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The Parable of the Profligate Patient

In 2009, an obese patient entered a doctor's office and confessed that although he was on a regimen to limit further weight gain to no more than 3%, he was going to bloat by over 15% that year. He was already more than 100% overweight and worsening at an alarming rate. Moreover, the patient complained about certain discolorations on his arms and legs which he was convinced were malignant.

In the aftermath of a large party the patient had successfully (but lavishly) hosted in 2004, the patient had combined some muscle growth with increasing amounts of fat, thus reversing a trend from the late 1990s when healthy growth was accompanied by reduction in obesity as the patient had successfully sought membership in an international fitness club which promised stability, muscle growth, and a higher metabolic rate. Muscle growth ceased in 2008, bringing on a depression to which the patient responded by overeating rampantly.

In near panic, the doctor brought in other experts to examine the patient. After much wrangling, they put the patient on a strict diet emphasizing burning muscle, homeopathic treatments for the discolorations and large doses of sugar to avoid hypoglycemia. It was reasoned that this regimen would increase the patient's obesity level in the short term, but in the longer term it would decline. A renowned expert from Washington expressed misgivings, arguing for greater focus on reducing eating, but ultimately went along with the majority. No biopsy was conducted to determine whether the blemishes were malignant.

The patient became weaker and fatter, and the discolorations grew despite the treatments. Moreover, the patient became impatient and threatened to walk away, to which the medical experts responded with threats, including expulsion from the prestigious fitness club. Eventually they settled for a pair of liposuctions in order to permit the remaining fat to metabolize more easily. External observers believe further liposuction will be needed since the patient remains unable to turn the fat deposits into muscle growth.

After three years of therapy, the patient has become weaker and even more overweight. Worse, further discolorations have emerged on his arms and legs. Convinced that they are malignant, the patient excises these blemishes at random with a dull knife, in the process removing muscle, and thus further weakening himself. Substantial girth reduction is essential to free up the arms and legs to allow them to move and grow stronger, but the patient is reluctant to reduce his sugar intake, and erroneously believes that he can lose weight by squeezing more energy out of burning muscle, and excising discolorations. A promise to cut consumption in 2013 has been rewarded by delivery of a large dose of sugar.

No biopsy has yet taken place to determine which discolorations are malignant tumors. Meanwhile, other members of the fitness club have experienced lesser versions of the same affliction. Medical knowledge has advanced on the diagnostic level, but the experts continue to disagree over the appropriate treatment. No cure is in sight as of the writing of this piece.

It does not take much imagination to realize that the story above represents an egregious case of misdiagnosis followed by inappropriate therapy that has taken a difficult situation and made it much worse. It should be equally evident that Greece is the patient to which the tale refers, and its economic situation since the debt crisis which broke out in late 2009.

Despite many structural inefficiencies, Greece experienced a decade and a half of uninterrupted economic growth up to 2008. Already carrying a sizeable debt, the then Government reacted to the economic slowdown resulting from the global financial crisis by borrowing recklessly and spending with abandon. When Greece announced in late 2009 that it had far exceeded the 3% of GDP fiscal deficit limit prescribed by the Stability Pact for the Euro, and would post a deficit over 15%, panic broke out about Greek debt sustainability.

Due to Greece's Eurozone membership, the European Commission, the European Central Bank and other Eurozone countries took a keen interest in the matter, fearing potential spillover effects. Eventually, the International Monetary Fund was brought in to form a 'Troika' which in May 2010 agreed upon a bailout package with the Greek government.

Greece's excessive public debt was caused by a profligate and inefficient public sector which ran oversized fiscal deficits. In addition to the deficits, the public sector discouraged economic activity for a host of reasons, including (but not limited to): bureaucracy, overregulation, legally enshrined economic inefficiencies on behalf of special interests, restrictions on competition, unpredictable and unfair tax regimes, and general unfriendliness to entrepreneurship and private investment.

Instead of acknowledging that public sector profligacy caused the debt crisis, the state blamed tax evasion. Admittedly, the blemish of tax evasion has long existed in Greece, and many companies and self-employed have systematically hidden earnings (and avoided taxes such as VAT). Furthermore, this has had a corrosive social effect, since it embeds a perception that those who can evade taxes do so, while the salaried tax base bears the burden. However, the size of tax evasion pales in comparison to the fiscal deficits, and belies the fact that the fact that the state was spending all resources it could get its hands on as it indulged in a borrowing binge facilitated by historically low interest rates and the global credit boom from 2000-08.

The tale of tax evasion proved especially pernicious since it distracted attention from the real issue: the need to reduce the size of the public sector and remove obstacles to productive economic activity, and was used to raise revenue by any means. Spending cuts were limited, at best, while direct and indirect tax rates skyrocketed. Structural reforms to increase competition, reduce influence of special interests, remove red tape or improve the investment environment were non-existent. The business climate deteriorated and economic activity declined, which led to revenue shortfalls and thus heavier taxation. Unemployment exploded, and the relative size of the state to that of the private sector grew.

A much touted term throughout the crisis has been 'internal devaluation'. Lacking its own monetary policy, Greece would have to boost competitiveness by enduring a contraction of consumption which would reduce domestic prices for goods and services, as well as wage levels. What has occurred in Greece since 2009 is a partial internal devaluation. Prices for non-tradable goods and services have declined. Property values and rents have plummeted, and low demand has put downward pressure on the price of tradable goods- with the notable exception of energy prices, which are determined globally but were also subjected to crippling excise tax increases. Unemployment has risen, and private sector wages have fallen (or fallen into arrears along with many other private payments). In all phases of private sector activity, the internal devaluation is both evident and substantial. But that is as far as it has gone. The public sector has dumped the pain of adjustment on the private sector. By contrast, prices for publically controlled activities have risen- electricity bills, public transport costs, road tolls, and other state controlled fees. Even assessed property prices have increased as actual values have dropped, thus leading to higher property taxes.

Despite the condemnation of tax evasion, little substantive progress has been achieved. The new taxes and increased rates of taxation were imposed primarily on the existing tax base, those already disproportionately burdened, with little expansion of the base. The state has arrested citizens for non-payment of taxes, but it has not distinguished between evasion and the inability to pay due to the economic decline. As perceptions of unfairness have increased, so has the propensity to avoid paying taxes.

Structural reforms have been promised by the Government but their delivery remains to be seen. There are plans to accelerate privatization to raise revenue to pay off debt, even though valuations are depressed and receipts are certain to fall short of targets. This program is revenue focused and pays little heed to the beneficial structural reforms privatization may achieve such as removing the inefficient state from economic activity, opening markets, increasing competition, etc. Lip service is paid to improving the business climate, but little has been done to remove existing red tape and overregulation, and the continuing fluidity and unpredictability of tax policy has resulted in further deterioration.

To the contrary, the obsession with tax evasion has resulted in more burdensome rules and regulations for firms and citizens. The financial sector, a liberalization and privately led growth success story from the 1990s, has been undermined and subsequently coddled by the state. Greek banks have become wards of the central bank; thus, public sector influence over the economy has grown further, while lending activity has largely ceased and whatever limited flows there are come from official sources.

'Liposuction' occurred twice in 2012- the Private Sector Initiative (PSI) which imposed a haircut on holders of Greek bonds and the debt buyback initiative in December. While growth in public sector debt may have been checked (though it likely remains unsustainably high), real reduction of its root cause, the bloated public sector, has not yet occurred.

Nearly all job losses observed in the unemployment rate which reached 26% at end 2012 were in the private sector. The state's role in the economy is as dominant as ever, with private activity still in decline. Since no one knows what yet will transpire, uncertainty remains high and new investment virtually non-existent. The Government desperately needs to achieve economic growth, but sustainable wealth creating growth can only come from the private sector. However, having been battered by the public sector and faced with a constantly shifting domestic situation, it does not consider the Government credible.

Tax evasion remains an obsession in Greek politics, and there is a fixation with increasing revenue levels. The two are not necessarily linked, although Greek political discourse conveniently assumes the first would bring the second. They are a dangerous distraction from the excessive size and scope of the state which continues to torment Greece, perpetuating an economic depression that will reach six years in 2013, and which has resulted in a rise in poverty, unemployment and emigration levels, while domestic political discourse has become substantially more polarized.

Under the best of circumstances, with correct diagnosis and treatment, Greece would have faced a difficult adjustment process involving sustained public sector belt tightening, deregulation, liberalization, and some privatization. But by 2013, the most difficult parts would have been achieved and prospects would have been neutral, if not benign. Instead, it has wastefully pursued the wrong treatment for three years, at great cost and suffering to society at large, with negative results and even worse prospects to show.