The Greek Crisis, Structural Reforms and EZ Convergence

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Questions on the Greek Crisis

- Why did the crisis happen?

- Have the problems been fixed?
  - What have the adjustment programmes accomplished?
  - What reforms remain to be done?

- What is the future outlook for Greece?
  - Can the remaining reforms be done?
  - What are growth prospects?
  - What should be done with the public debt?
  - Does the Euro benefit Greece?

And Some Answers

- Why did the crisis happen?

  Long-term domestic problems, exacerbated by flaws in EZ architecture.

- Have the problems been fixed?
  - What have the adjustment programmes accomplished?

    Elimination of twin deficits and some significant reforms.
  - What reforms remain to be done?

    Significant reforms in taxation, pensions, product markets, public sector (justice, education, etc).

- What is the future outlook for Greece?
  - Can the remaining reforms be done?

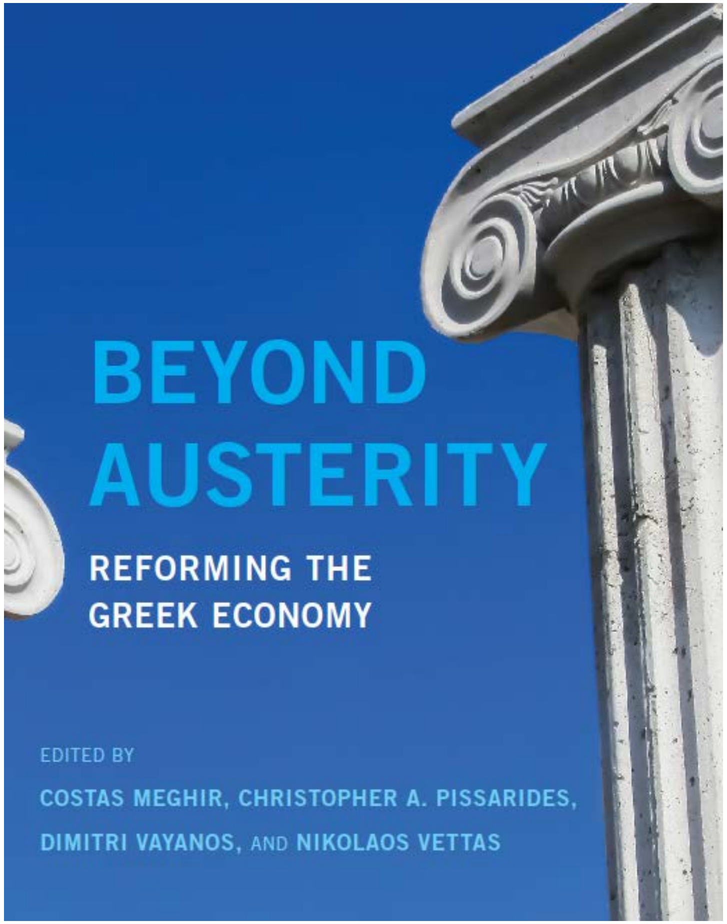
    Possibly, as governments can no longer generate growth by borrowing.
  - What are growth prospects?

    High, if reforms continue.
  - What should be done with the debt?

    Gradual reduction, conditional on reform milestones.
  - Does the Euro benefit Greece?

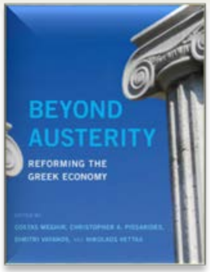
    Yes, discipline to reform, provided EZ architecture is set right.

Our Book



- "Beyond Austerity: Reforming the Greek Economy", MIT Press.
  - https://mitpress.mit.edu/books/beyond-austerity
- Economic institutions and resulting incentives, across wide range of areas.
  - Pre-crisis situation.
  - Changes during crisis.
  - Policy proposals going forward.
- Collective effort of Greek economists in Greece and diaspora.
- Grateful to LSE's Hellenic Observatory for funding the research (data collection and processing, etc) reported in the book.
- Greek edition: «Πέρα από τη Λιτότητα: Για μια Νέα Δυναμική στην Ελληνική Οικονομία», Πανεπιστημιακές Εκδόσεις Κρήτης.

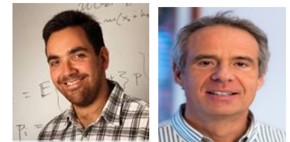
Beyond Austerity: Reforming the Greek Economy



1. The Greek Economy

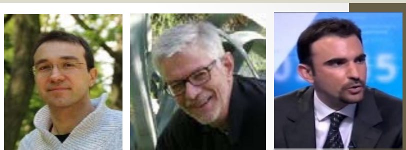
C. Meghir, C. Pissarides, D. Vayanos, N. Vettas

2. Greece and the Euro



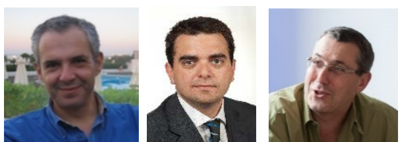
G. M. Angeletos, H. Dellas

3. Trade Balance



C. Arkolakis, A. Doxiadis, M. Galenianos

4. Product Markets



Y. Katsoulacos, C. Genakos, G. Houpis

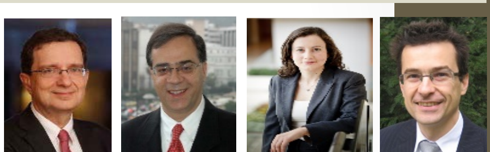
5. Privatizations

V. Skreta

6. Labor Market

A. Lyberaki, K. Meghir, D. Nicolitsas

7. Financial System

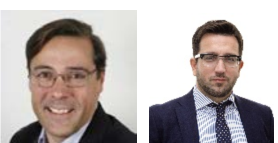


M. Haliassos, G. Hardouvelis, M. Tsoutsoura, D. Vayanos

8. Education

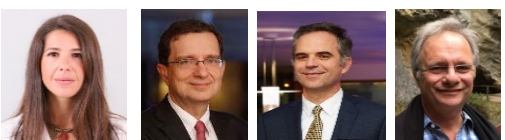
N. Vettas

9. Healthcare



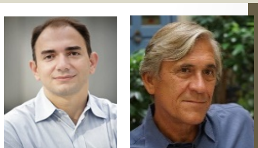
P. Kanavos, K. Souliotis

10. Taxation



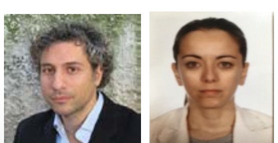
M. Flevotomou, M. Haliassos, C. Kotsogiannis, C. Meghir

11. Pensions



S. Panageas, P. Tinios

12. Justice System



E. Papaioannou, S. Karatza

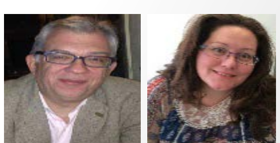
13. Corruption

C. Azariadis, Y. Ioannides

14. Public Administration I

M. Jacobides

15. Public Administration II



P. Karkatsoulis, E. Stefopoulou

Why Did the Crisis Happen?

Key Points

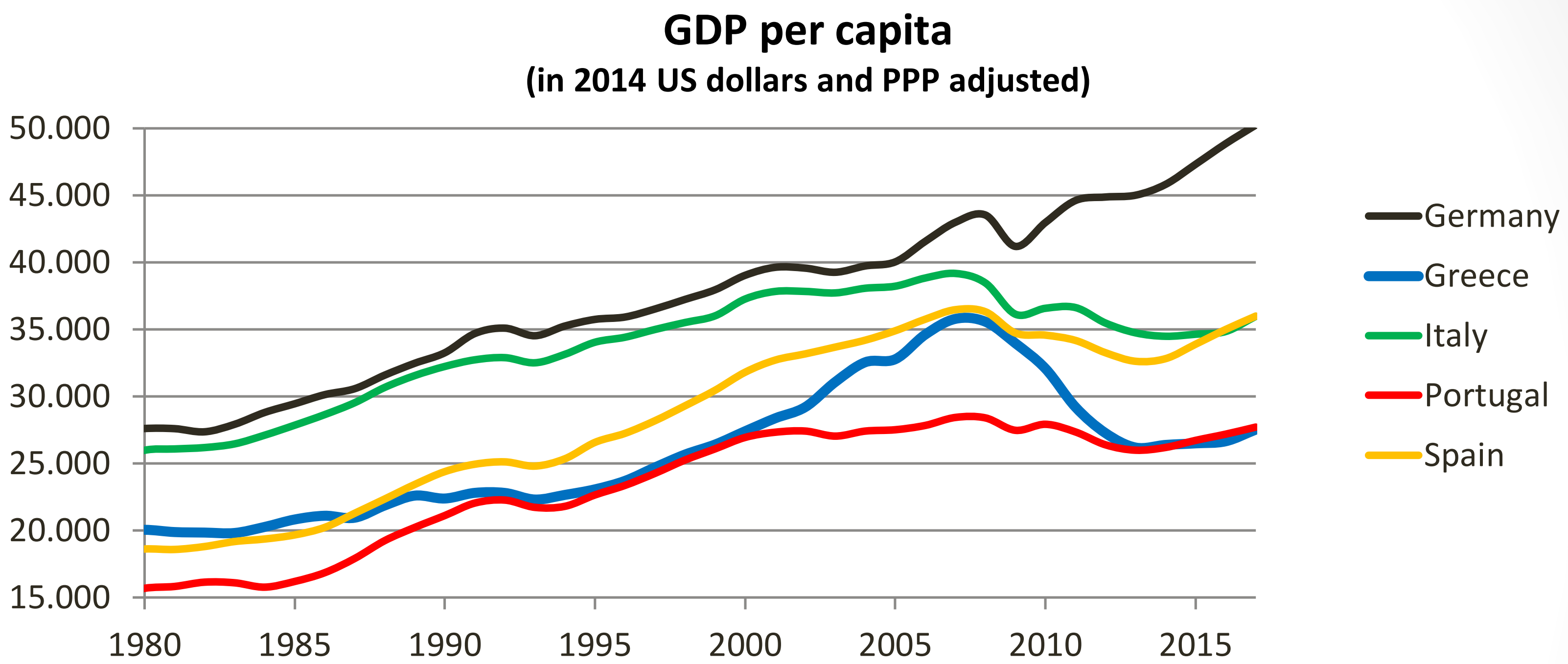
- Crisis partly due to long-term domestic problems, as evidenced by:
  - Low long-term growth.
  - Low corporate investment and FDI.

- Crisis exacerbated by flows in EZ architecture that facilitated excessive borrowing and current account deficits.
  - No framework for sovereign default within EZ.
  - Weak bank-regulation framework.

- Greece was “canary in the mine” – weaker and first to fall.
  - High current account deficit (as Portugal and Spain).
  - High government debt (as Italy) and deficit.

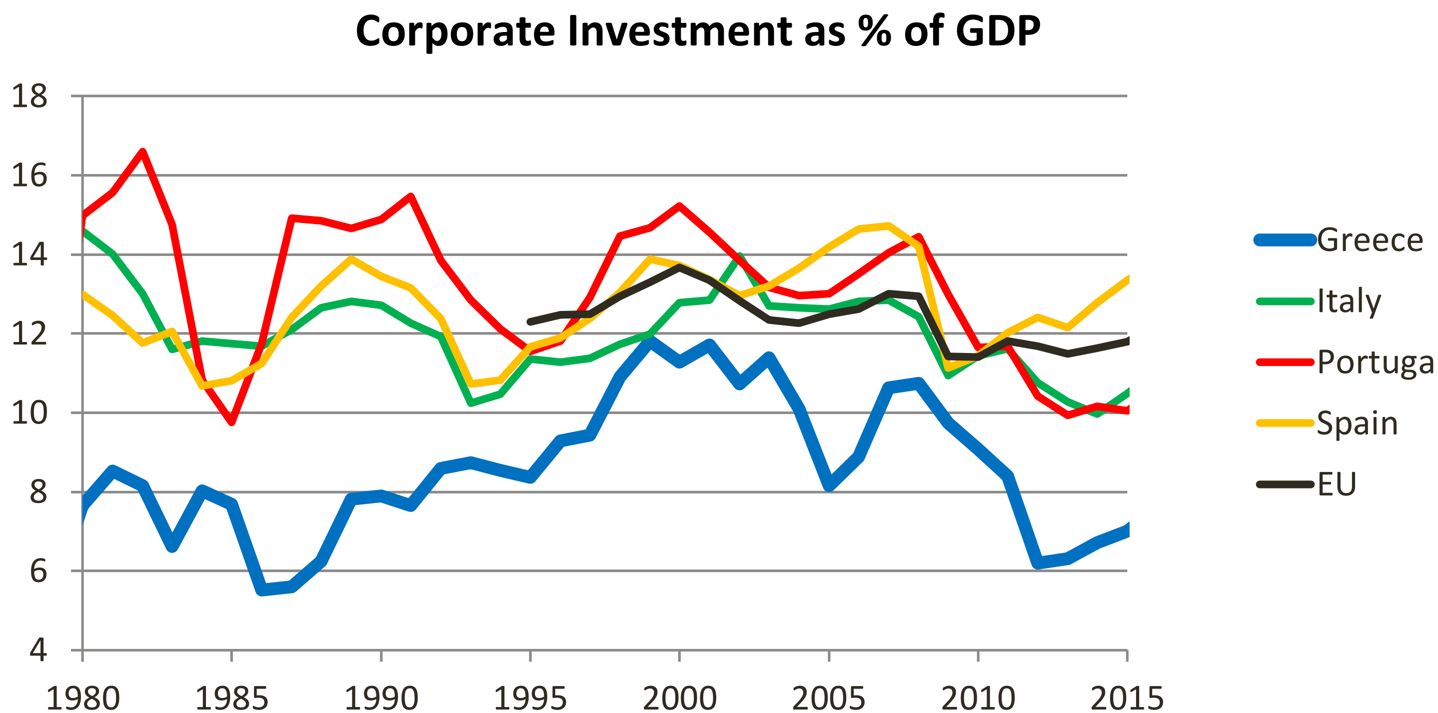
- Euro entry had some positive outcomes for Greece.
  - Increase of productive (corporate) investment.

GDP



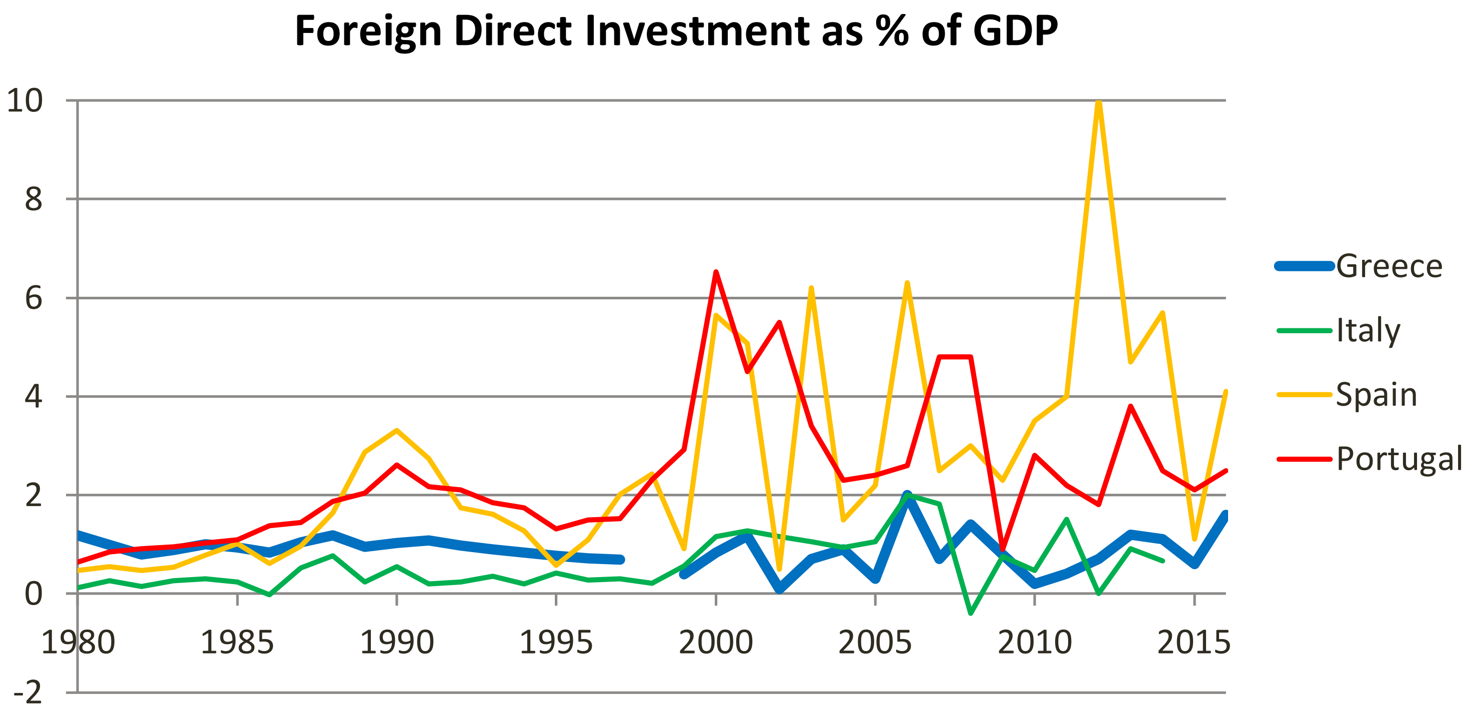
- Greece experienced a large growth and subsequent decline of GDP after Euro entry.
- Its growth over the long term (1980-2017) has been relatively small.
  - Similar to Italy.
  - Similar before and after Euro entry.

Corporate Investment



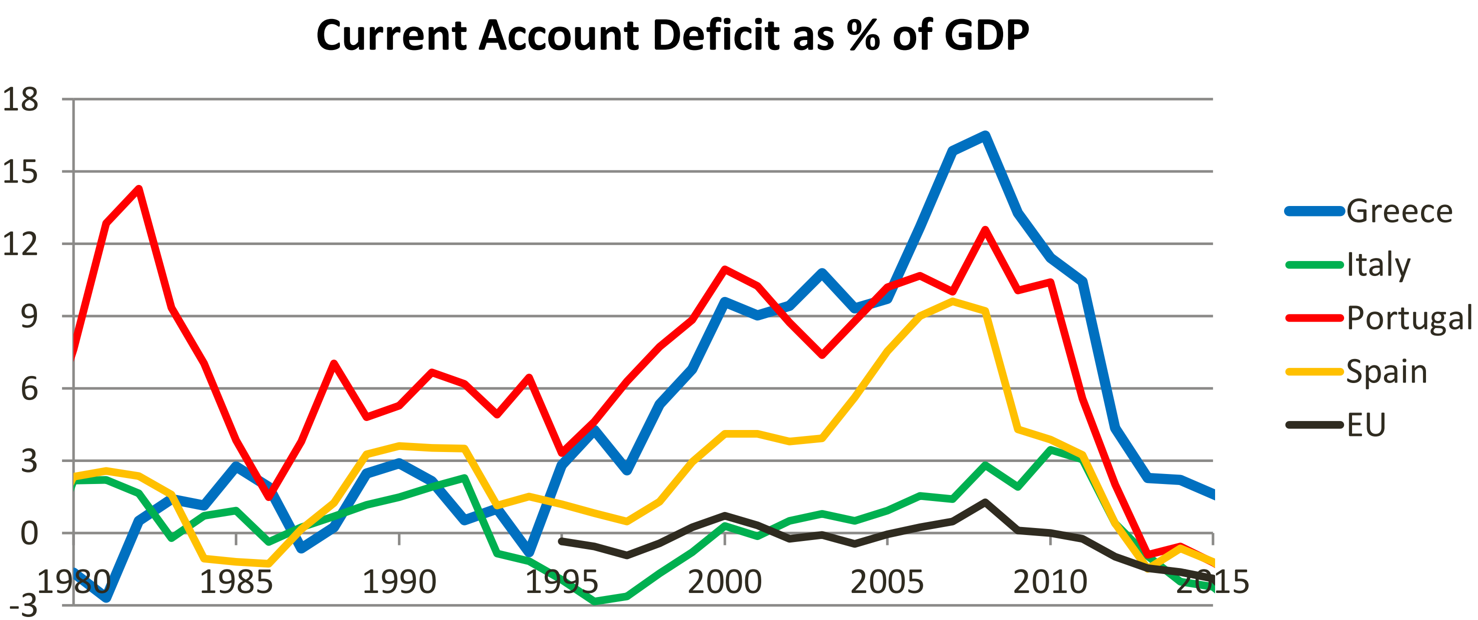
- Corporate investment in Greece has been relatively low.
    - But total investment (incl. housing) is comparable to EU average!
- It rose significantly in the run-up to Euro entry, but dropped again during the crisis.

Foreign Direct Investment



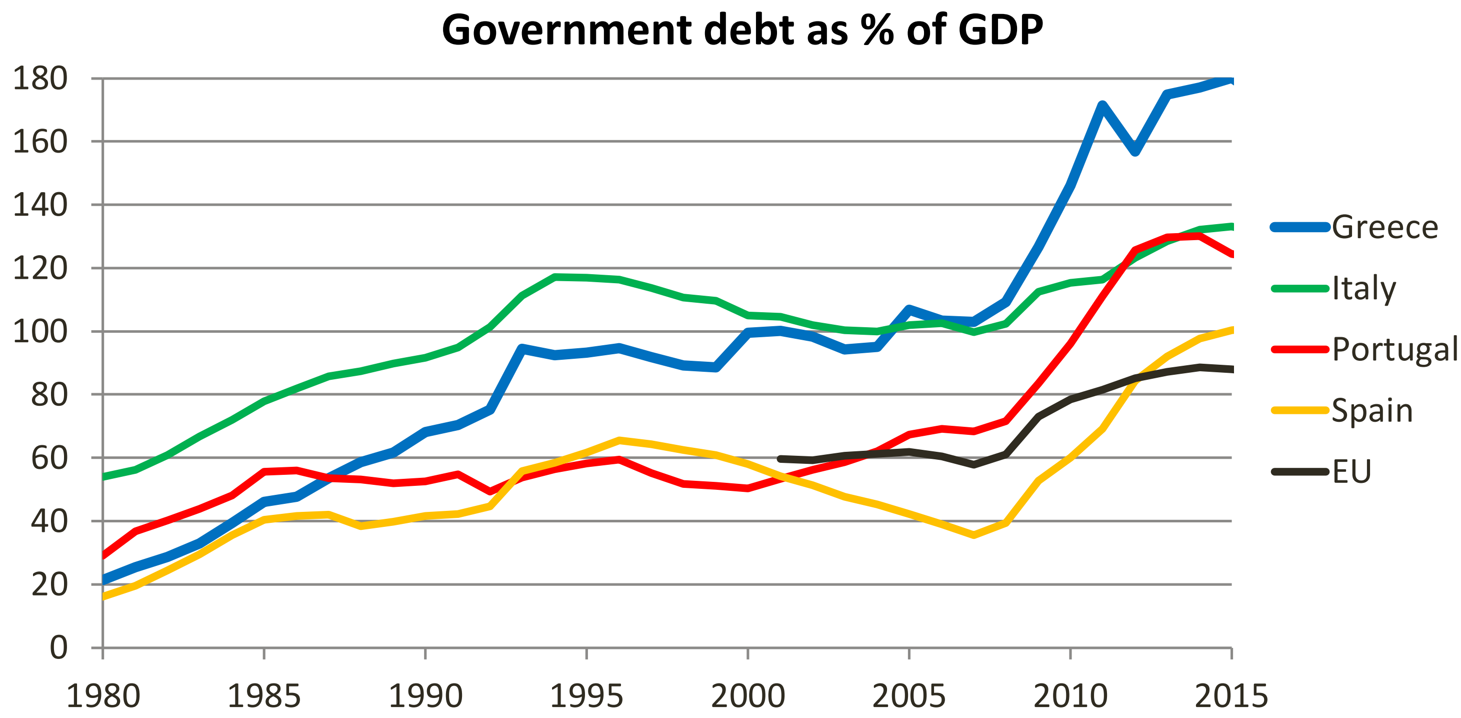
- FDI in Greece has been low.
  - Similar to Italy.
  - Even during the boom years after Euro entry.
- Indicative of broader problems with business environment.

Current Account Deficit



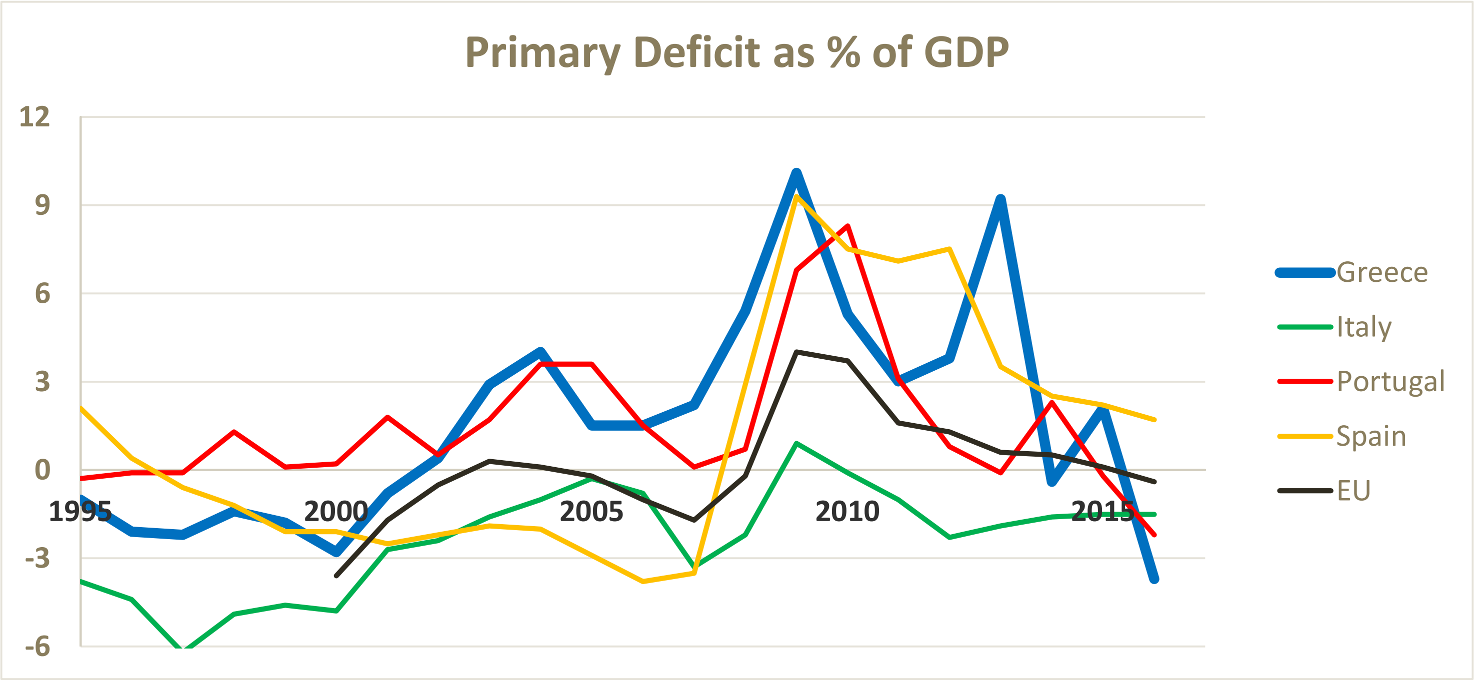
- Current account deficit rose significantly in the run-up to and after Euro entry.
  - Similar to Portugal and Spain.
  - Rise in investment, consumption, and GDP.

Government Debt



- Debt to GDP grew sharply in the 1980s.
  - Similar to Italy.
- Debt remained a large percent of GDP until the crisis, despite the rapid growth in GDP.

Government Deficit



- Primary surpluses during mid-1990s turned to deficits.
  - Unlike in Italy.

Have the Problems Been Fixed?

Twin Deficits

- Twin deficits pre-crisis:
  - Large current account deficit.
  - Large government deficit.

- Both deficits were reduced drastically from 2010 onward.
  - Current account almost balanced by 2014.
  - Government is now running primary surpluses.

Structural Reforms – Key Improvements

- Labor market.
  - Significant deregulation of a formerly over-regulated labor market.
- Pensions.
  - Unification of a highly fragmented pension system.
  - Viability achieved through significant pension cuts.
- Product markets.
  - Significant deregulation and reduction of barriers to entry.
- Tax administration.
  - Establishment of independent tax collection authority.
  - Fully electronic filing.

Labor Market

- Over-regulated before the crisis.
  - EPL in 2008 fifth-highest in OECD.
  - High % of long-term unemployed and of self-employed.
  - Low reallocation rate (hirings and firings).
- Key changes in regulation.
  - Severance pay has been halved, to five months of salary.
  - Collective dismissals no longer require ministerial approval.
  - Firm-level agreements have become possible, and effectively replaced collective agreements.
- EPL in Greece is now at OECD average.

Pensions

- Costly, inefficient and fragmented system before the crisis.
  - Pension expenditure in 2007 second-highest in EU (12% of GDP), and projected to double by 2060.
  - Yet, high old-age poverty.
  - Rules mapping contributions to pensions differed across professional groups.

- Key changes:
  - Single pension calculation for all.
    - Minimum pension (384 Euros).
    - Pension proportional to number of working years.
  - Single retirement age at 67.
  - ➔ Drastic cuts to some existing pensions.

Product Markets

- Over-regulated before the crisis.
  - PMR in 2008 second-highest in OECD.
- Reduction in barriers to entry and competition in a number of key sectors.
  - Implementation of "OECD tool-kit".
- PMR improved significantly.
  - Fourth-highest in OECD in 2013.
  - Dropped from 2.21 to 1.74. OECD average dropped from 1.59 to 1.47.

Tax Administration

- Tax administration before the crisis was inefficient and prone to political meddling and corruption
  - Tax collection agency was within Ministry of Finance.
  - Tax filing involved personal contact with inspectors.

- Key changes.
  - Independent tax collection agency.
  - Fully electronic tax filing.
  - Efficient system of random audits.
  - Data on wealth collected and analysed, in addition to income.

Looking forward

- Economy has been stabilized; but more progress is needed for a sustainable growth path to be attainable.
- Economy does not generate new fiscal deficits; but current mix of tax revenue and expenditure neither contributes to growth nor serves social protection.
- Trade deficit has been fixed; but exports growth is weak and uneven.
- Public debt has been stabilized; but level of public and private debt hinders growth and access to finance remains problematic.

Key conditions

- Uncertainty keeps investment out: not only it depresses growth directly, but it also weakens incentives and effectiveness related to structural reforms.
- Shift to a new growth model, with investment and exports representing a larger part of the economy.
- Diminish burden of State on economy: allow dynamic part of the economy to grow faster.

Structural reforms

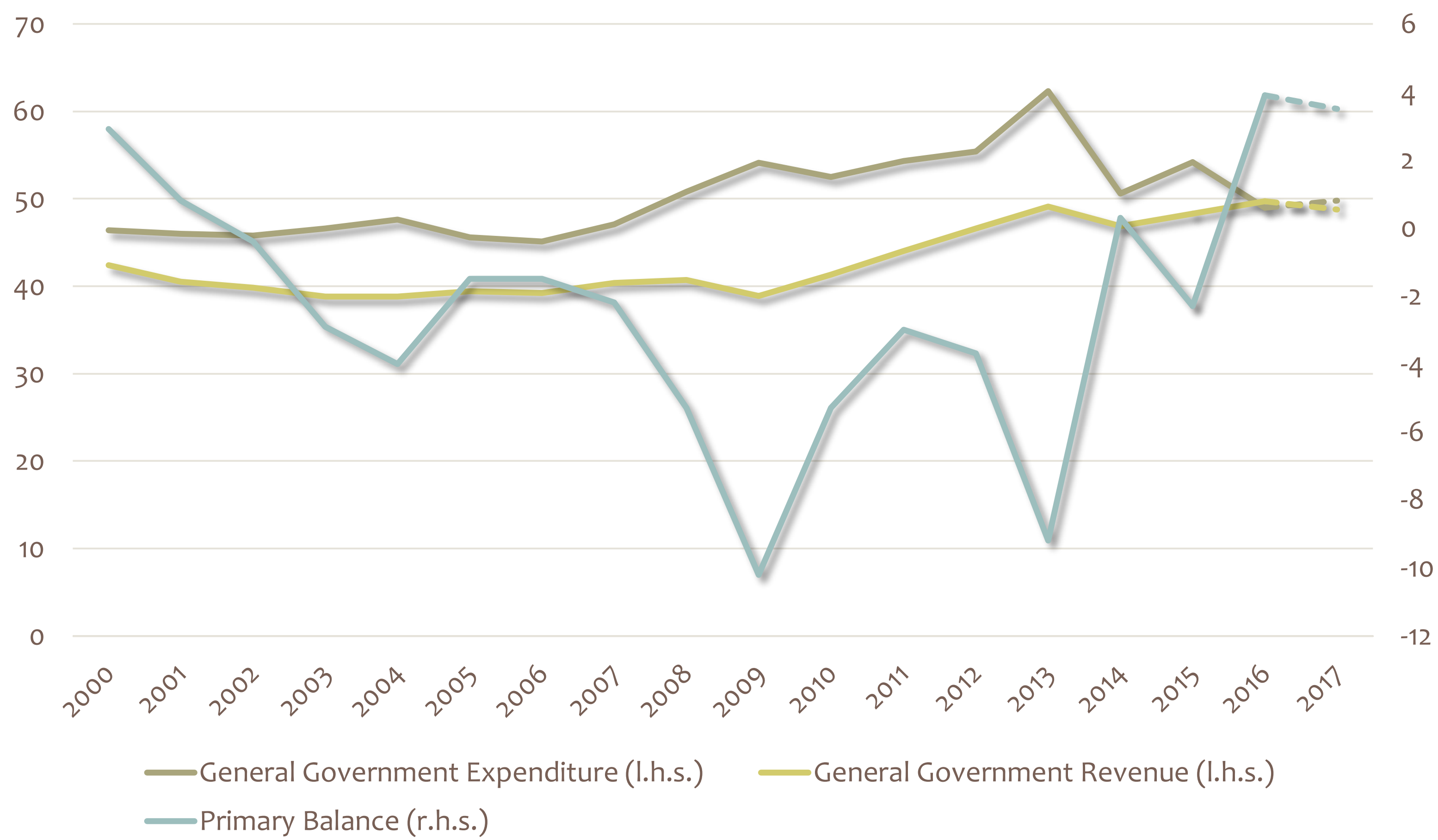
In three (interrelated) areas where progress remains to be made:

- Taxation, pensions, welfare system, privatizations (immediate priority)
- Product markets, public administration, non performing loans (essential)
- Education, justice, health care (continuous effort, but starting today)

Use of funds by the State

- Simplifying and redesigning the tax system. Diminish burden of income tax, rationalize real estate tax.
- Improving welfare programs. Supporting individuals in a deregulated economy.
- Current pensions system hinders growth, acting manly as a tax. Shift to a three-pillar system with built-in incentives.
- Privitizations remain an opportunity to bring in new capital and management methods; key is to increase competition.
-

Government Expenditure, Spending, Primary Balance (% GDP)

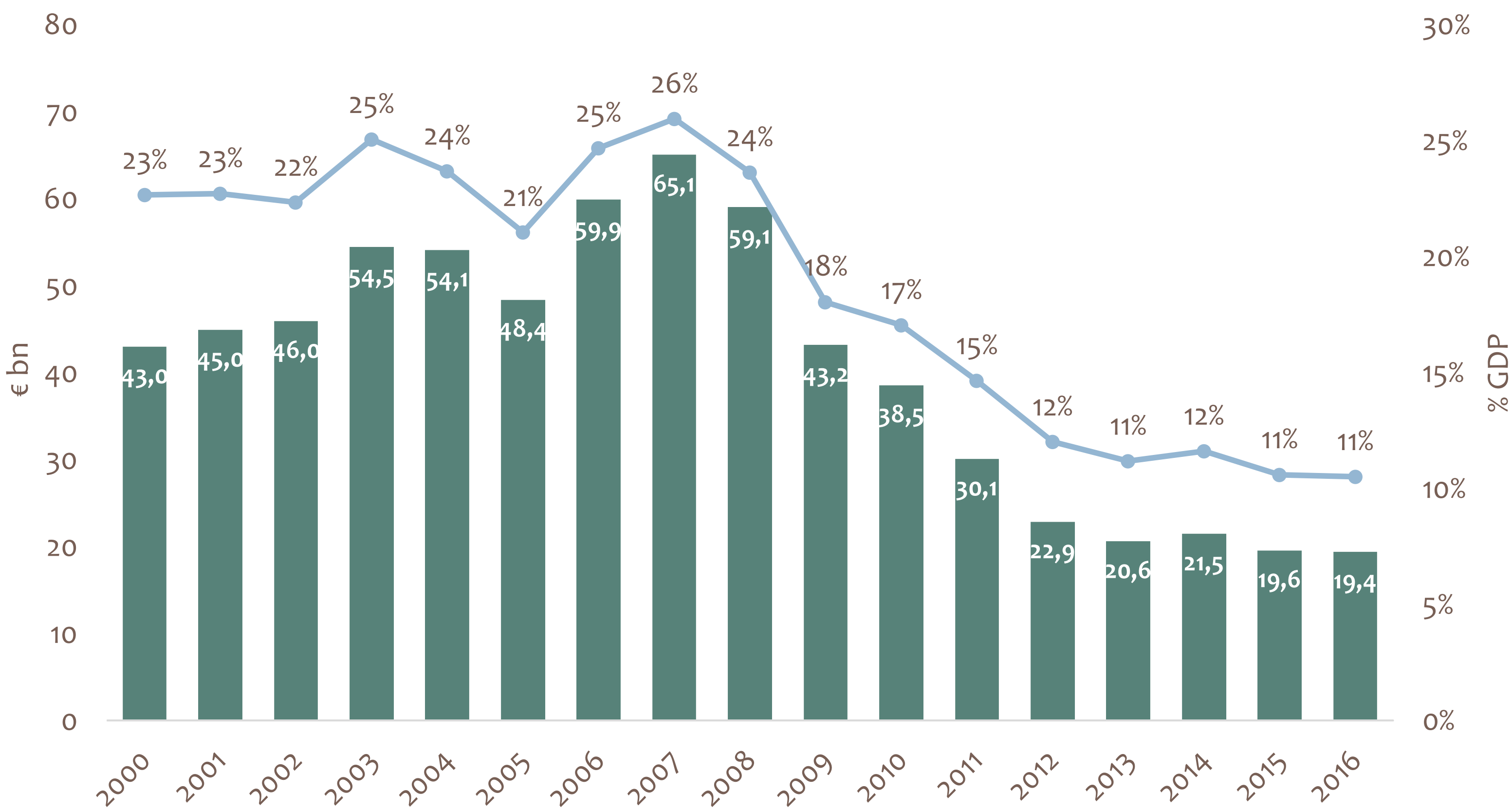


Sources: Eurostat/European Economic Forecast, winter 2017, European Commission

Business environment

- Continuous effort in decreasing (legislated and non-legislated) entry and growth barriers in product markets. Increase intensity of competition.
- Public sector salaries and employment have been significantly decreased, but (a lot) more needs to be done in terms of increasing efficiency and decreasing burden on private activity. Expand use of digital technologies.
- Decrease burden of tax system on business activity.
- Diminishing uncertainty is key for attracting new money (in particular, long term investment) and new investors. NPLs is an opportunity, as much as a challenge.

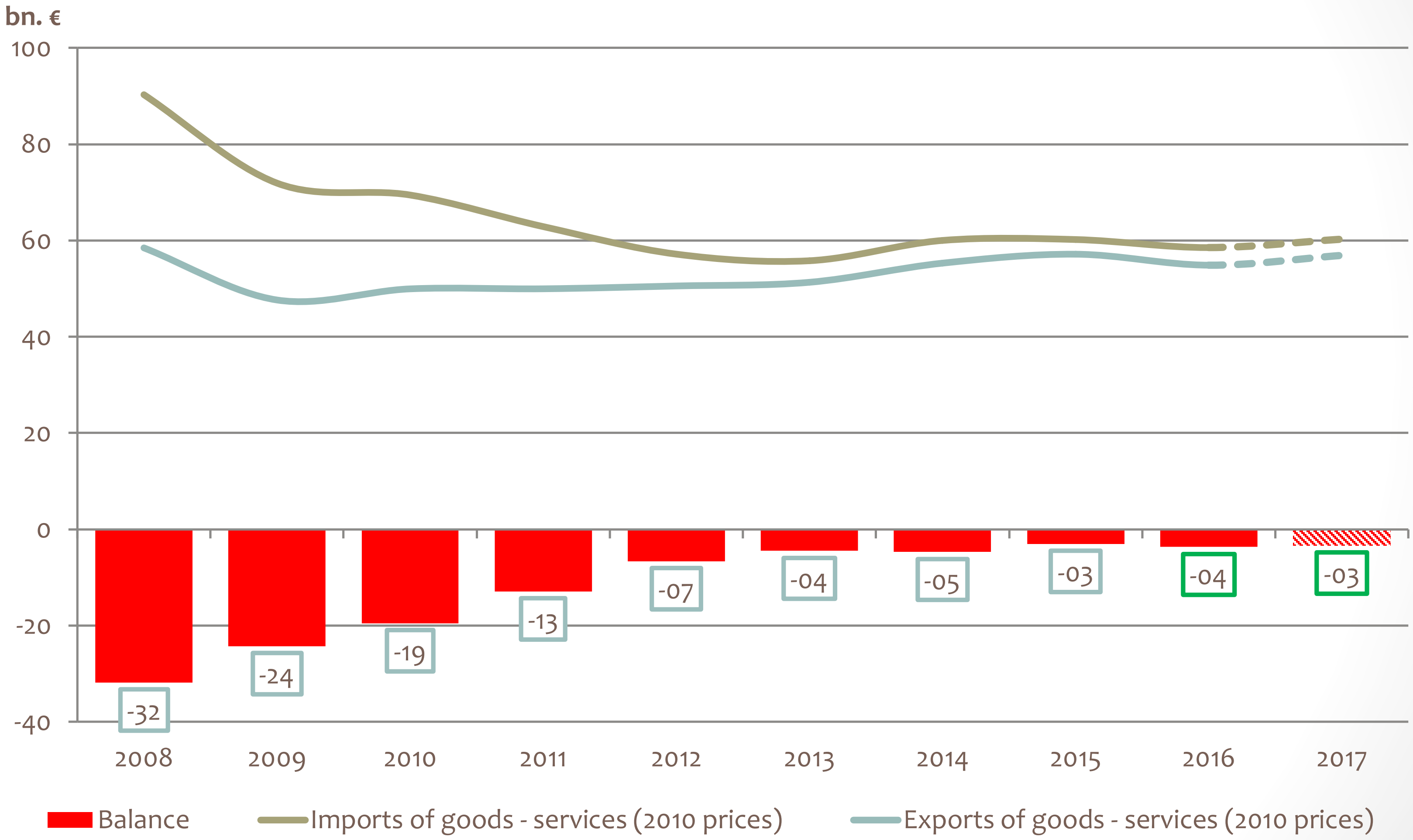
Investment collapses



Sources: Eurostat/ELSTAT

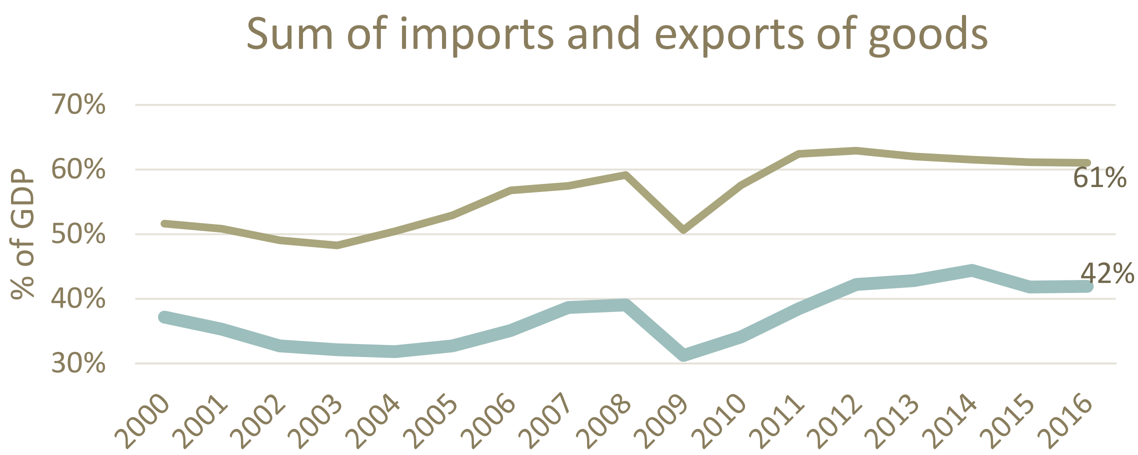
- Highest investment level in 2007 (€65.1 bn)
  - Highest level of investment as a % of GDP in the same year (25.9%)
- Significantly lower investment in 2016 (€19.4 bn, 10.5% of GDP)

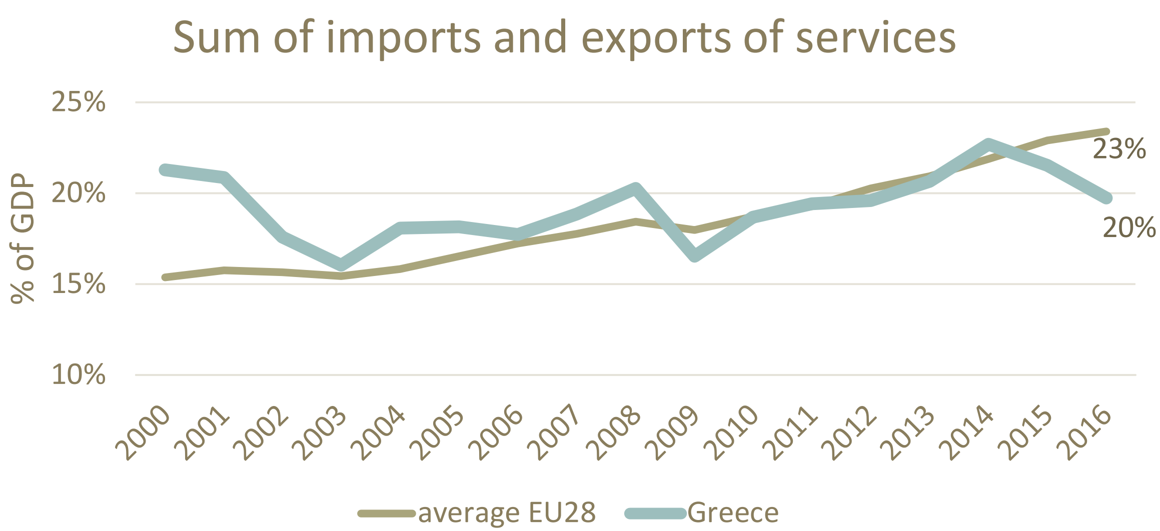
Trade Balance (goods – services)



Source: AMECO

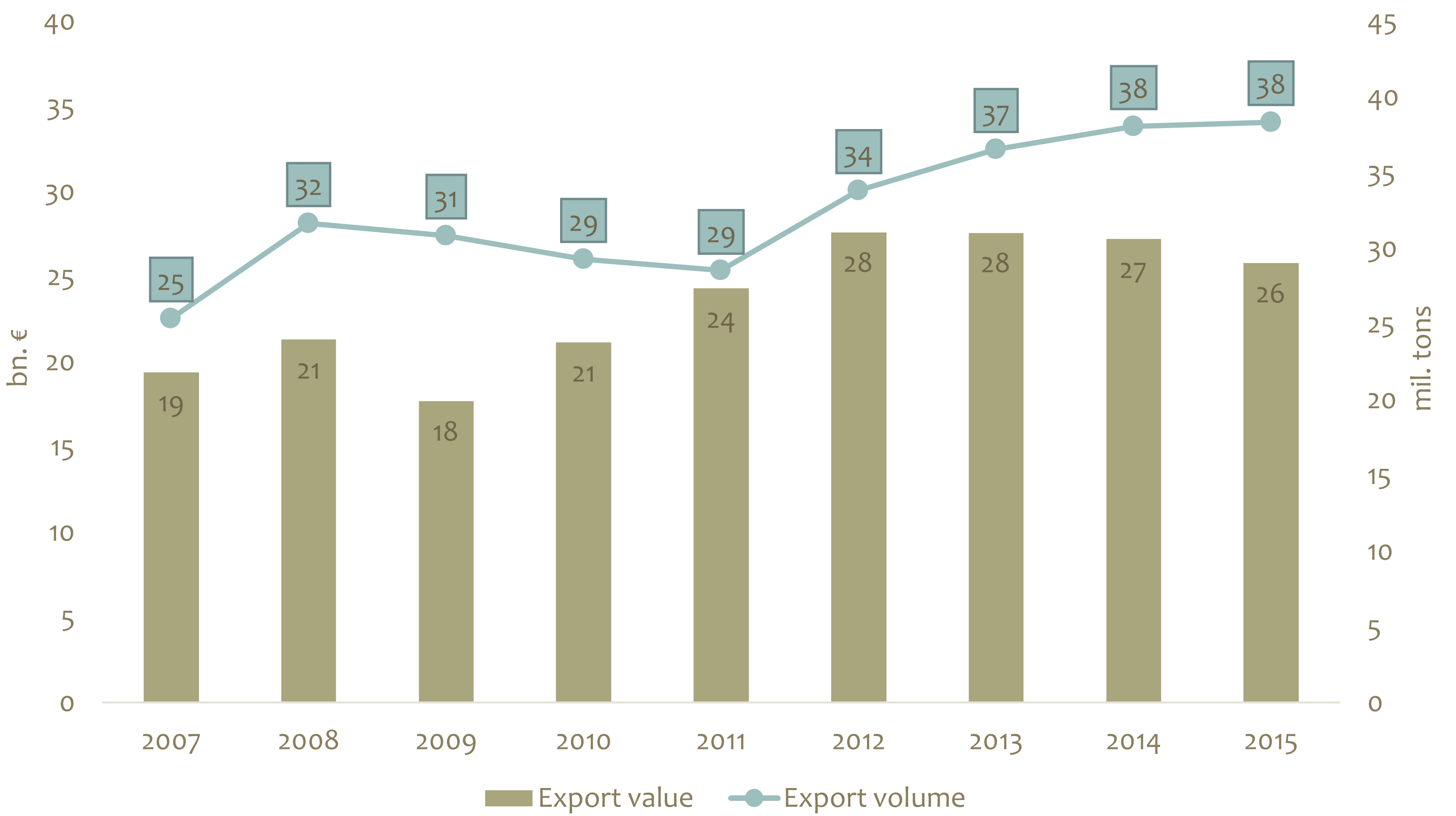
Openness





Source: Eurostat

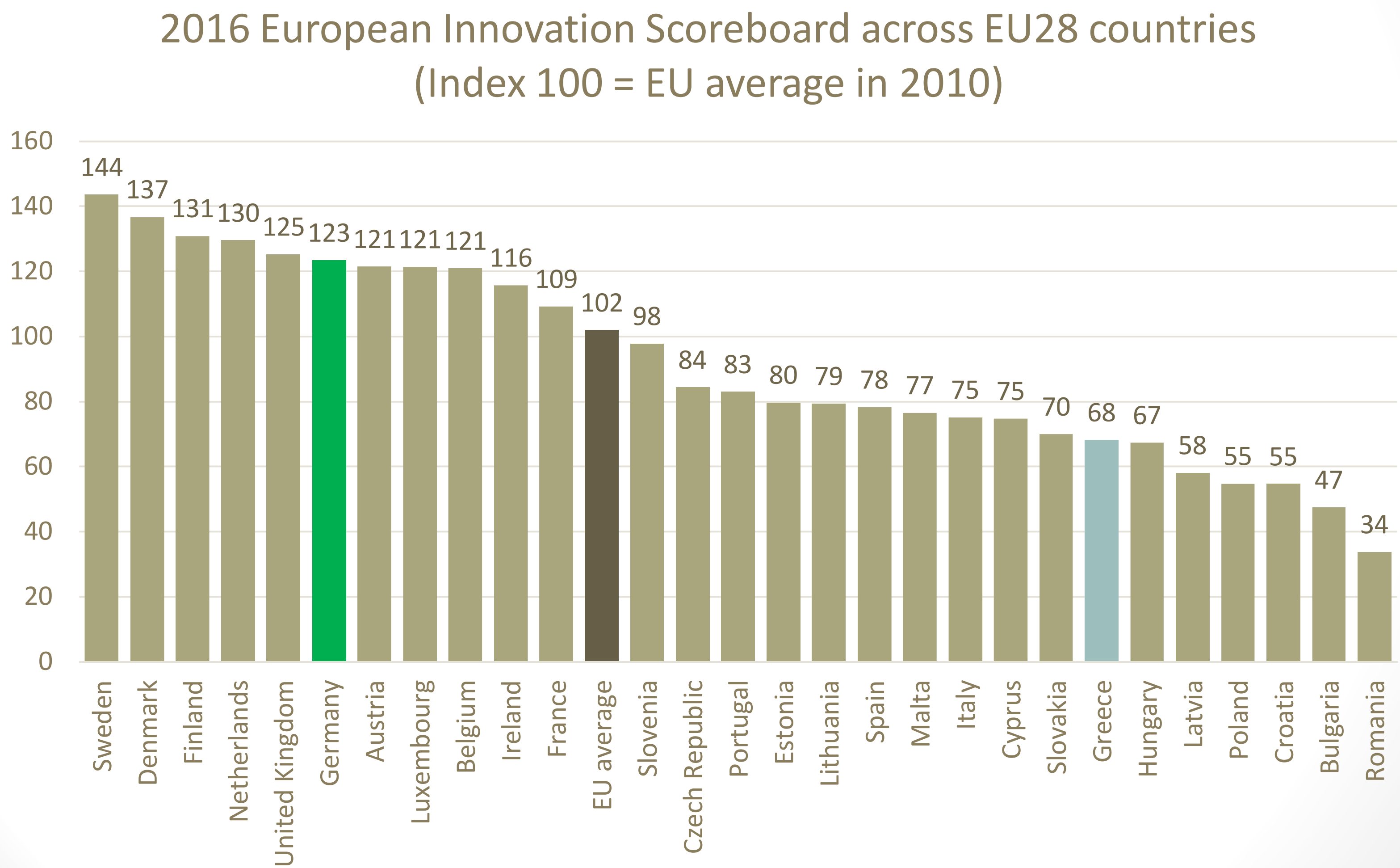
Exports of goods



Source: Eurostat

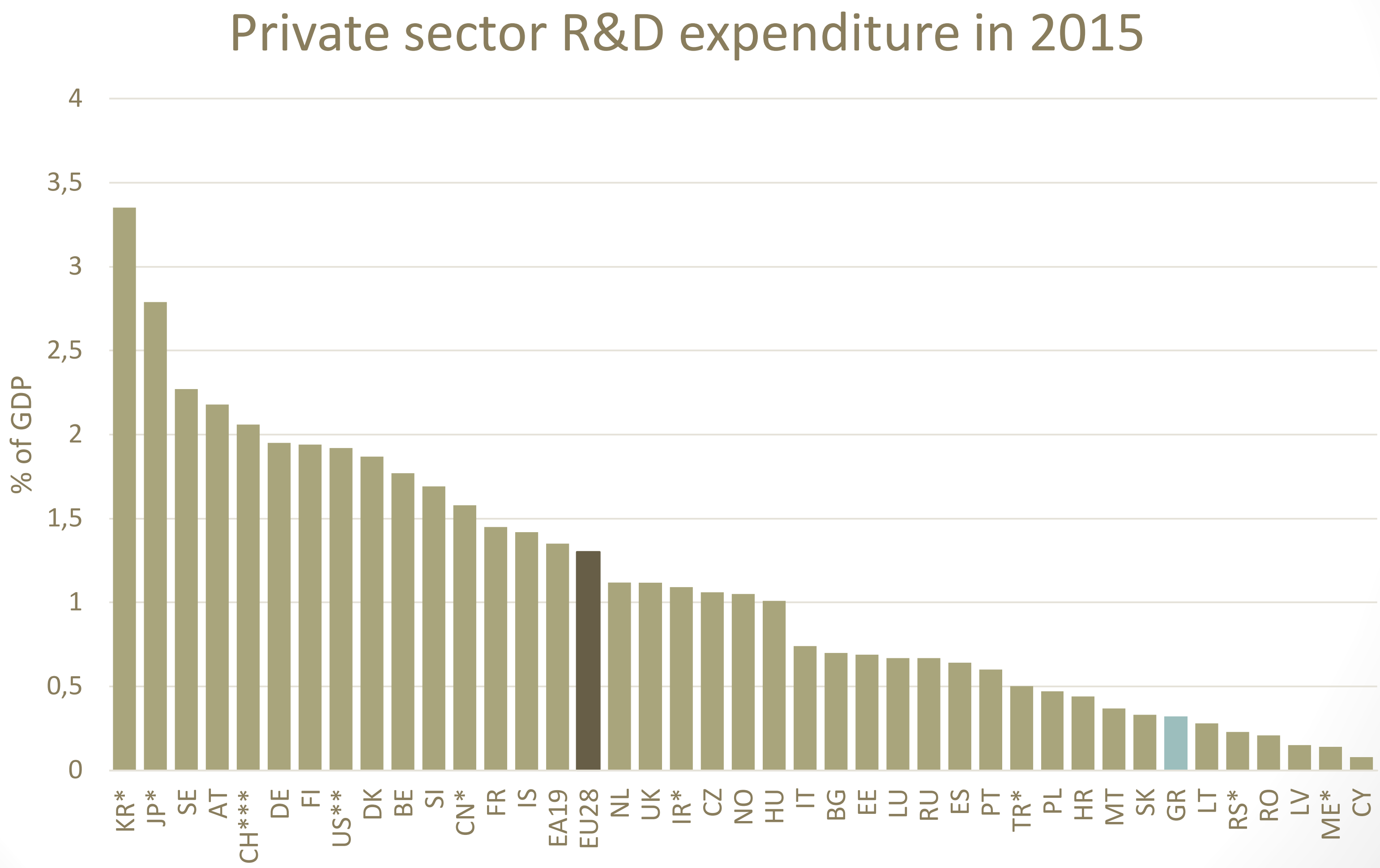
- Change in the value of exports, 2007-2015: +33%
- Change in the volume of exports, 2007-2015: +51%

Innovation



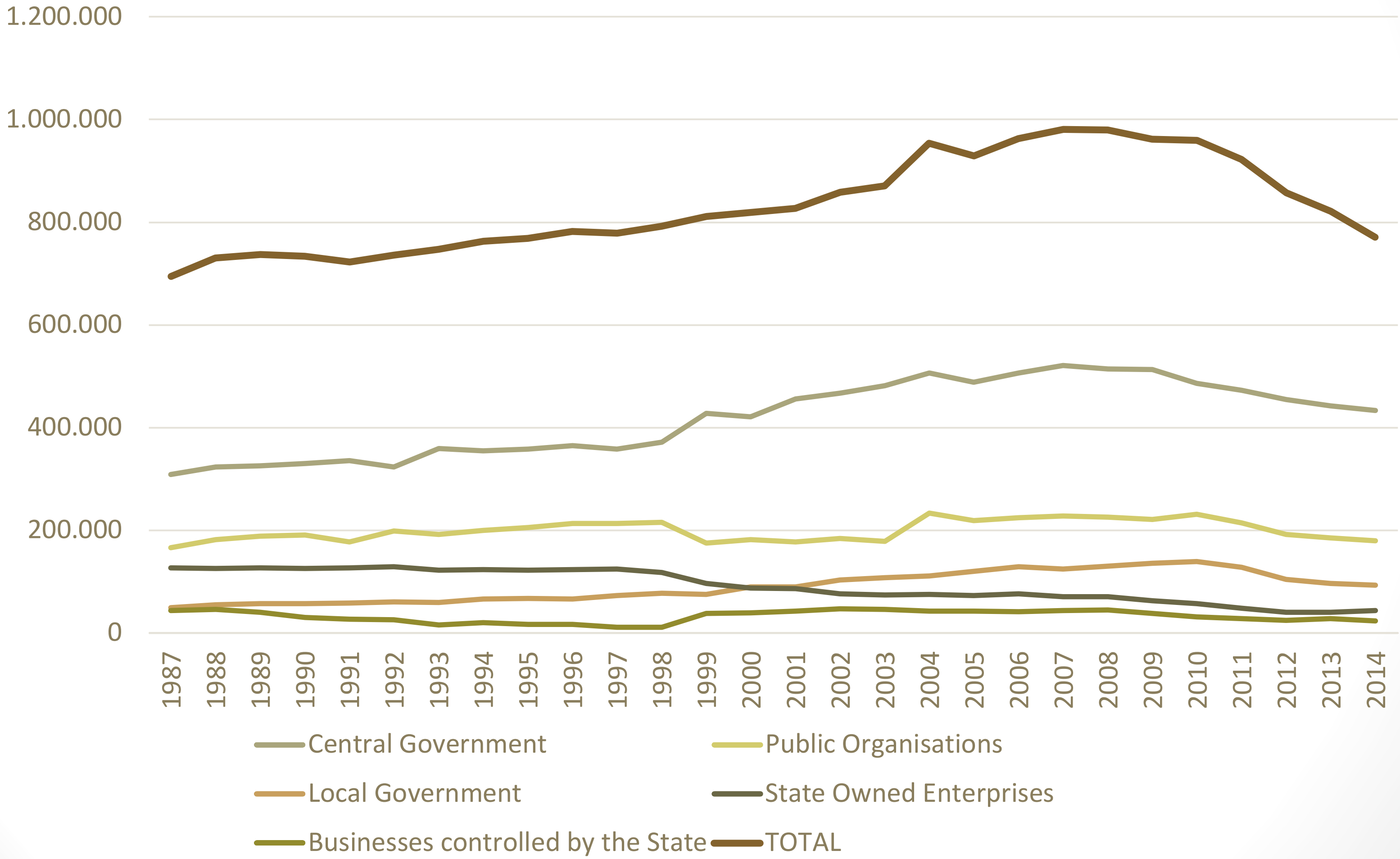
Source: European Commission

R&D Expenditure



Source: Eurostat, IOBE estimates *2014 **2013 ***2012

Employees in the public sector

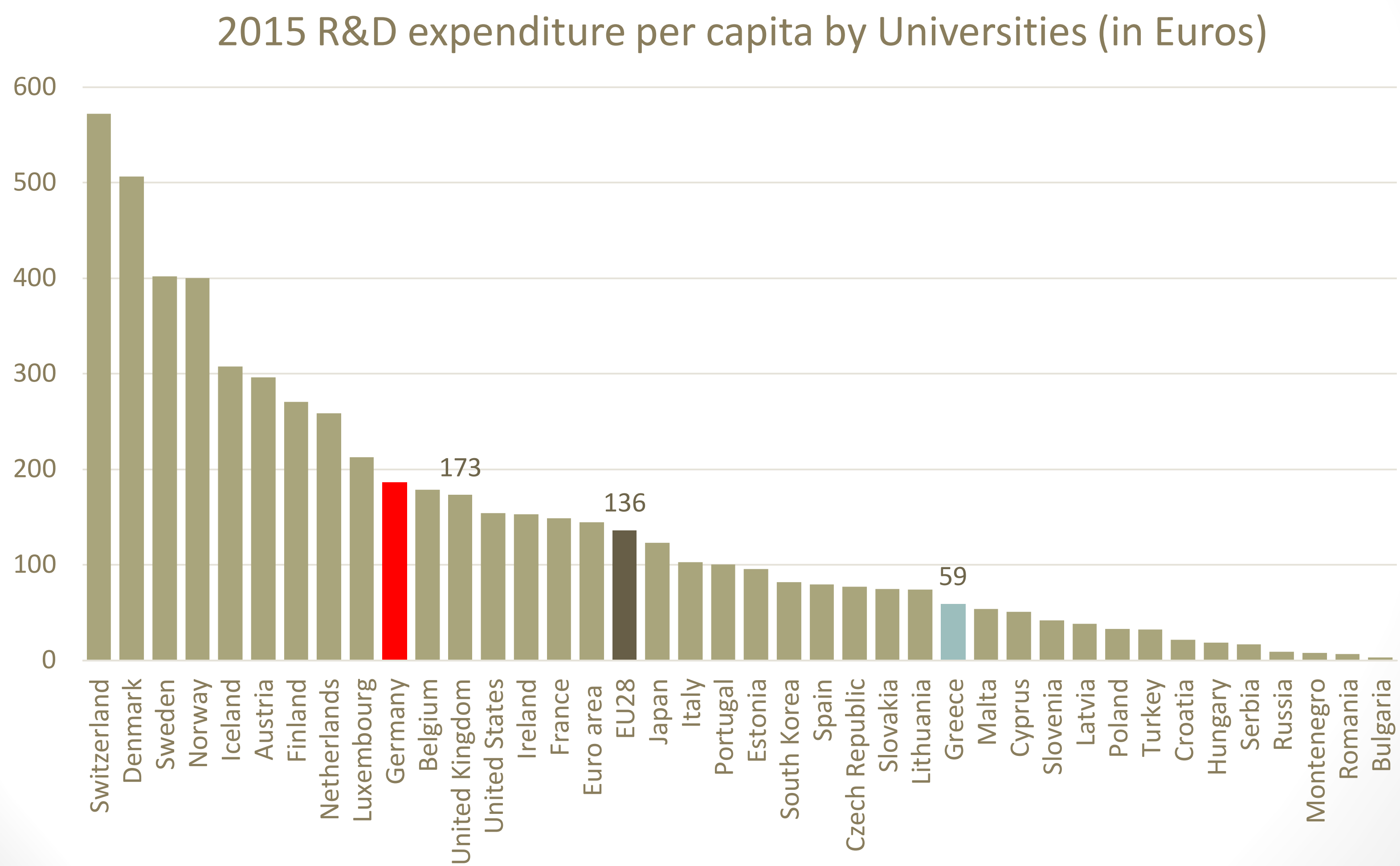


Source: ELSTAT, apografi.org.gr

Foundations for growth

- Education system: governance needs modernization, too heavy control by state.
- Health care: significant reduction of public expenditure but structure should provide incentives.
- Fine-tuning the level of autonomy of units from central control.
- Health care and education also provide important opportunities for investment and growth with Greece becoming a local hub.
- Justice: remains slow and efforts to speed up need to be intensified.

Universities R&D per Capita



Source: Eurostat

Growth prospects

- Economy has been stabilized ('twin deficits fixed'). Structural reforms have been implemented in important areas.
- However, productive sectors and business units remain under high pressure.
- Burden on households is also high and increasing (on all, but especially the weaker, at the poverty line),
- Growth prospects are high, but only as long as reform efforts continue.
- Reduction of uncertainty is essential to facilitate investment inflow and management of public and private debt.

Overall perspective

- Adjustment programs have operated as an implicit contract between Greece and its debtors: managing old debt versus fixing structure and eliminate deficits.
- Incentives: sticks and (any) carrots? Investment?
- Current level of public debt is high - a credible mechanism is needed that will (a) prevent debt from generating excessive tax burden and (b) provide systematic incentives for reform.
- The Greek economy is recovering, however this should not be misinterpreted as the start of a high growth path, without appropriate responses in economic policy.
- Greece has significant unrealized potential. Transformation to an open economy, with shift towards tradables, and strong institutions can be obtained within the EZ.