The Fiscal Adjustment Program of Greece: Success or Failure?

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CONTENTS

I. METHODOLOGICAL ISSUES (1)

1. Programs are based on forecasts.
2. The program parameters are often subject to renegotiation.
3. Not all policy decisions taken by a country result from the assistance program.
4. Program success is contingent on implementation by national authorities.
5. Program outcomes are affected by spillovers from other countries.

I. METHODOLOGICAL ISSUES (2)

- Not an assessment based on the fulfillment of the targets set.

- Focus on specific topics of European relevance.

- Starting with the picture of Greece before and after the crisis.

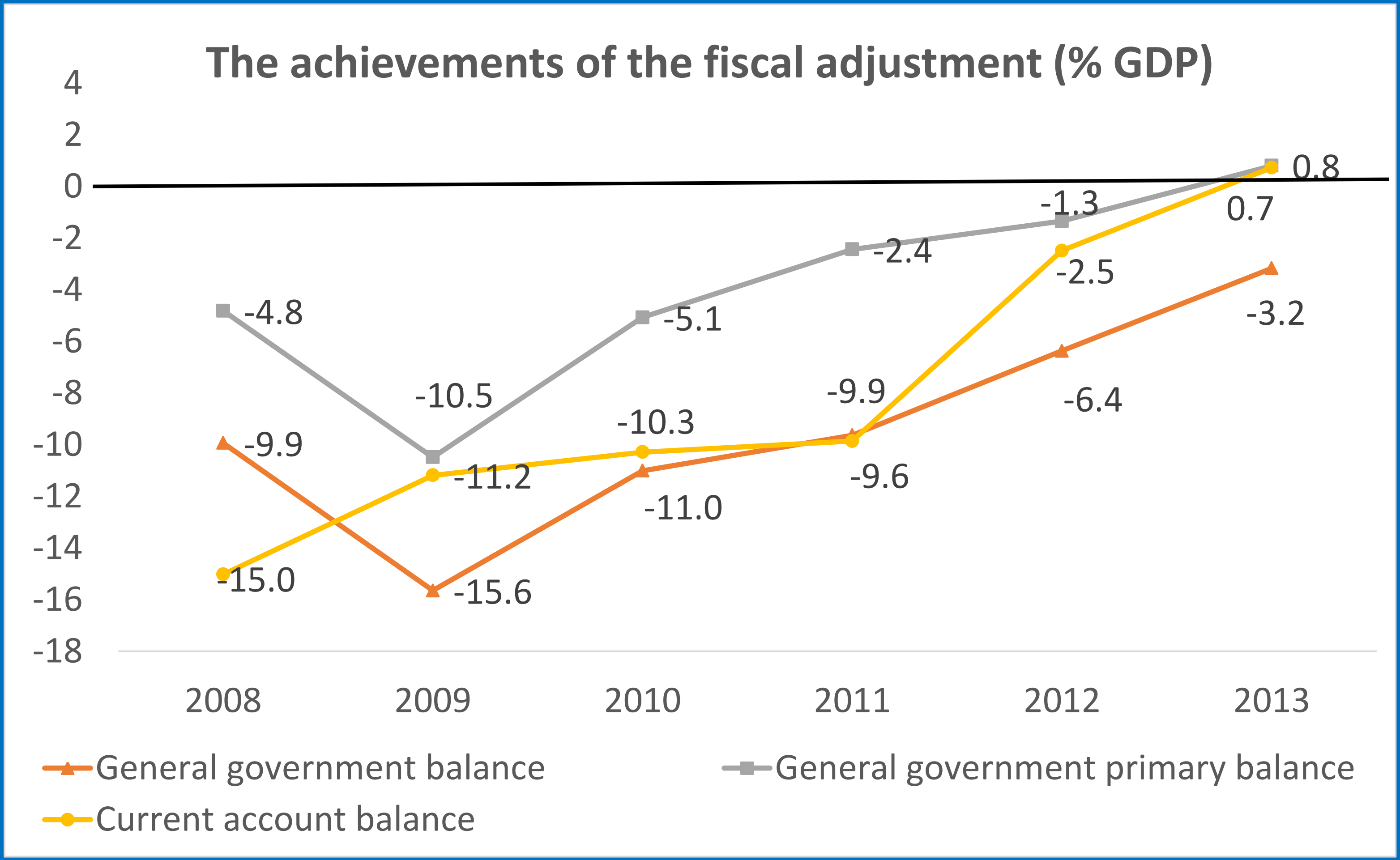
II. GREECE 2008 vs GREECE 2013 (1)

Variables	2008	2013
General government primary balance*	-4.8	0.8
General government balance*	-10	-3.2
current account balance*	-15	0.7
inflation**	4.2	-0.9
General government gross debt*	113	175
People at risk of poverty or social exclusion#	28.1	35.7
unemployment rate ***	7.7	27.3
GDP per capita****	21,000	16,500

* % GDP, ** percent change, average consumer prices, # percentage of total population, *** percent of total labor force, **** current market prices in €

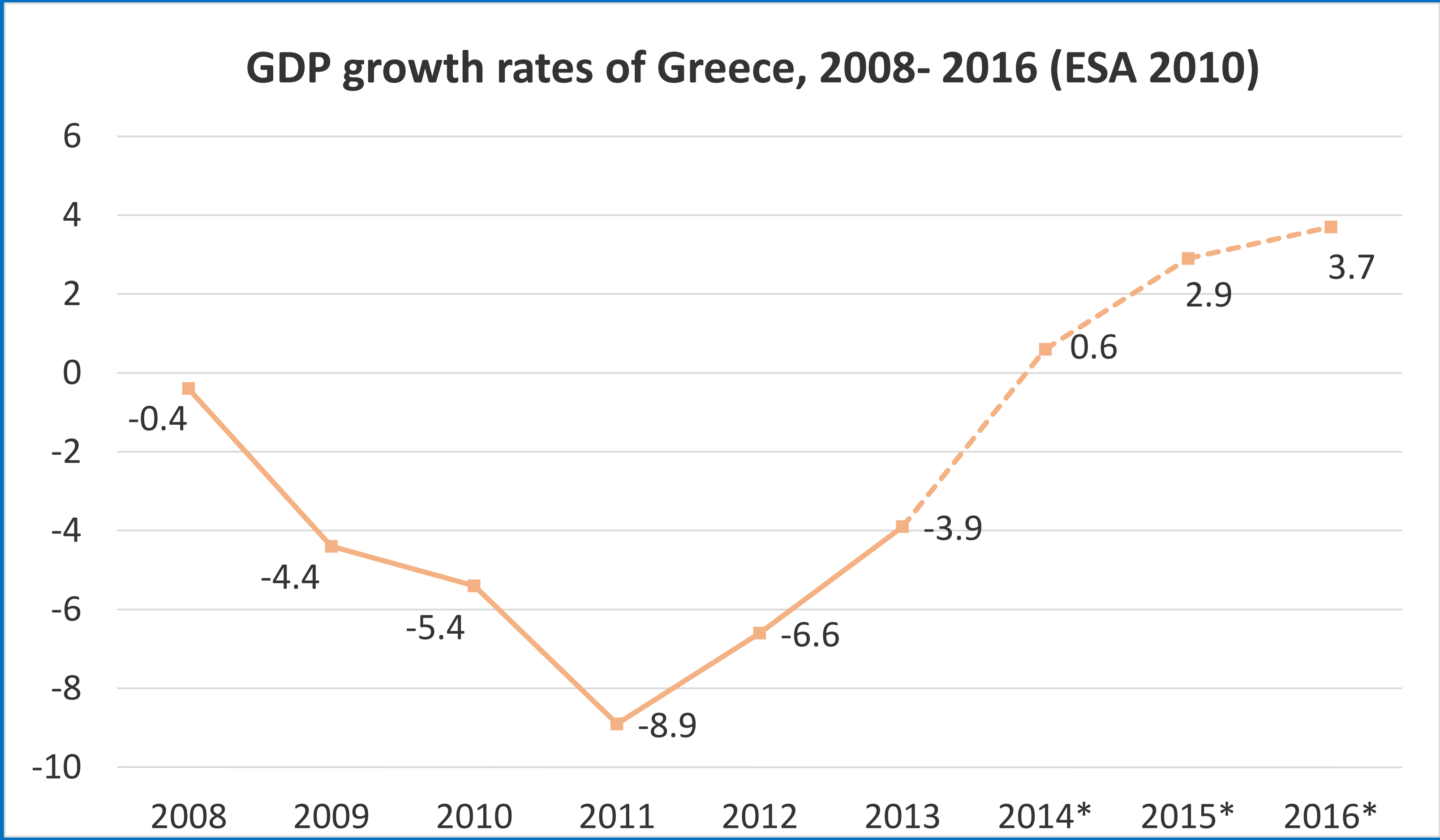
Source: IMF World Economic Outlook database, October 2014, Eurostat

II. GREECE 2008 vs GREECE 2013 (2)



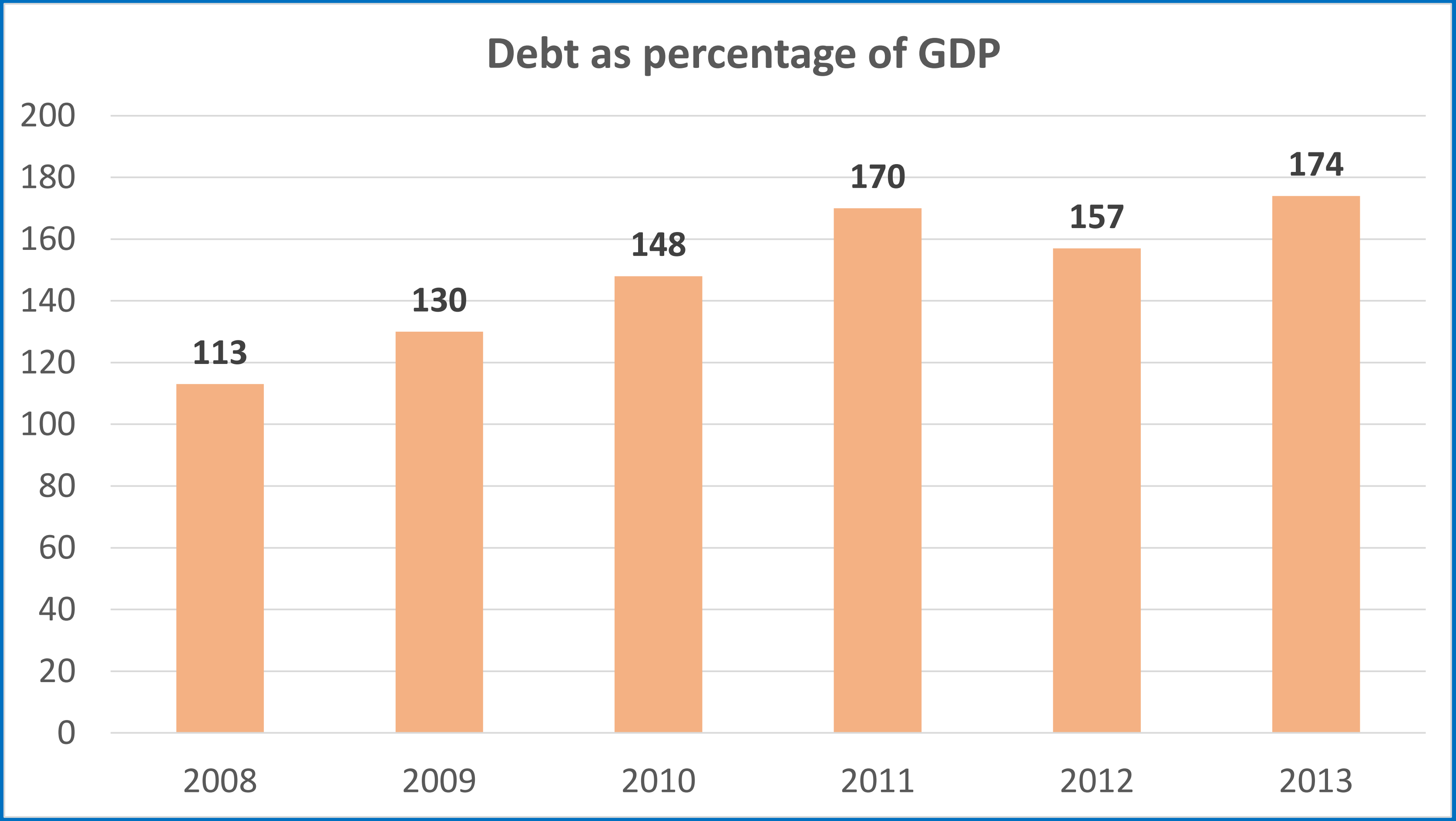
Source: IMF World Economic Outlook database, October 2014

II. GREECE 2008 vs GREECE 2013 (3)



Source: European Commission, Autumn Forecasts, 2014

II. GREECE 2008 vs GREECE 2013 (4)



Source: IMF World Economic Outlook database, October 2014

III. WHAT WENT WRONG?

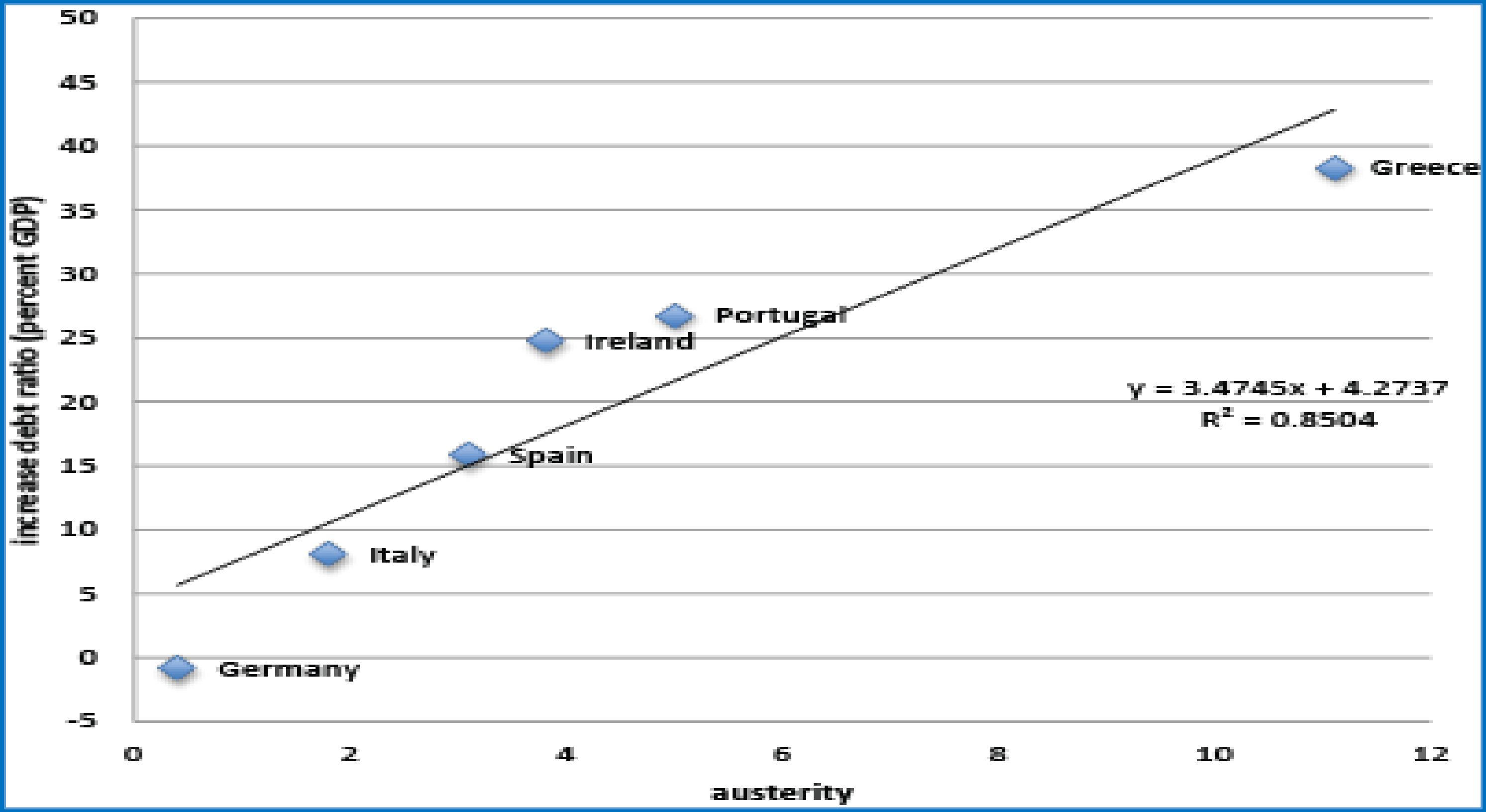
- Austerity
- Expectations
- Policy mix
- Institutions
- Fairness
- Exports

AUSTERITY

Paul de Grauwe, 2013

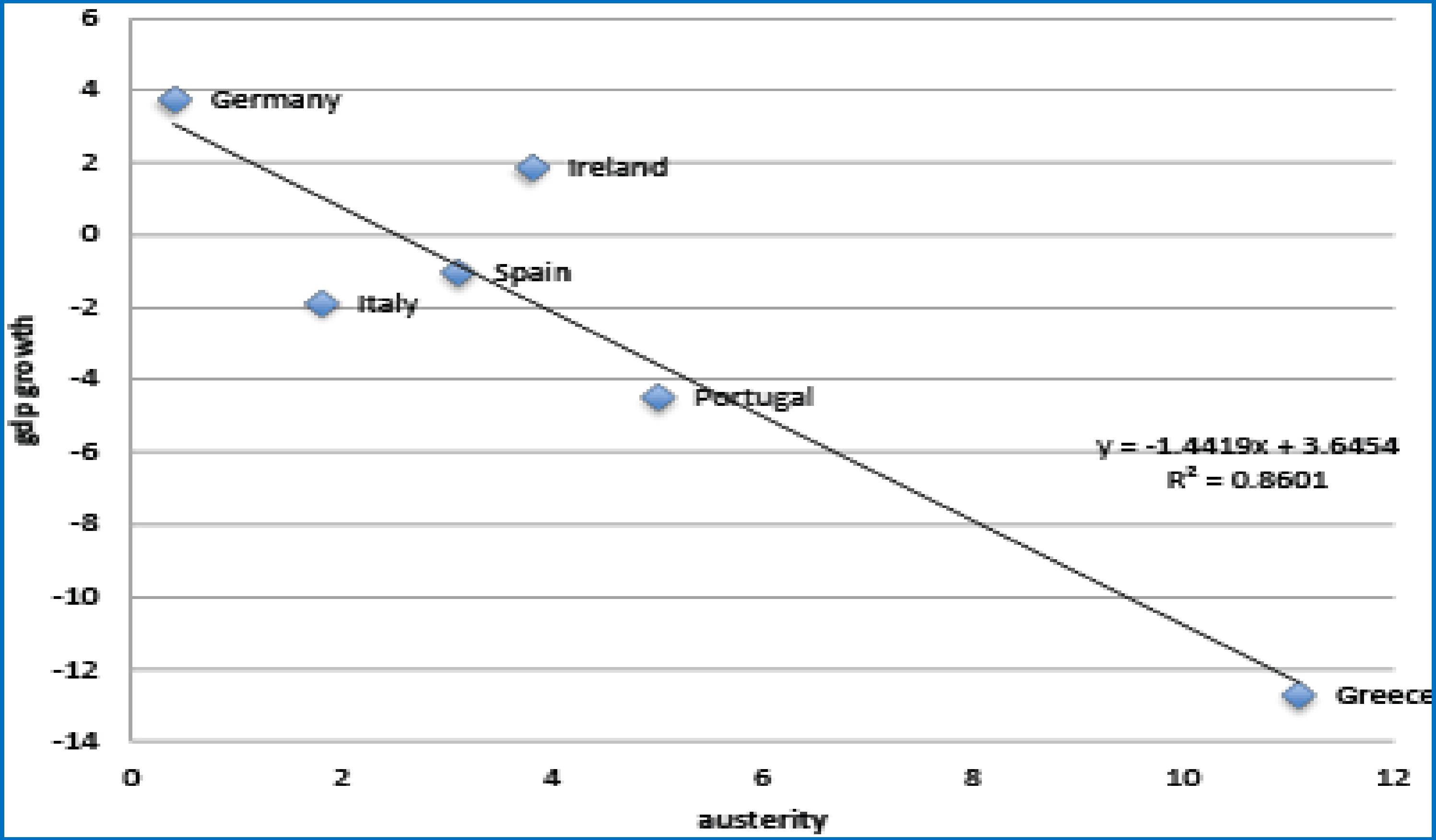
- Extremely frontloaded and implemented in panic, especially in Greece.
- Markets pushed the country into implementing severe austerity (through the increase of bond spreads).
- The more severe the austerity was, the deeper the recession of the economy (→ explosion of the debt to GDP ratio).
- Combined with severe liquidity constraints (in Greece).

AUSTERITY AND DEBTS



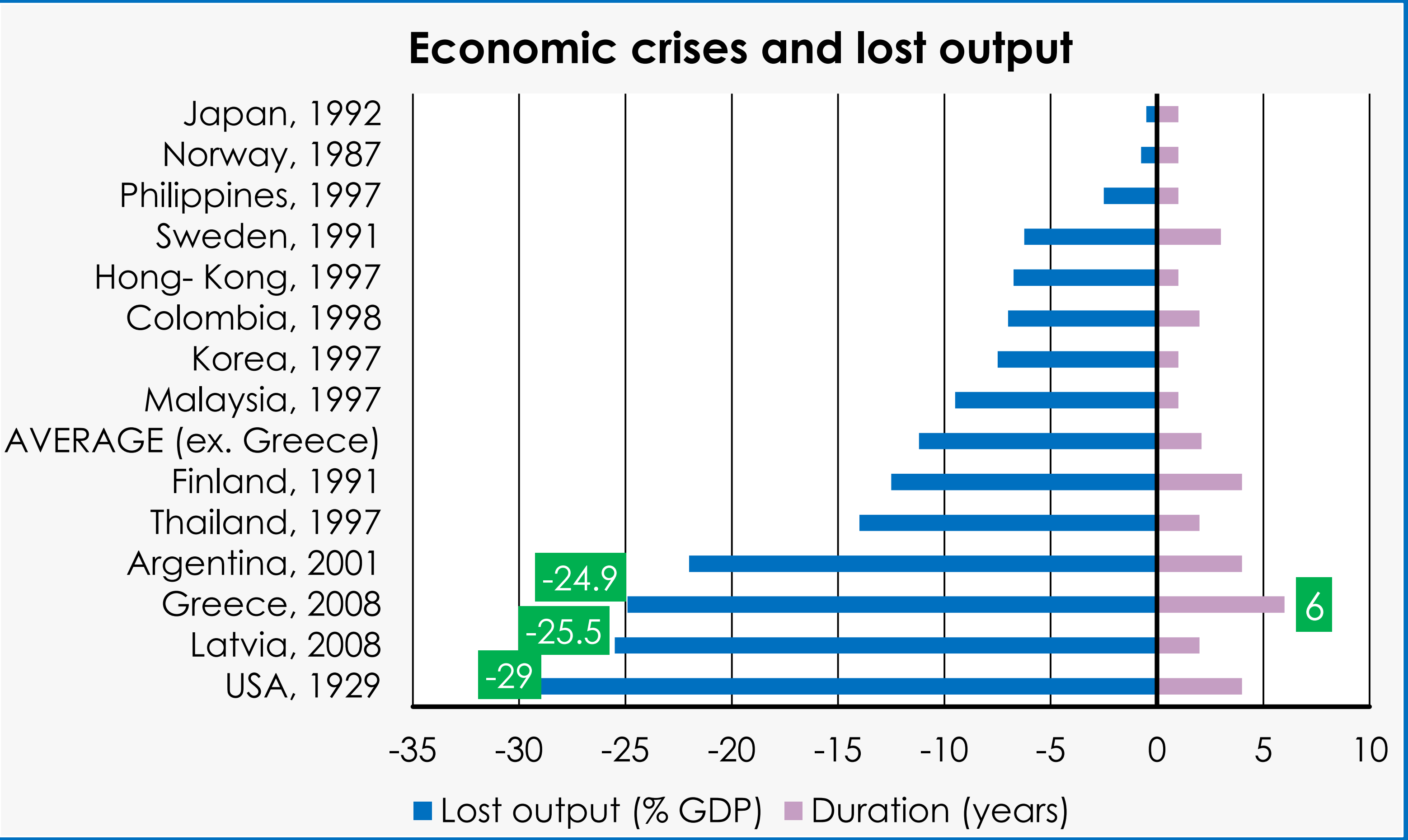
Source: Paul De Grauwe

AUSTERITY AND GDP GROWTH



Source: Financial Times and Datastream

AUSTERITY AND RECESSION



Source: IMF, Reinhart & Rogoff (2009), Budget Introductory Report 2012 & 2013, Hellenic Statistical Authority

EXPECTATIONS (1)

Giavazzi and Pagano, 1990

- The policy choices failed to create positive expectations about the future developments of the Greek economy.

- The responsibility lies on both, domestic and foreign factors.

- The Greek government sent ambiguous signals to the markets:
  - Structural reforms lagged constantly behind the program
  - Great delays in dismissals of public sector's employees and privatizations
  - Excessive tax increases
  - Lack of strong political determination

EXPECTATIONS (2)

Giavazzi and Pagano, 1990

- Inappropriate statements (about "Grexit") from European officials further fueled uncertainty around the Greek economy (→ investment nosedive, under-consumption, stock market turbulence).

POLICY MIX (1)

Alesina and Perotti, 1997

- The Greek adjustment was not sufficiently based on permanent cuts on primary expenditure.

- Empirically optimal: (at least) 70% on the expenditures side (except for public investment) and (at most) 30% on revenue side.

- Only in 2010 and 2013, this fact was hardly implemented.

- In the depression years 2011 and 2012 (cumulative loss of 15.5% of GDP), only 45% and 49% respectively were on the expenditures side.

POLICY MIX (2)

Alesina and Perotti, 1997

- Excessive cuts on the Public Investment Program even in 2015.

- Overall the adjustment was:
  - **Unsustainable**
  - **Recessionary**
  - **Unfavorable for positive expectations**

DOMESTIC INSTITUTIONS

Daron Acemoglu, 2014

Institutional
- **Instability**
- **Fragmentation**
- **Divergence**

- ➢ Was the timing wrong?

- ➢ Institutions should amplify the positive outcomes of the consolidation and not undermine them.

  e.g. Tax Administration enhancement should have been prior to the large tax increases in 2011 (→ increased tax revenue).

  e.g. Goods market liberalization should have been prior to the private sector's wage cuts (→ reduced prices).

EUROPEAN INSTITUTIONS

Daron Acemoglu, 2014

- They did not seem to be ready for a Eurozone member State debt crisis (→ participation of the IMF).

  - Delayed reaction
  - Lack of experience
  - Insufficient know- how
  - Relied on a USA “partner”
  - Fragmentation

- Eventually, Europe managed to create mechanisms (ESM) for any future cases.

FAIRNESS (1)

Kaplanoglou, Rapanos and Bardakas, 2013

- The sixth commandment of O. Blanchard and C. Cottarelli.
- Fiscal consolidations → serious distributional consequences.
- Fairness is crucial for the success of fiscal consolidations.
- “Fair fiscal adjustments” may provide the double dividend of enhancing the probability of success of the adjustment and of promoting social cohesion.

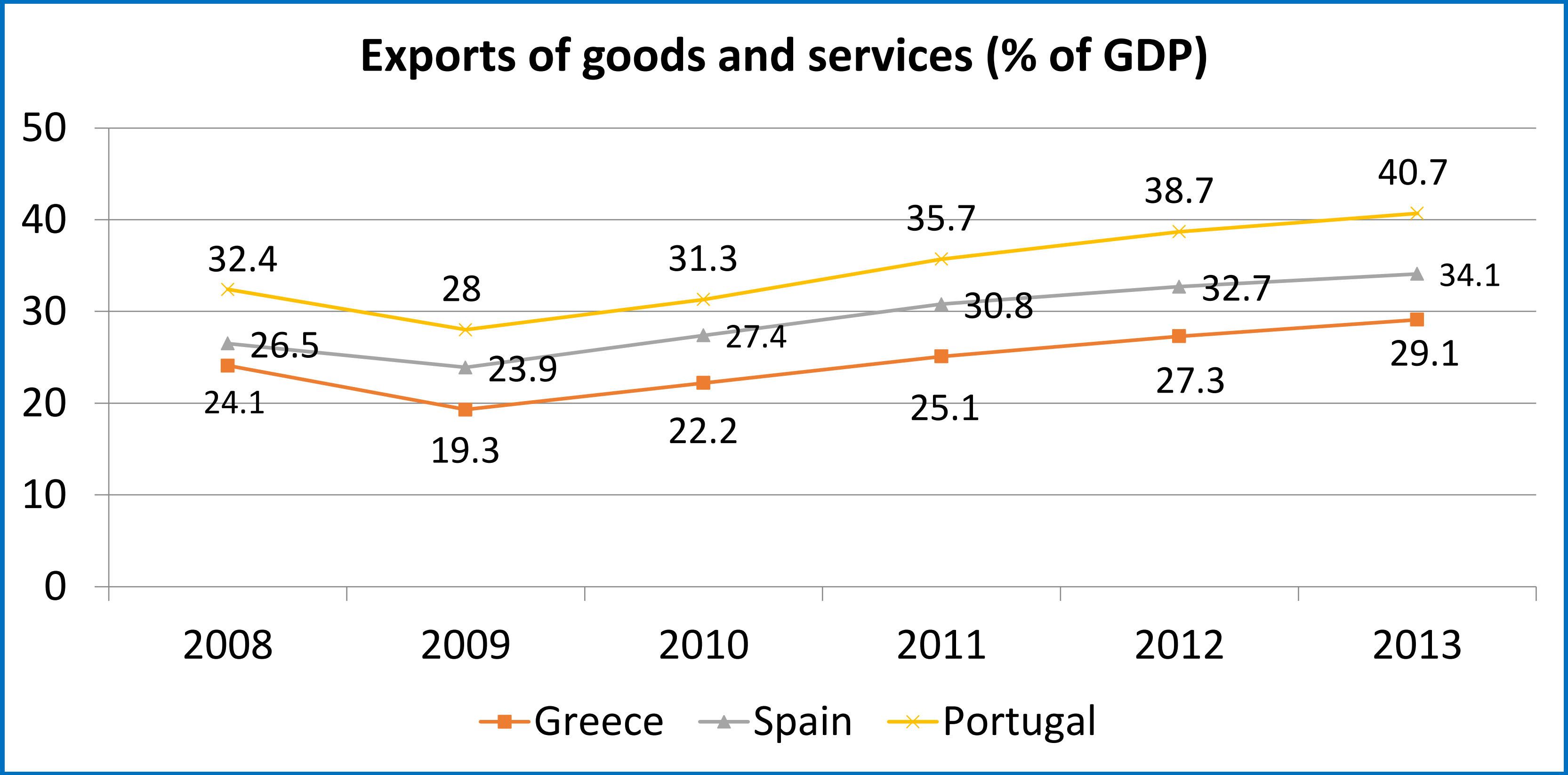
FAIRNESS (2)

Kaplanoglou, Rapanos and Bardakas, 2013

- Measures like:
  - targeted and effective social transfers
  - higher public expenditure on active labor market programs
  - decreasing the VAT rate on necessities
- In Greece, the consecutive tax increases (combined with the huge tax evasion) levied a disproportionate burden on pensioners and wage earners.
- A safety net is only provided by the recently launched pilot program for the Guaranteed Minimum Income (GMI).

EXPORTS (1)

Daniel Gros, 2014



Source: Eurostat

EXPORTS (1)

Daniel Gros, 2014

- Greece seems to have the poorest export performance among the countries of Southern Europe.
- Ireland increased its exports to over 100% of GDP in the respective period.

EXPORTS (2)

Daniel Gros, 2014

- The really important target for any country starting an adjustment program with a double-digit current-account deficit must be export growth.
- The Greek economy has remained so distorted (despite any reforms) that it has not responded to changing price signals.
- Low international competitiveness, narrow production base.
- Except for tourism that skyrockets.
- Greece should transform its productive structure based on innovation and technology towards an export orientation.

IV. WHAT REMAINS TO BE DONE? (1)

Sustainability of growth pattern. This depends on:

a) The relief of the public debt

b) The quality and the continuation of the outstanding structural reforms

c) The political stability

d) Any sudden external shocks

IV. WHAT REMAINS TO BE DONE? (2)

- The Greek problem is part of a general European problem of competitiveness and fiscal governance and developments in the EU favor solutions such as: ***Less austerity, more and deeper structural reforms plus European solidarity (joint initiatives for growth and employment).***

- Do not underestimate the potential of a country that faces difficulties to raise funds from the ESM on favorable terms and use the new tools provided by the ECB and the EIB.

Thank you for your attention!