AMERICAN ENTERPRISE INSTITUTE
for PUBLIC POLICY RESEARCH

ARTICLES & COMMENTARY

An IMF Band-Aid Won't Help Greece

Letter to the Editor

By Desmond Lachman

Financial Times
Wednesday, March 24, 2010

Resident Fellow
Desmond Lachman

Sir, Your editorial "Time to send the IMF to Athens" (March 22) frames Greece's crisis as essentially one of liquidity, in which the Greek government needs breathing space to put its public finances in order. However, a closer look at how far a number of Greece's key economic ratios have got out of line would suggest that we are dealing more with a solvency than a liquidity problem.

Greece's public debt to gross domestic product ratio is approaching 120 per cent, its budget deficit has swollen to 12.75 per cent of GDP, and it has lost around 30 percentage points of international competitiveness over the past decade. As Latvia and Ireland's recent experience with budget austerity suggests, attempting to bring Greece's budget deficit down towards the Maastricht criteria's 3 per cent of GDP limit by savage expenditure cuts and without recourse to currency devaluation could result in a cumulative contraction in Greece's GDP by 15-20 per cent over the next few years.

At the same time, attempting to correct Greece's large loss in international competitiveness within the straitjacket of eurozone membership through deflation will necessarily involve an eventual decline in Greek prices and wages of at least 20 per cent.

At the same time, attempting to correct Greece's large loss in international competitiveness within the straitjacket of eurozone membership through deflation will necessarily involve an eventual decline in Greek prices and wages of at least 20 per cent.

Were Greece's GDP to decline by 15 per cent and its price level to fall by 20 per cent, its public debt to GDP ratio would be more of the order of 175 per cent rather than its present 120 per cent. One would think that such a prospective public debt level would be more suggestive of the need for debt rescheduling and for Greece to exit the eurozone rather than for an International Monetary Fund Band-Aid that at best would only kick the Greek can down the road.

Desmond Lachman is a resident fellow at AEI.

You can find this article online at http://www.aei.org/article/101836