FINANCIAL TIMES

November 3, 2011 5:05 pm

Why I would have voted no in a Greek referendum

21

By Samuel Brittan

There is an old English saying that all work and no play makes Jack a dull boy. Whether that is true or not, it is pretty clear that all finance and no adjustment makes for a dull international economy.

Let me explain. Nearly all the action and discussion on problem countries and areas take the form of financing packages. And if such a package runs into difficulties another refinancing package is dreamed up. Moreover, nearly all the unofficial comment is on the same lines, with ever more ingenious insurance and leverage introduced. For those who like this sort of thing, this is the sort of thing they like. Meanwhile, those of us who were brought up think of international economics in terms of costs, prices and exchange rates are made to feel like dinosaurs.

What is missing from the discussion is the role of adjustment. By adjustment, I mean correcting what is fundamentally wrong in a country's international position. If a country is not paying its way internationally, it needs to sell more and/or buy less from its trading partners – or to attract more long-term physical investment from them For a country in the happy position of being outside a misconceived arrangement such as the eurozone, adjustment might be helped by devaluation. Exchange rate changes often need to be backed by domestic retrenchment. But to rely on that alone is a form of sadomasochism.

Yet that is what is being forced on the peripheral members of the eurozone, and a similar approach is promulgated elsewhere. The one form of adjustment that is made a condition of financial support is ever more severe fiscal austerity. Never mind that Greek national output is already more than 9 per cent below its 2008 level and industrial production nearly 23 per cent down. Never mind that unemployment has soared to 17 per cent. The Greeks are being told by international institutions and creditor countries to squeeze, squeeze and squeeze again. I know how I would have voted in a Greek referendum on the package, were it to have gone ahead.

A domestic reduction of costs and prices by a country in difficulties is in principle possible. In Ireland, unit labour costs in manufacturing have fallen a good 30 per cent since 2006: it has experienced an internal devaluation. But Ireland is not Greece. Nor is it Portugal or Italy. And Ireland's transformation has been achieved at enormous cost. In the past few years its economy has contracted by some 12 per cent. Unemployment has soared to nearly 15 per cent. And the return flow of Irish workers to the homeland which characterised the boom years has given way to the net emigration reminiscent of earlier, sadder years.

Financing has its place in a reasonable economic policy. The Bretton Woods agreement of 1944 provided for international financing for a country in payments difficulties. But if the difficulties proved long-lasting an exchange rate adjustment was not merely permitted, but required. John Maynard Keynes, in commending this agreement, said that never again would deflationary policies be forced on such countries. How wrong he was. Now such policies are insisted upon as the main adjustment mechanism. Yet they may even fail in their own terms, because negative economic growth will adversely affect national budgets. And if disappointments on this front are met by still more austerity, we could face a never-ending downward spiral – until the "street" takes over.

But to return to the financing packages. All the discussion is on financial engineering. No one asks whether the various loans will be a real drain on the real resources of the creditor countries – or just pieces of paper. And what will be the effects on the money supply of the various countries involved?

Let me try a homely analogy. A shopkeeper is operating at a loss. Family and friends try to help with many types of loan, some of which may even be guaranteed by the local bank manager. But the shopkeeper makes no efforts to reduce his costs or find new products which might sell better. To keep down his interest and financing costs he reduces his opening hours, which aggravates his problems. In the end he goes out of business or even commits suicide.

Analogies are always imperfect. Nations cannot commit suicide or even go out of business. And small shopkeepers cannot devalue. But there is still enough in the parallel to make the orthodox feel uneasy.

The problems discussed in this article are but one aspect of a phenomenon to which I have alluded before: the tendency of the financial tail to wag the economic dog. Winston Churchill – no less – once said he would like to see "finance less proud and industry more content". He uttered these words in 1925 in a letter to Otto Niemeyer, a senior Treasury official, just before he, as chancellor, was bounced by the then governor of the Bank of England, Montagu Norman, into returning sterling to gold at an overvalued parity. Mutatis mutandis, his words apply today.

samuel.brittan@ft.com