the active government intervention and increase demand for goods and services as it places income with those with high propensity to spend their money on for domestically produced goods and services, thus enhancing demand.

Contrary to the current policy prescriptions, the times for reducing the deficit and the debt are boom times not times of slump and recession. Thus, as Keynes urged amidst the Great Depression, the government should borrow from its own citizens in order to spend in building prosperity. This undoubtedly increases the nation's debt. But as Keynes also pointed out, the debt of a nation to its own citizens is a very different issue from the debt of an individual or debt to non-national entities. The citizens comprise the nation and to owe money to them is like owning money to one's self. In so far as interest payments will have some adverse redistribution effects as wealth to the lenders this is a disadvantage, but it is a small matter compared with the importance of facilitating the establishment of general prosperity.

In summary, if the private individuals are unwilling to spend in new capital investment then it is essential the government does it for them. But there is no justification for not doing it at all. Apart from the humans costs of the austerity policies outlined earlier Franklin D. Roosevelt has warned us:

> *'We have come to a clear realization that true individual freedom cannot exist without economic security and independence. People who are hungry and out of a job are the stuff of which dictatorships are made'*[26]

The central message of this essay is the vital necessity for the efforts to recovery to be well-orchestrated, well programed by the strategic intervention of the government to increase he economic activity. As Keynes put it

> '*I expect to see the State … taking an ever greater responsibility for directly organising investment… a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment*'[27] (Keynes 1936).

Is this programme towards prosperity feasible for Greece or other EU countries within the EU; whether inside or outside the Eurozone? The answer to this is left to the reader's judgment.

[See below for Figure 1 and Tables 1 and 2, and for Footnotes]

Figure 1

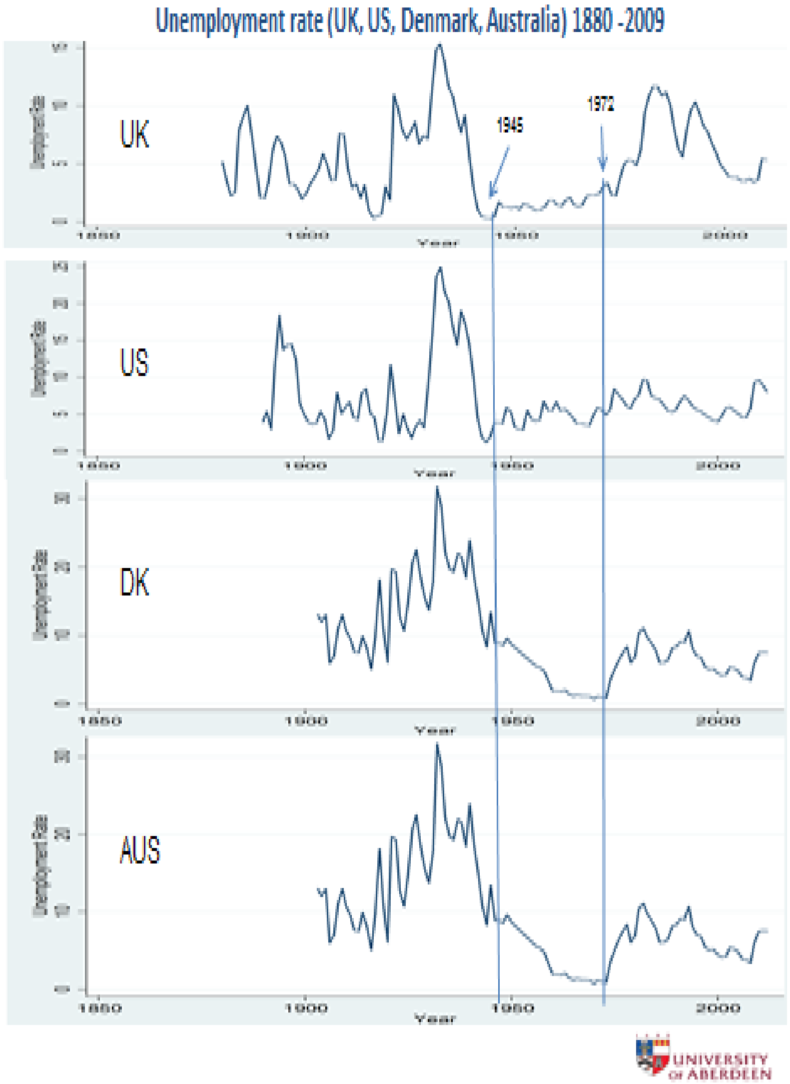
Unemployment rate (UK, US, Denmark, Australia) 1880 -2009
UK
1945
1972
US
DK
AUS
Year
1850
1900
1950
2000
UNIVERSITY OF ABERDEEN

Table 1: % Change in Real Wages and % Change in Employment Rate since Q4 2007 (to Q4 2015)

	Real Wage	Employment
	Wage Down	Employment Down
Greece	-10.4	-9
Portugal	-3.7	-5
	Wage Down	Employment Up
Great Britain	-10.4	0.6
	Wage Up	Employment down
Italy	0.9	-2.3
Ireland	1.6	-7.9
Spain	2.8	-8.5
Netherlands	3.4	-1.7
Finland	4.3	-3.8
Belgium	4.4	-0.7
Slovenia	7.2	-4.3
France	10.5	-1.8
Luxemburg	11.1	-1.2
	Wage Up	Employment Up
Austria	6.5	1.2
Germany	13.9	5.1

Note: OECD calculated real wages (derived from national accounts information) by dividing total wages by hours worked and putting into real terms with the household consumption, deflator
Calculations by G.Tily (2016) ToUChstone blog.org.uk. http://touchstoneblog.org.uk/2016/07/uk-real-wages-decline-10-severe-oecd-equal-greece/

Table 2: Gross fixed capital formation (GFCF), Selected EU countries

	1990	2007	2015
Germany	24.4	20.1	20
France	23.3	23.1	21.5
Netherlands	23.5	21.8	19.5
Austria	25.5	21.4	22.1
Finland	29.7	24.2	20.3
Belgium	24.1	23.2	23.3.
Ireland	19.2	28.7	19.2
Spain	25.9	31	20.4
Portugal	26.7	22.5	15
Greece	24.8	26	11.7.

Note : Gross fixed capital formation (GFCF) refers to the net increase in physical assets (investment minus disposals) within the measurement period. It does not account for the consumption (depreciation) of fixed capital, and also does not include land purchases. It is a component of the expenditure approach to calculating GDP.

Footnotes:

[1] Keynote presentation delivered at the 13th International Conference of the Economic Society of Thessaloniki, Aristotle University of Thessaloniki, 24/11/2016
[2] Lucas R. E (2003) 'Macroeconomic Priorities', American Economic Review, 1-41, P 1.
[3] Keynes J. M. 1931; The Economic Analysis of Unemployment.
[4] Committee on Finance and Industry, Minutes of Evidence (London, H.M.S.O, 1931, II, p48
[5] see Stiglitz (2016) The Euro, p.14
[6] The OECD uses figures derived from national accounts information, dividing total wages by hours worked and putting into real terms with the household consumption deflator
[7] http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics
[8]Poverty and social exclusion, Employment Social Affairs and Inclusion, European Commission, http://ec.europa.eu/social/main.jsp?catId=751
[9] Hardoon Deborah, Oxfam GB. D. Hardoon (2015), http://policy-practice.oxfam.org.uk/publications/background-data-for-oxfam-briefing-a-europe-for-the-many-not-the-few-exploring-575925, based on data from Credit Suisse.
[10] http://ec.europa.eu/eurostat/web/products-datasets/-/tipspd20
[11] Keynes J. M (1933) National Self –Sufficiency' New Statesman July)
[12] http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina225&plugin=1
[13] Labrianidis L., N Vogiatzis (2013) 'Highly Skilled Migration: What Differentiates the 'Brains' Who Are Drained from Those Who Return in the Case of Greece?', Population, Space and Place, 19- 5, 472–486.)
[14] Gropas Ruby and Anna Triandafyllidou (2014)' Emigrating in times of crisis Highlights and new data from an e-survey on high skilled emigrants from Southern Europe and Ireland' Global Governance Programme, European University Institute, SURVEY REPORT.
[15] Hardoon Deborah (2015) Oxfam GB. D.
[16]http://ec.europa.eu/eurostat/statistics-explained/index.php/People_at_risk_of_poverty_or_social_exclusion
[17]http://greece.greekreporter.com/2016/06/09/study-fifteen-percent-of-greeks-live-in-extreme-poverty/#sthash.Hk41Din3.dpuf
[18] Rachiotis George, David Stuckler, Martin McKee, Christos Hadjichristodoulou (2015) 'What has happened to suicides during the Greek economic crisis? Findings from an ecological study of suicides and their determinants (2003–2012)' *British Medical Journal*, BMJ Open 2015;5:e007295 doi:10.1136/bmjopen-2014-007295
[19] http://www.bbc.com/news/world-europe-33507802
[20] Keynes J. M. (1919) The Economic Consequences of the Peace
[21] Keynes J. M. (1930) The Great Slump of 1930
[22] Keynes J .M. (1923) Alternative Aims to Monetary Policy, in Essays in Persuasion (1963), Norton, NY.
[23] The Great Slump of 1930.
[24] For a perspective regarding this policy see Richard D. Wolff (2013) Democracy at Work: A Cure for Capitalism Haymarket Books.
[25] In this respect the rhetoric currently in fashion that taxing the top incomes has deleterious effects on investment activity has no historical basis. For instance during the Roosevelt era the marginal rate for the top incomes (those earning over $25000 equivalent to current $370000) in the US was 94%. This means that for every dollar of income earned above the $25000 threshold, 94 cent was taken be the tax authorities. As history shows this did not prevented the US investment rates from increasing at an extraordinary rate. In contrast over the last 30 or so years the marginal tax rate for top incomes in the US has declined to roughly 36% with an effective marginal tax rate of roughly 26%. This significant reduction of the tax burden for the top incomes had overall anaemic effects on investment. Similar historical trends are observed for most advanced economies.
[26] *State of the Union Message to Congress, January 11, 1944*
[27] Keynes J. M (1936) *The General Theory of Employment*, Interest and Money, Macmillan