AUSTERITY AND THE HAIR-CUT OF RATIONALITY

George Koumoullis
Economist, Social Scientist

FOR DECADES, before 2013 we had been living beyond our means. In other words, we enjoyed a standard of living much higher than the standard of living of our potential. Obviously, this well-being could not last forever – it had an expiry date. In such cases, the level of the artificial standard of living always falls below the level of the standard of living of our potential for a period of time, so that the debts could be repaid. This is exactly what is now happening in the case of Cyprus.

For the economic meltdown we have only ourselves to blame. It is not the fault of the Americans, the Germans, the English, the Eskimos or the aborigines of Tasmania. The guilty are, on the one hand, the Cyprus governments which throughout the years ran the country on budget deficits and, on the other, our crooked bankers who squandered Cypriot deposits worth billions on risky Greek government bonds.

What the Cypriot bankers did in 2010 is an incredible blunder and answers should be given. They were buying Greek bonds at a time when other European banks were getting rid of them and The Economist, The Financial Times and Wall Street Journal warned of an imminent haircut of the Greek National Debt which eventually occurred in October 2011. The Cyprus banks registered a loss of 4.5 billion euros, i.e. 25% of our GDP.

Inevitably this shocking behaviour of the Cypriot bankers brings to my mind a CNN documentary film about an Englisman, named Ashley Revell, who took his life savings to Las Vegas and wagered everything on a single spin of the wheel! And when I say life savings, I mean *everything.* He sold his house, his car, favourite watch, old trophies, all of his clothes except for the ones on his back and then added every penny in his bank account to create a gambling fund of $135,000, nearly $200,000 at 2015 prices.

With not a single possession except for the clothes on his back, Ashley Revell flew to Las Vegas and bet everything on red. On the big day, Revell threw down a $135,500 wager on red in front of an audience of millions. The roulette ball began making smooth trips around the wheel and then began to slow. The orbit wobbled, the ball took a few bounces and eventually came to rest on red 7. With one spin of the roulette wheel, Ashley Revell had doubled his net worth.

Presumably, the Cypriot bankers felt jealous of Revell and tried to emulate his feat. They were buying extremely risky Greek bonds in 2010 with a huge discount expecting on the one hand to earn a high yield and on the other realise considerable capital gains when they would mature.

Unfortunately, they did not have the luck of Revell and their folly proved to be the heaviest blow to the Cyprus economy.

Consequently, the combination of a persistent budget deficit and the decapitalisation of the banking sector required’corrective measures, i.e. an austerity policy. This is a policy of necessity rather than a policy of choice. No country in the world would have opted for austerity if it was not forced to do so. In March 2013 we found ourselves at a crossroads. We had to either follow the road of the memorandum and loan agreement or the path of disorderly bankruptcy. There was no middle way.

If these were different times and we were not a member of the EU, bankruptcy would have been disorderly and not controlled. The difference between controlled bankruptcy (which we have at present) and disorderly is that, with the former, the political-business establishment which had caused it survives whereas with the latter it collapses and falls apart with tragic consequences.

If we had not been helped by the ‘hated’ troika to avert disorderly bankruptcy nothing would have been left standing in this country. Our partners might not have had altruistic motives in helping Cyprus, but their help should still be appreciated rather than castigated.

And because for our economy’s Waterloo foreigners are always to blame, our native Napoleons are constantly criticising the ECB chief Mario Draghi to whom they attribute the decision for (a) the haircut of deposits in 2013 and (b) the fire-sale of the Greek branches of the Cypriot banks to Greece. Admittedly, the second was a big mistake, but I do not think Draghi intended to favour Greeks at the expense of Cypriots. As he explained, there were tactical reasons at the time (March 2013) for the Cypriot banks to get rid of their branches in Greece. At any rate, if all the opposition parties believe that billions had been stolen from us, why do they not discard their inferiority complex and direct their fire at those who pocketed out money – Bank of Piraeus – asking at the same time for full backing for their demand from the central bank of Greece and Prime Minister Alexis Tsipras. As they believe the money had been stolen, why do they not ask for it to be returned from Tsipras himself? Unless, of course, Tsipras’s philhellenism is confined to mainland Greece.

A very hot economic issue is who came up with the idea for the haircut of bank deposits in March 2013, as if it were the sin of the century. Swimming against the tide, I firmly believe that the decision taken was the least painful, bearing in mind the prevailing conditions at the time, for three reasons.

First, the alternative solution – the government (the taxpayer, in reality) taking the responsibility for the recapitalisation of the banks – would have led to a much deeper recession. Public debt would have soared to 150%

of GDP and its sustainability would have been doubtful. Salaries, pensions and allowances would have been significantly lower than at present, so that the bigger debt could be repaid. As a result of the fall of aggregate demand, unemployment would have exceeded 25%. In countries in which the public debt has climbed above 150% of GDP, such as Greece and Argentina, the unemployment rate has exceeded 25%.

Second, it was of critical importance that the deposits haircut did not greatly affect consumption (the expenditure of households for the purchase of goods and services) and thus the national income. Consumption is not much affected by a hair-cut of the deposits of the rich. The first hair-cut proposal that was rejected by the legislature (6.75% on bank deposits above €20,000 and 9.9% on bank deposits above €100,000) would have had much more negative consequences on consumption, national income and employment.

Third, the Robin Hood effect (an economic term that refers to the reduction of inequality in the distribution of national income) was activated. As we all know, the legendary Robin Hood stole money from the rich to give to the poor. This is what most developed societies do to ensure there is some social justice – the government taxes the rich and distributes the revenue among the poor in the form of benefits and allowances.