Joint Economic Committee
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MEMBER VIEWPOINT: SENATOR JIM DEMINT

Greek to US?:
Lessons America Must Learn from Greece to Avoid Our Own Debt Crisis

Greece is in the throes of one of the worst fiscal crises in the history of the industrialized world. Decades of profligate government spending, deficit-spending, and exorbitant taxes that were often evaded made Greece acutely vulnerable—economically, politically, and culturally—to the impacts of the global financial crisis that hit in 2008.

After several increasingly futile attempts by its Eurozone partners to prop up Greece's sinking fiscal ship, Athens may be only weeks or months away from outright default. Greece now faces a situation in which its economic policy is set more by foreign creditors than its own citizenry, undermining self-government in the nation where democracy was born.

It is tempting for Americans to take comfort in the belief that the size and strength of the U.S. economy will protect us from the consequences now facing Greece, but no nation is exempt from the basic laws of mathematics and economics. A closer inspection of the Greek crisis suggests that the United States may not be far behind on the road to ruin and we ignore the lessons of Greece at our own peril.

Greece's Path to Crisis

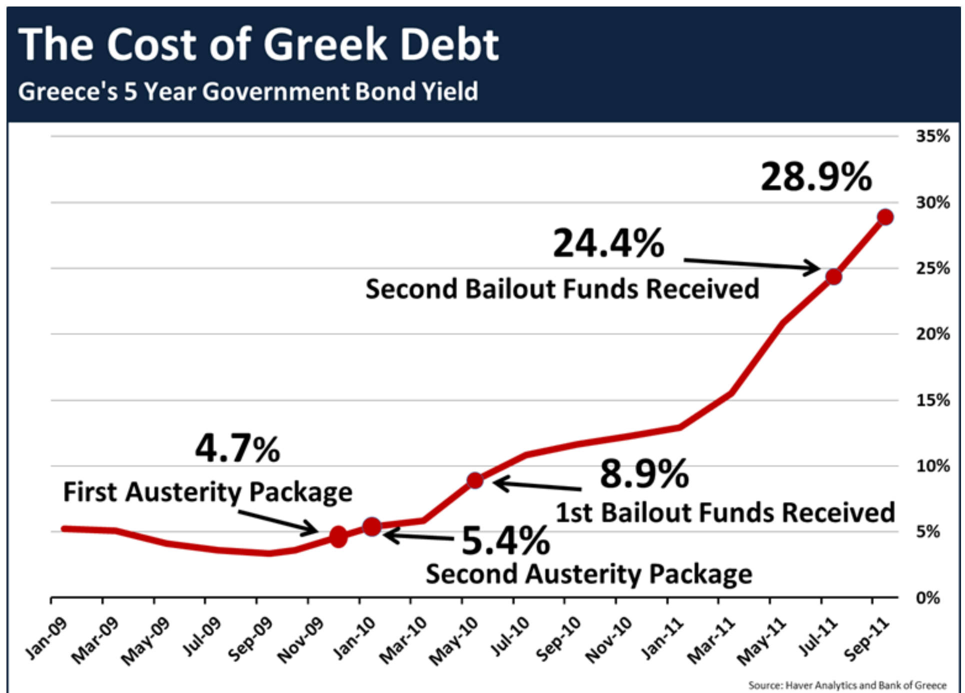
In 2001, Greece became the twelfth country to join the European Monetary Union,[1] replacing its own currency, the drachma, with the Euro. Although Greece's original application to join the Eurozone in 1999 was denied because its high level of government debt as a percent of its GDP and high inflation rate,[2] Greece gained entry by promising to implement deep cuts in government spending and to reduce inflation and interest rates to bring the drachma more in line with the Euro, as outlined in the Stability and Growth Pact.[3] By 2004, though, it was revealed that either the measures were insufficient, or the books had simply been cooked to make it look like Greece was in better shape than it was.[4] Greek debt has been a threat to the Eurozone ever since, but the problem was largely ignored during the credit-fueled economic boom that led up to the crisis.

Between 2000 and 2007, Greece's GDP grew at an average annual rate of 4.3%, compared to the Eurozone average of 3.1%.[5] This was driven primarily by increases in private consumption, as Greeks suddenly had access to more credit at lower interest rates due to their entry into the Eurozone. Over that same time, the Greek government also went on a spending spree in which government outlays increased 67% while government revenues increased only 55%.[6]

When the global financial system slammed into crisis in 2008, years of government borrowing and consumer excess led to a quick bursting of Greece's credit-fueled bubble and sparked an urgent crisis for Europe and the financial world.

Greece Hits the Debt Tipping Point

Since the crisis began, all sectors of the Greek economy have been shaken. Real GDP in Greece declined 2.3% in 2009, 4.4% in 2010, and is expected to shrink by an additional 5% this year.[7] Banks have had to write off 21% of the value of their Greek debt and to exchange it for new bonds. And the EU has suggested even greater write-offs, on the magnitude of 40%-60%, may be needed.[8] Both Standard and Poor's and Moody's have already downgraded Greek debt to "junk" status. And interest rates on the Greek five-year bond have shot up from less than 5% prior to the crisis to nearly 30% today.



The unemployment rate has doubled from 8.3% at the end of 2008 to 16.7% at the end of the second quarter of 2011. There are now fewer people employed in Greece than there were in 2002.

American Parallels

Greece became ground zero of a potential global sovereign default crisis through a series of familiar circumstances: unsustainable government spending obligations that were masked by dishonest government accounting and ignored during the false prosperity of a credit-fueled bubble. Greece was seen by investors as a solid investment because it was backed by the good name of the Euro. This enabled the Greek government to borrow at low interest rates, afforded consumers access to easy credit, and allowed government spending to soar without immediate consequence. When the bubble burst, Greece was left lacking resources to finance its government, void of leaders and institutions ready to take the bold actions necessary to tackle the fiscal crisis, stripped of much of its political independence, and with a citizenry protesting and evading the austerity measures enacted to save the Greek economy.

Greece reached its tipping point when its debt reached 137% of GDP.

Today, total United States debt has surpassed 100% of our economy. And that's just today. Social Security and, especially, Medicare and Medicaid are akin to balloon mortgages. They will grow so expensive in coming decades that the American economy simply will not be able to afford them in their current forms. The Congressional Budget Office's long-term projections model breaks down somewhere in the 2030s or 2040s because our debt levels grow so high that CBO's computers can no longer estimate economic and budget conditions with any accuracy. While 2030 or 2040 may seem a long way off, we cannot forget how quickly the debt outlook can worsen—it was just over a decade ago, in 2001, that CBO projected debt held by the public in 2011 would be less than 5% of GDP.[9] Today, the debt held by the public is 68% of GDP, or $10.2 trillion.

The long-term shortfalls facing our entitlement programs equal tens of trillions of dollars. Social Security and Medicare are already in permanent cash-flow deficit, spending more money than they collect in taxes. The Social Security trust fund is full of IOUs, not cash. And, according to Pew Research Center, 10,000 baby boomers will turn 65 each day for the next 19 years, relentlessly adding to the burden of both programs.[10]

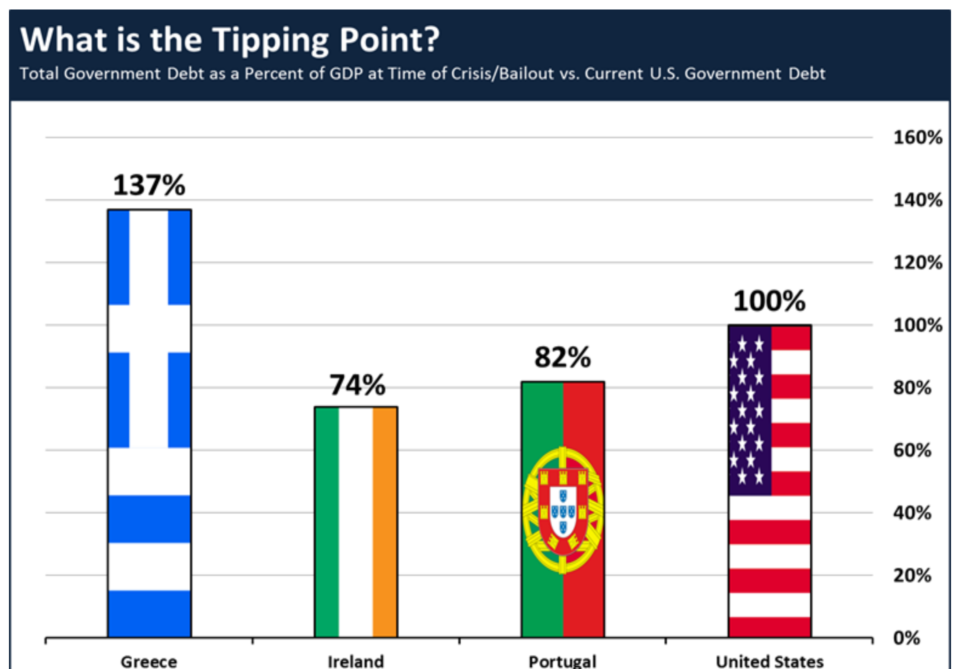
Added to the already unsustainable entitlement programs is the massive entitlement of ObamaCare. CBO projects that ObamaCare will increase federal spending by $938 billion between 2010 and 2019, and the number of people covered under Medicaid will increase by 16 million people.[11] And history tells us that even such dire projections are still probably rosy.

Like Greece, the United States government has made spending promises it mathematically cannot keep. Like Greece, our credit rating has been downgraded. Like Greece, much of our debt is held by foreign creditors, who could turn away from U.S. government debt any time they stop seeing it as a solid investment. Like Greece, the United States is now enduring historic levels of unemployment, and perhaps even worse, long-term unemployment. Like Greece, the cost of our welfare and entitlement programs are growing so quickly that, if action is not taken soon, the programs will go bankrupt. And finally, like Greece, many of our elected officials have demonstrated an appalling lack of courage and candor when faced with a universally acknowledged looming crisis.

We have obviously not traveled as far down the Road to Serfdom as Greece, but there is no question we are on that same path. The Obama Administration's economic agenda is designed to turn the U.S. into a European-style social democracy: appropriating massive Keynesian stimulus spending, promoting growth-crippling tax increases, and insisting on structural government expansion while recklessly denying the need for budget reform. We are steaming toward an economic iceberg, and the president's and Congressional Democrats' plan is to stay the course, full speed ahead.

Austerity and the 2012 Budget

Again, Greece hit its fiscal tipping point when its national debt was at 137% of its GDP. By the end of the first quarter of 2011, Greece's debt hit 160% of GDP. By comparison, Ireland encountered its crisis at 74% of GDP, and Portugal hit theirs at 82% of GDP. Every country and every crisis is unique, but with the United States' debt over 100% of GDP, there is no question we have entered the government debt "red zone."



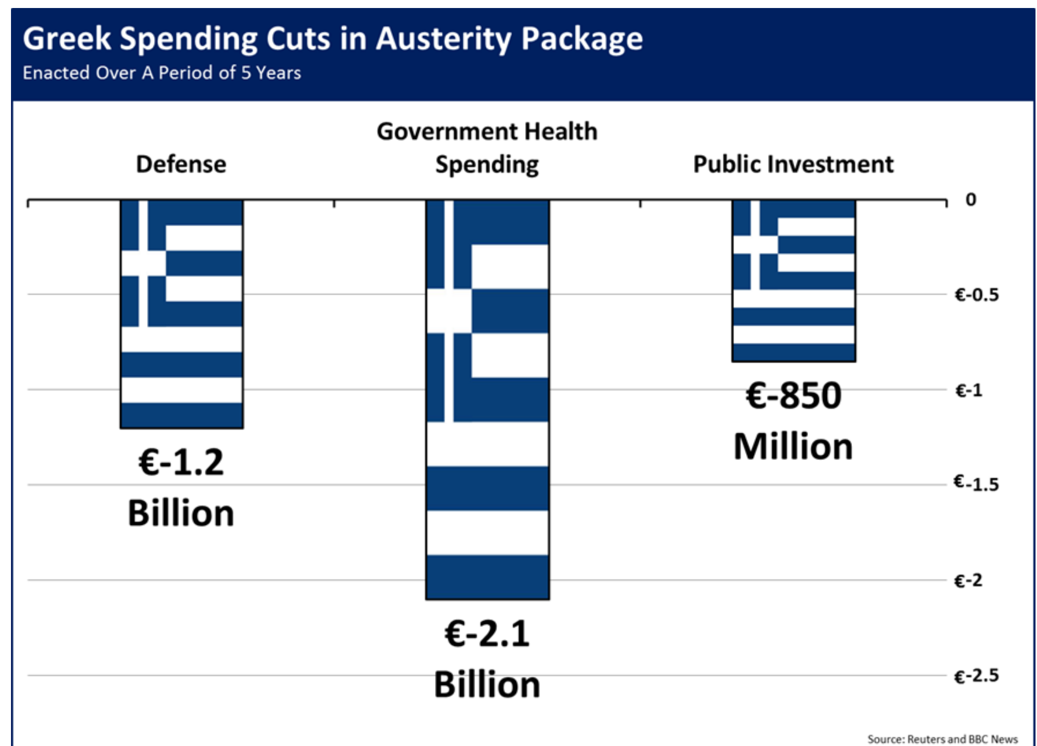
When a debt tipping point is reached, nations have no choice but to accept severe austerity measures. Like an individual or

business drowning in debt, the only road back to solvency and self-sufficiency is extremely unpleasant. As is the case with bankrupt individuals or businesses, bankrupt Greece is no longer calling its own shots.

On May 2, 2010, the Eurozone members and the International Monetary Fund agreed to a €110 billion (about $145 billion) Greek bailout package, contingent on Athens's acceptance of a pre-approved plan to cut €14.32 billion ($20.5 billion) from Greece's budget and raise €14.09 billion ($19.3 billion) in new taxes over the next five years.[12] Despite passage of the austerity measures, Greece is still struggling to meet requirements to receive the next installments of bailout loans. Due to the continued budget shortfall, the Greek government has had to resort to other measures besides those imposed in the initial austerity package, like selling off state assets, further cuts in public sector employment and pensions, and additional tax increases.

Spending Cuts

By 2016, Greek general government expenditures are expected to decrease by 12% of GDP, from 53% in 2009 to 41% of GDP in 2016.[13] Some of the spending cuts will be in the area of defense, which will be cut by about 10% over the next five years. Spending on health care will be cut by €2.1 billion (about 2% of annual health care spending),[14] and spending on Greece's equivalent of Social Security will be cut about 10%.[15] The health care cuts include reducing regulated prices for drugs as well as cuts in hospital budgets, mental health facilities, and drug rehabilitation centers. The cuts in social security will include an increase in the retirement age from 61 to 65 as well as means-testing for future eligibility (previously, the pensionable age for some groups began at 50 years of age).[16]



The Greek government also recently announced that current monthly pensions for government employees will be cut by 20% (above a €1,200 threshold), while the cut for those under age 55 will be 40% (above a €1,000 threshold).[17] In addition, public sector wages for current employees will be cut by 15% while wages for employees of state-owned enterprises will be cut 30%. And 1,976 schools will be closed or merged to reduce education costs.[18]

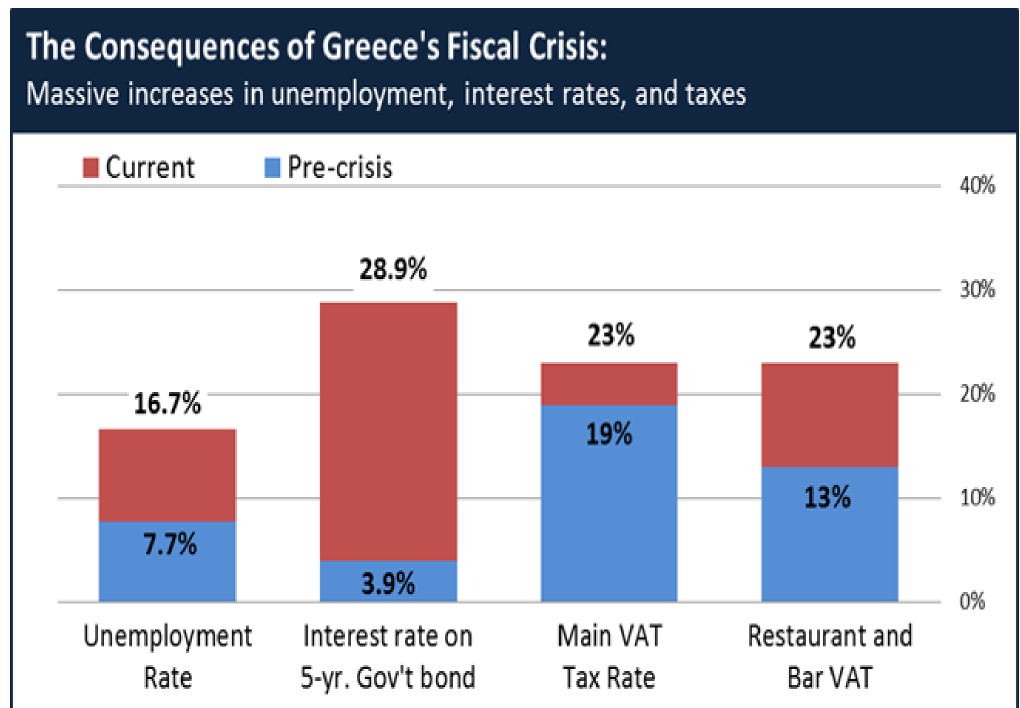
These are the types of severe cuts the United States could avoid by making prudent decisions today to reform future entitlement benefits. If the United States delays, not only will individuals under age 55 be subject to significant reforms in entitlement benefits, but cuts for individuals in and near retirement, who do not have sufficient time to plan ahead for such changes, may become unavoidable.

In addition to spending cuts, Greece is also preparing to sell off airports, highways, state-owned companies, banks, real estate and gaming licenses, and even state-owned islands to meet the ECB and IMF demands.

Tax Increases

While slashing spending, Greece will simultaneously hike taxes on an anemic economy.

Greece is already heavily taxed—a necessity given its multitude of generous social welfare programs. The current austerity plan requires total tax increases of €14.09 billion by 2015,[19] which is about a 3.1% increase in total tax collection above current IMF projections. The IMF cautioned Greece against trying to make up its deficit with new taxes, as doing so could further harm the economy, and said that the country should instead seek to reduce public spending and reform its tax collection.[20]



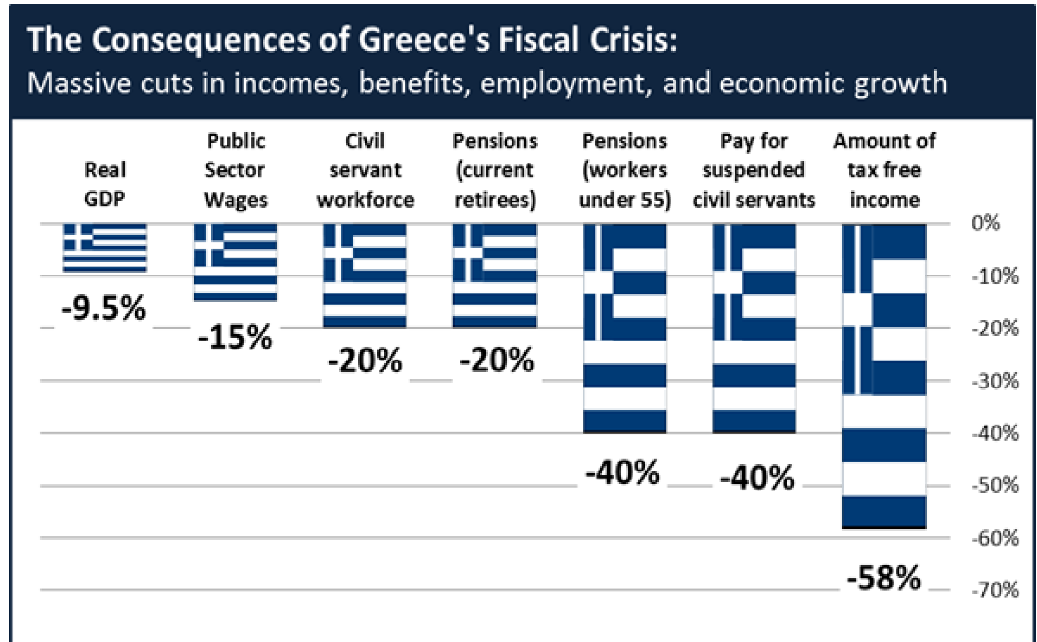
As of 2011, Greek individuals are taxed at rates ranging from 18% to 45%, with the highest rate applying to incomes over €100,000 (equivalent to $132,259).[21] On top of the individual income tax is Greece's social security tax, which totals 44% of total salaries (the employer's contribution is 28% of the salary and the employee's contribution is 16%).[22] The portion of tax-free annual income will be cut 58% from €12,000 ($16,908) to €5,000 ($6,818).[23] And yet, despite the fact that government taxes amount to upwards of 60%-80% of workers' salaries, total tax revenues in Greece have averaged less than 40% of GDP since 2000.[24] Clearly, these excessive tax rates are both depressing economic growth and causing a high level of tax evasion.

Despite already exorbitant tax rates, Greece is attempting to further increase tax rates on the few in its economy who have managed to prosper through the crisis. Greece plans to impose special levies on profitable firms, high-value properties and people with high incomes.[25] Today many Greeks say they are simply incapable of paying the new tax increases imposed by the government. As evidence of the effect of the taxes on businesses, there was a 3.8% drop in private consumption and a 4% reduction in investment spending in 2010.[26]

One of the new tax measures is a two-year, €2-3 billion homeowner's tax that will affect 5.5 million homeowners, or about 80% of Greek households.[27] The average cost of the tax is estimated to be €800 to €1,500 per family per year (about $1,045 to $2,041).[28] However, the electricity companies, who were

charged with collecting the tax, have refused to do so. A tax on housing is an interesting tax, because it is a tax on non-cash wealth that may not - and for many in the recessed Greek real estate market, *can not* be capitalized. Thus, the tax could make it unaffordable for homeowners to stay in their homes and could further worsen the troubled real estate market and broader economy.

A major source of anticipated new tax revenue in Greece is an increase in the Value-Added Tax (VAT), which is expected to raise €6 billion within three years.[29] With the third highest VAT rate in Europe, Greeks will be immediately forced to pay more for simple necessities, like fuel, clothes, automobiles and building materials, among other consumer goods. For many consumer goods – a cup of coffee at a restaurant, for instance – the new VAT rates will increase costs 10% in a year. This is the second time in a year that Greece's VAT was increased. The first increase was in March 2010, when the main VAT rate rose from 19% to 21%. The increases in the VAT rates are expected to bring in €750 million ($1.072 billion) in additional revenue over the next year, according to the Greek finance ministry.[30]



Further tax increases in Greece include the addition of new goods and services that will be subject to the VAT tax, as well as a 33% increase in excise taxes on fuel, cigarettes and alcohol. These massive tax increases and excessive rates could prove counterproductive, as they are likely to smother the one indispensable hope for future economic solvency and political independence—Greece's private sector.

Slashing of Jobs

Greek government employees—who have historically comprised a fifth of Greece's workforce—have long enjoyed significantly higher salaries than their private-sector counterparts, as well as the constitutional promise of a job for life. Wages in Greece have increased at a 5% annual rate since the adoption of the Euro, about double the average rate of the Eurozone.[31] Greek government workers also were accustomed to receiving "13th and 14th month salaries," meaning that they worked for 12 months but got paid for 13 or 14. However, many of these public employees will now be suspended on partial pay as Greece has been forced by the EU and the IMF to cut 20% from its government sector workforce by 2015. The number of civil servants who will be suspended on partial pay will rise to 30,000 (a little over 3.5% of the civil servant workforce) by the end of 2011, up from the previous level of 20,000.[32] These workers, about three-quarters of whom are at least 60 years old, will be paid 60% of their salaries for a year and thereafter will receive nothing despite the supposedly iron-clad promise of a job for life.

Cuts in public sector wages, layoffs of public workers and cuts in pensions are among the most contested parts of the austerity package. But these measures were absolutely necessary considering that public

sector wages and pensions constituted 75% of total non-interest government spending in Greece.[33] An excessive welfare state financed by deficit spending has been the driving factor in Greece's plunge off the fiscal cliff, and other countries would do well to heed the ongoing reform of Greece's overly generous welfare state.

What Would Greek-Like Austerity Measures Mean for the United States?

As the Greek experience demonstrates, when a nation hits its debt tipping point, the necessary solutions are sudden, drastic, and painful. There is no time to gradually ease-in reforms to entitlement programs or gradually tweak the budget. The IMF writes that the fiscal measures Greece has had to undergo in the first bailout, as well as the measures previously taken before the bailout, will reduce Greece's projected debt-to-GDP ratio by 16% of GDP (this does not include the additional measures Greece has had to take to receive additional bailout installments).[34]

Greece has been forced to cut €14.32 billion ($20.5 billion) from its budget over the next five years.[35] This is equal to about 1.3% of GDP or 2.8% of its estimated budget over that period.[36]

This is similar to the U.S. cutting approximately $542 billion from its budget over the next five years, or $1.2 trillion over the next ten years.[37] And this is on top of the more than $1 trillion in deficit savings enacted, but yet to be specified, in 2011's *Budget Control Act*. These projections further assume interest rates do not rise, and thereby don't crowd out other spending.

Current Social Security recipients in the United States have been upset in recent years when, despite negative or no inflation, they have not received annual cost-of-living increases in their benefits. If the U.S. were to enact similar changes as Greece to its social security program, beneficiaries would have their benefits *cut* rather than receive annual increases, and current workers about to turn 66 and become eligible to collect full Social Security benefits would instead have to wait *four* more years, until they were 70 (and future workers would have to wait until age 71), before they could collect the benefits they were promised. Furthermore, future means-testing would mean that some workers would be left with absolutely no Social Security retirement benefits despite having paid Social Security taxes throughout their lifetimes.

And if the U.S. government were to decrease its public sector wage and pension expenses like Greece, there would suddenly be nearly 100,000 furloughed government workers without jobs, and those fortunate enough to keep their government jobs would receive an average pay cut of $11,500.[38] Additionally, pensions for current government retirees would fall by about $5,000 overnight and

government workers under age 55 would receive about $10,000 per year less than they were promised and expecting.[39]

If the U.S. were to undergo the same 6.7% decline in GDP that is expected for Greece in 2011, it would amount to a nearly $1 trillion loss from 2010 to 2011, the equivalent of 19 million $50,000-a-year private sector jobs.[40] And if the unemployment rate in the U.S. were to rise to Greece's level of 16.7%, it would amount to the loss of 11 million jobs on top of the already 14 million Americans currently unemployed.[41]

In regards to tax increases, Greece was challenged to increase their tax revenues by €14.09 billion over five years, a 3.1% increase.[42] If the United States was forced to increase taxes by a similar amount, we would need to collect an additional $517 billion in taxes over five years or $1.2 trillion over ten years, and these tax increases would come on top of the already scheduled $3.7 trillion in tax increases—including those on middle-class families—which are included in current revenue projections.[43,44] A 3.1% tax increase would cause the average tax filer to owe $8,700 more in taxes over the next ten years (about $870 more per year), and the combination of a 3.1% tax increase on top of already scheduled tax increases would amount to an average tax increase of more than $35,000 per tax filer over the next ten years.[45]

What Can the United States Learn From Greece?

Greece indulged in an unsustainable welfare state that eventually consumed its entire economy. The Greek government swelled while providing extremely generous government jobs and pensions to almost a quarter of the eligible working population, while doling out other benefits to almost everyone else. When the government ran out of money, so too did the Greek citizens who had become so dependent on the welfare state. Now, Greece's private sector is being squeezed in an effort by the Greek government to salvage their economy and secure bailout funds.

The United States should learn that an unreformed government entitlement programs that promise to pay out benefits far in excess of taxes collected are simply unsustainable and pose a huge threat to economic survival. When Greece finally realized their mistakes it was too late to implement gradual reforms. Sweeping and immediate cuts have left no one in Greece untouched.

The United States Congress has been warned since 1972 that changes to Social Security were necessary in order to ensure the solvency of the program and yet the unfunded liability of Social Security is larger today than at any point since the early 1980s. And instead of trying to shore-up the even-more-severely underfunded Medicare program, Congress stole alleged "cuts" from Medicare to pay for another huge entitlement program—ObamaCare. The United States still has the opportunity to gradually implement reforms to entitlement programs that could set us on a path to long-term solvency without affecting current or near-term beneficiaries, but time is running out before more drastic and abrupt cuts will have to be made.

The abrupt nature of the Greek crisis should also serve as a lesson to the United States.

Just as Greece enjoyed years of low interest rate loans to finance their debt due to the backing of the Euro's good name, the United States is today enjoying a time of artificially low interest rates as a result of loose monetary policies from the Federal Reserve and global markets' assessment of the United States as a relative safe haven. The era of cheap borrowing for the United States will eventually end, and the longer Congress waits to enact serious fiscal reforms, the more painful that day will be.

Finally, the United States should learn from Greece that the good reputation of a strong currency will not inoculate us from irresponsible fiscal decisions. Greece was backed by the good name of the Euro for years, but nonetheless, investors eventually turned on Greek government debt. Today the Euro is facing a crisis. The fact that the U.S. dollar is today the reserve currency of the world does not make the United States immune to a fiscal crisis.

Conclusion

According to the Chairman of the Athens Chamber of Commerce and Industry, Constantine Michalos, the Greek government has it all wrong:

> *The private sector in Greece has taken the full burden of this recession ever since the government began this austerity program….What we need now is more austerity and less stimulus. And unfortunately both the government and the troika don't realize that the recipe they have been following over the last two years is incorrect—it's hitting against a brick wall, and unless we change very soon I fear the worst.*[46]

Current Greek citizens are bearing the burden of years of reckless decisions by their government. Because of the crisis, policies were changed rapidly and affected all sectors and members of society. The Greek government had little choice: they could either accept the measures imposed on them by the ECB and outside creditors, or default and face even more severe consequences.

Will American lawmakers take Greece's lessons to heart and change course now? Or will they wait and continue spending until it is too late, kicking the can all the way down the road, and then kick it off a cliff? If changes are implemented now, there is still time to implement reforms gradually and not break promises to current and near-beneficiaries of entitlement programs. If we continue to delay and sugarcoat the necessary fiscal medicine, we will lose this flexibility.

The Greek crisis developed seemingly overnight. There were warnings for years about the high risk of Greek debt, but once the crisis hit there was no time for incremental reform. The United States has had ample warning, including a recent downgrade from a major credit ratings agency and a report from the president's own debt commission. Yet, despite acknowledgement of the warnings, lawmakers have failed to act. If action is not taken soon, our country could face an abrupt, irreversible, and all-embracing crisis similar to that which is currently consuming Greece.

The mistakes that led to the collapse of Greece's economy should serve as a warning to Washington. Greece dug a hole of debt and is now reliant on the assistance of other Eurozone members as it attempts to salvage its economy. The United States—whose $15 trillion economy is almost 50 times larger than Greece's roughly $310 billion economy—might not be so lucky.[47] If the United States defaults, what country would have the resources to bail us out?

It was 230 years ago that our Founders looked to the Greeks to learn how to create a democracy; now we must do the same to learn how to save one.

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[1] The European Monetary Union was created to form policies aimed at converging the economies of members of the European Union to allow them to adopt a single currency, the euro. All member states of the European Union are expected to participate in the EMU.

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[39] Calculations are based on a retiree with 30 years of federal service and the current average federal salary of $76,374 used as the retiree's high-three average earnings years.
[40]Calculations on lost U.S. GDP are based on the most recent October 2011 Blue Chip Consensus Forecast for nominal U.S. GDP growth of 3.8% for 2011. The most recent IMF forecast is for a nominal decline in Greek GDP of 6.7% for 2011. The difference between a 3.8% nominal increase and a 6.7% nominal decline in GDP from 2010 to 2011 is $1.525 trillion. $1.525 trillion is equivalent to 30.5 million $50,000 jobs.
[41] Based on September 2011 data from the Bureau of Labor Statistics. This calculation assumes that the percent change in the number employed in the United States (which is used to calculate the unemployment rate and which is separate from the payroll employment figure used to report monthly job gains and losses) is the same as the percent change in the total number of nonfarm payroll jobs. A 16.7% unemployment rate amounts to an 8.4% decline in payroll jobs and the number employed.
[42] International Monetary Fund, World Economic Outlook, September 2011, http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/index.aspx
[43] Estimated tax increases based on: Congressional Budget Office, Budget and Economic Outlook: An Update, August 2011, http://www.cbo.gov/doc.cfm?index=12316
[44] Estimates on already scheduled tax increases based on: Congressional Budget Office, The Long-Term Budget Outlook, June 2011, extended baseline and alternative fiscal scenario revenue projections, http://www.cbo.gov/doc.cfm?index=12212
[45] Calculations based on 2009 data from the IRS showing a total of 140,494,127 tax filing units, as well as estimated tax revenues from CBO for both baseline and alternative fiscal scenarios. A 3.1% tax increase above current CBO revenue projections amounts to $1.218 trillion over 10 years. Total tax increases already scheduled amount to $3.744 trillion over 10 years (this represents the difference between CBO's current revenue projections and their alternative fiscal scenario revenue projections).
[46] Marketplace, Raising taxes in Greece could hurt businesses, but not help government, September 28, 2011 http://marketplace.publicradio.org/display/web/2011/09/28/raising-taxes-in-greece-could-hurt-businesses-but-not-help-government/?refid=0

[47] The IMF estimates Greece's GDP to be $312 billion in 2011, according to their September 2011 World Economic Outlook.