Practical Effects of Poor Decisions

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"Experience, wrote Frederic Bastiat, teaches us effectually, but brutally. It makes us aware of the all the effects of an action, by causing us to feel them; and we cannot fail to finish by knowing that fire burns, if we have burned ourselves". The Greek drama of the last months has led me to reflect on our own experience with the crises of the seventies to the nineties and my conclusion is less benign that what I had anticipated.

We tend to congratulate ourselves on the fiscal health that the government enjoys, at least until a few years ago. After decades of poor management, excessive spending and a growing debt, the country finally achieved breaking with the piling of recurring crises and, although it has not attained high growth rates of the economy, at least there are no sudden ups and downs in the currency exchange rate or in prices, at least ones directly attributable to internal factors.

Thus, while far from being perfect, our fiscal situation is infinitely better than that of innumerable countries, beginning with many of the developed nations. In contrast with the latter, our risk of overstepping ourselves entails causing a crisis in the balance of payments and fiscal accounts, with devastating consequences for employment and stability. It is for that reason that, from 1994, the greater part of the political establishment acceded to not being able to put fiscal equilibrium at risk.

This that we learned the hard way is something that various European countries lost sight of when they entered into the European Monetary System. On being part of the euro, bucountries with weak institutions like Greece, Italy, Portugal and Spain achieved German interest rates with Mediterranean comportments. That is, they appeared to be enjoying the privilege of those who were elevating their productivity in systematic fashion, without having to work like they do. Two decades later, the costs have just become evident: the southern countries, such as Greece, have accumulated enormous debts but are trapped in the monetary system that made the lustfulness possible.

The Greek crisis has made me reflect on how it was that we achieved steering the fiscal accounts to a happy ending. The Greeks affirm that they have reduced their expenses, adjusted some salaries and improved the productivity of their economy; while that adjustment has been infinitely less grand than the similar one taken on by other European economies in distress, in absolute terms it has been ludicrous. The conclusion I've come to is that what has permitted us to procure fiscal adjustment in Mexico was the combination of two things: a group of technocrats with mental clarity about what had to be achieved (the condition sine qua non), but also a devaluation. It was the sum of these two elements that allowed for the adjustment. At least to date, none of these two is present in Greece.

Let us begin at the beginning, why is it a devaluation. What is visible about devaluation is the change in the relative value of one currency in terms of another. However, the immediate consequence is that all profits denominated in the devaluated currency depreciate, that is, salaries, pensions and fringe benefits possess, of a sudden, a new (lower) value. The Mexican devaluations from the seventies to the nineties, all caused by poor financial and fiscal management, implied an immediate adjustment of the internal costs. In this manner, while there were many difficult decisions that the authorities were required to make in budgetary matters in those years, a great part of the adjustment occurred due to the very fact of the devaluation itself, not because the government had fought with the unions, businesses or bureaucrats. The devaluation made their job easy, something impossible for Greece within the euro.

For the Mexican technocrats who had to deal with the devaluations, the problem was acting in order to avoid internal prices from increasing rapidly, assigning scarce resources for the greatest economic benefit they could supply and dealing with the debt in foreign currency that multiplied without warning.

The problem of Greece is two-fold: first, on being within the euro it has not way of depreciating the value of its liabilities in order to begin to recover; but, second, on exiting the euro, it would need a technocratic team –which the current government plainly lacks- to convert the devaluation into an opportunity. Otherwise, Greece would end up in an even worse crisis. I never imagined viewing devaluations as a salvation, but Greece requires one.

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