



The Eurozone Crisis, Greece, and the Experience of Austerity



From Austerity to Development: The Challenges Ahead

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Central Messages

1. Austerity policies have failed miserably with high economic, social and political costs.
2. Apart from excessive fiscal contraction and unwarranted internal devaluation or the continuation of the debt overhang, the failure can be attributed to the nature of so-called “structural measures” which have turned out to be fiscal or corporatist measures in disguise.
3. Greece can exit the crisis through “pro-growth reforms ,” which support investment and productive restructuring embedded in a coherent policy of reducing the debt overhang, sustaining domestic purchasing power and last but not least promote “inclusive” as opposed to “extractive” policies and institutions.

Austerity has failed....



| EU Countries | GDP* | | General Government Gross Debt** | | General Government balance** | | Unemployment Rate | |
|--------------|------|------|---------------------------------|-------|------------------------------|-------|-------------------|------|
| | 2008 | 2012 | 2008 | 2012 | 2008 | 2012 | 2008 | 2012 |
| PORTUGAL | 0.0 | -3.2 | 71.6 | 123.6 | -3.6 | -6.4 | 8.5 | 15.9 |
| SPAIN | 0.9 | -1.4 | 40.1 | 84.2 | -4.5 | -10.6 | 11.3 | 25.0 |
| IRELAND | -3.0 | 0.9 | 44.3 | 117.6 | -7.3 | -7.6 | 6.3 | 14.7 |
| GREECE | -0.2 | -6.4 | 113.0 | 156.9 | -9.8 | -10.0 | 7.7 | 24.3 |
| ITALY | -1.2 | -2.5 | 106.1 | 127 | -2.7 | -3.0 | 6.7 | 10.7 |
| EU17 | 0.4 | -0.7 | 70.2 | 90.6 | -2.1 | -3.7 | 11.4 | 11.4 |
| EU27 | 0.4 | -0.4 | 62.3 | 85.3 | -2.4 | -4.0 | 10.5 | 10.5 |

* Annual percentage change

** As a percentage of GDP

*** 2005=100 (Price deflator, exports of goods and services)

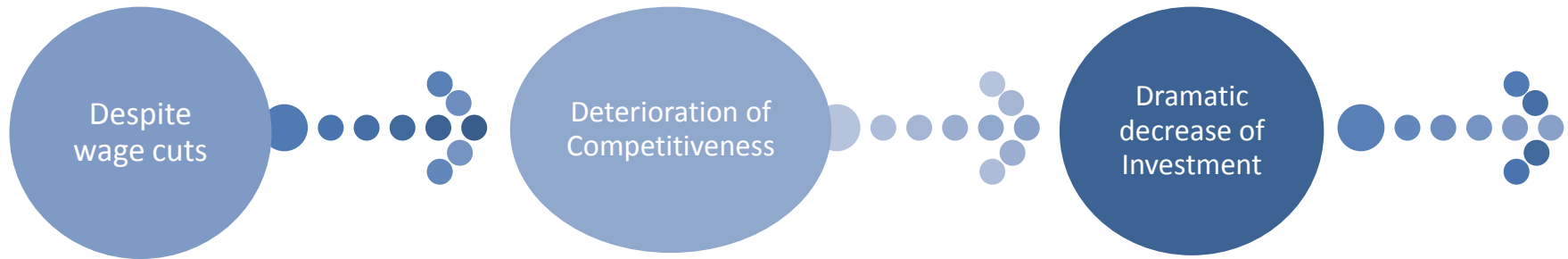
2013 forecasts in parentheses

Source: EUROPEAN ECONOMY 6 | 2011, European Economic Forecast, EUROPEAN ECONOMY 2 | 2013, Spring 2013

Despite Wage Cuts, Competitiveness has deteriorated....

- ✓ Real Exchange Rates, calculated on the basis of final export prices, have appreciated, despite sharp declines in labour compensation per employee (Greece by 6.75%)
- ✓ Investment to GDP ratio in Greece has dropped by 9.5 percentage points.
- ✓ Current account improvements due to recession, fall investment demand and exogenous factors are not sustainable.

Despite wage cuts, price competitiveness has in fact deteriorated...



| | Labour Compensation per Employee**** | | Annual Real Effective Exchange Rates vs Euroarea*** | | Gross Fixed Capital Formation as (% of GDP* | | Current-Account Balance** | |
|-----------------|--------------------------------------|-------|---|--------|---|------|---------------------------|------|
| | 2008 | 2012 | 2008 | 2012 | 2008 | 2012 | 2008 | 2012 |
| PORTUGAL | 108,7 | 110,1 | 101.94 | 102.61 | 22.5 | 16 | -12.6 | -1.9 |
| SPAIN | 115,2 | 120,4 | 102.84 | 103.51 | 28.7 | 19,2 | -9.6 | -0.9 |
| IRELAND | 114,9 | 111,5 | 94.48 | 96.35 | 21.8 | 10 | -5.6 | 5.0 |
| GREECE | 111 | 103,7 | 103.84 | 111.02 | 22.6 | 13,1 | -17.9 | -5.3 |
| ITALY | 107,5 | 111,1 | 101.35 | 100.88 | 21.0 | 17,9 | -2.9 | -0.7 |
| EU17 | - | - | 100.00 | 100 | 21.5 | 18.3 | -1.5 | 1.2 |
| EU27 | - | - | - | - | 21.0 | 17.9 | -2.1 | 0.3 |

* Annual percentage change

** As a percentage of GDP

*** 2005=100 (Price deflator, exports of goods and services) ****OECD Index base (2005=100)

2013 forecasts in parentheses

Source: EUROPEAN ECONOMY 6 | 2011, European Economic Forecast, EUROPEAN ECONOMY 2 | 2013, Spring 2013

Deterioration of Competitiveness due to....

a). Increase in Indirect Taxes”: Contribution of Indirect Taxes to Inflation 69.9%

| | HICP-CT | HICP | HICP-CT | HICP |
|----------------|---------|--------|---------|--------|
| | 2008* | 2008 | 2012 | 2012 |
| European Union | 108,22 | 108,56 | 116,89 | 118,43 |
| Euro area | 107,24 | 107,83 | 114,98 | 115,7 |
| Greece | 111,18 | 110,9 | 114,77 | 122,61 |
| Spain | 110,34 | 110,91 | 116,55 | 119,18 |
| Italy | 108,7 | 108 | 117,9 | 117,5 |
| Cyprus | 109,75 | 109,03 | 117,87 | 119,52 |
| Portugal | 107,44 | 108,34 | 111,99 | 115,85 |

Source: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database
*M12 of years 2008 - 2012

Harmonized
Index
Consumer
Price

Greece:

- Total Growth of HICP- CT **3,22%** btw 2008-2012

- Total Growth of HICP **10,5%** btw 2008-2012

The Difference among HICP(CT) and HICP is the Contribution of Indirect taxes at the Prices

Contribution of Indirect Taxes to Inflation: 69,9%

b). Productivity declines, which have led to ULC increases

Labour
Productivity

Greece:

- Labour compensation **decrease** - **6,57%** btw 2008-2012

- Unit Labour Cost **increase** **1,4%** btw 2008-2012

Despite wage cuts overall productivity of labour declines

| | Unit Labour Cost* | |
|----------|-------------------|-------|
| | 2008 | 2012 |
| PORTUGAL | 104,5 | 99,8 |
| SPAIN | 113 | 106,4 |
| IRELAND | 112,6 | 96,5 |
| GREECE | 101,5 | 102,9 |
| ITALY | 107,5 | 115 |

*9)
Source: European Commission – Eurostat Database, OECD Stat Extracts

Deterioration of Competitiveness due to...

c). Increases in Energy Prices which have exceeded 30% on average

| Industry Energy Price (Euro per Kwh) | 2008 (S2) | 2012 (S2) | Δ(%) |
|---|-----------|-----------|--------|
| Consumption < 20 MWh | 0,1505 | 0,2013 | 33,75% |
| 20 MWh < Consumption < 500 MWh | 0,1237 | 0,1653 | 33,63% |
| 500 MWh < Consumption < 2 000 MWh | 0,1006 | 0,1381 | 37,28% |
| 2 000 MWh < Consumption < 20 000 MWh | 0,0873 | 0,1197 | 37,11% |
| 20 000 MWh < Consumption < 70 000 MWh | 0,0792 | 0,1064 | 34,34% |
| 70 000 MWh < Consumption < 150 000 MWh | 0,0727 | 0,0757 | 4,13% |

Source: European Commission – Eurostat Database

Energy
Price

Greece:

- Mean Energy Price Increase
30,04% btw 2008 -2012

The effect of price increase counterbalance the effect of nominal wage reduction

d). Oligopolistic practices, transfer pricing and “corporatist” practices have not allowed prices to fall:

- ✓ High concentration ratios in each sector (2-3 companies over 60-70% of market shares)
- ✓ Impediments to entry lead to high markups
- ✓ High “guaranteed” prices in specific sectors

The IMF evaluation does not tell the whole story....

What it does say:

- Fiscal adjustment contraction has been unprecedented....(but no link to economic, political and social repercussions)
- Multipliers were underestimated....(but why?)
- Debt restructuring should have happened earlier....(but why did it not happen?)
- Debt overhang persists today and debt is probably “unsustainable”(but no action is taken)
- Structural reforms delayed or incomplete....(but no evaluation is offered)
- The program has been successful and should continue!

The IMF evaluation.....

What is does not say:

a). PSI was delayed and costly

- The “one size fits all” approach - offering the same bundle of new bonds and cash to all investors, irrespective of the maturity of their old bonds, and with no distinction between foreign law bonds and Greek law bonds – was costly.
- The decisions to exempt the central banks from the exchange, and not to bail-in bank bondholders was problematic.
- Different design would have achieved additional debt relief of perhaps €60 billion in face value terms —almost 25 percent of GDP.
- The decision to conduct the December buyback at market prices (via an auction mechanism), instead of opting for a negotiated buyback at predetermined prices.
- Even after the Greek PSI and a maturity extension and interest reduction, Greek debt continues to be unsustainable.
- Not tackling the public debt problem decisively at the outset or early in the program created uncertainty about the euro area’s capacity to resolve the crisis; A delayed debt restructuring provided a window for private creditors to reduce exposures by 130 billion and shift debt to European taxpayers

The IMF evaluation.....

What is does not say:

b). Diagnosis did not take into account the structure of production and employment in Greece:

- The SME sector is more important in Greece than in the average EU country (Greek SMEs account for 99,5% of total private sector enterprises, providing 87% of total country employment, with micro enterprises accounting for 96,5% of them and providing 58% of the country employment).
- The Greek SME sector is estimated to have been hit particularly hard by the crisis in terms of the number of enterprises, which is now not only inferior to 2008, the last year before the crisis, but also to the base year of 2005.
- The economic crisis has put Greek SMEs under considerable stress both through a credit squeeze and an internal demand shock. Greek SMEs reported also the highest decline in turnover and profits (ECB, 2013).

The IMF evaluation.....

What is does not say:

c). The impact of the liquidity crisis has been neglected.

- The financial crisis produced a domestic liquidity crisis making households and firms unable to obtain credit; The credit crunch in conjunction with the dramatic fall in disposable incomes made them unable to pay back their obligations.
- Between 2009-2012, credit to enterprises has been reduced by 17.5% and to individuals by 11%. Greek SMEs reported the strongest increase among eurozone countries in their need for bank loans (31%) as well as increase in financial obstacles (64%), reflecting needs for financing working capital in an environment of weak profits, squeezed liquidity buffers and insufficient availability of internal funds
- EU funds that could be leveraged to provide loans and guarantees to SMEs have remained largely undisbursed from the Greek banking system.
- Domestic loans to enterprises or households have not been adequately restructured.

The IMF evaluation.....

What is does not say:

c). The impact of the liquidity crisis has been neglected (cont)

- The recapitalization of the Greek banking sector with 50 billion euros does not imply provision of liquidity to the private sector.
- SMEs unable to cover fixed costs, close down permanently with negative effect for unemployment , tax payments and social security contributions
- Loans in arrear are increasing
- Banks will probably need a new recapitalization program

The IMF evaluation.....

What is does not say.....

d). Structural reforms pursued are fiscal or Corporatist measures in disguise

“Tax Reform” :

- Increases in income taxes, property taxes and indirect taxes
- Selective retention of tax exemptions for favoured groups
- Little progress in tackling tax avoidance and evasion or broadening the tax base
- Weakening of tax auditing and tax collection capacity
- No progress in simplifying tax system and making it stable and investment-friendly

The IMF evaluation.....

What is does not say.....

d). Structural reforms pursued are fiscal or Corporatist measures in disguise

“Administrative Reform” :

- Horizontal reductions in public sector pay ad incentives
- Retention or mobility programs to reduce expenditures
- Reductions in posts and lay offs
- Closure of state enterprises

The IMF evaluation.....

What is does not say.....

d). Structural reforms pursued are fiscal or Corporatist measures in disguise

“Labor Market Reforms “:

- Reductions in wages and labour compensation
- Reductions in hours worked
- Lowering of minimum wage
- Dismantling of collective bargaining and agreements
- Complete deregulation of labor market
- Non- compliance with international labor standards
- Weakening of oversight capacity
- f) Banking Sector Reform
- Reduction in Potential Competition
- Lack of Transparency in Recapitalization Process and Mergers

The IMF evaluation.....

What is does not say.....

d). Structural reforms pursued are fiscal or Corporatist measures in disguise

“Regulatory and Banking Sector Reform”:

- Reduction in potential competition
- Lack of transparency in recapitalization process and mergers
- Safeguarding high markups and profits for few

From Austerity to Prosperity: What can be done?

Answer:

- a). Promote technological and productive restructuring through active investment policies and pro-growth structural reforms
- b). Restructure debt for adequate financing and pursue sound fiscal management
- c). Restore liquidity to market and purchasing power to households.
- d). Create jobs and minimum social protection floor.
- e). Strengthen transparency and “inclusive” institutions

From Austerity to Prosperity: What can be done?

A. Promote technological and productive restructuring through active investment policies and pro-growth structural reforms

Regulatory reforms

- ✓ Reduce administrative costs for licensing operation and closure of firms as well for timely settlements of disputes
- ✓ Reduce the cost of investment and doing business
- ✓ Simplify legislation
- ✓ Remove barriers to entry and enhance competition and “fair pricing” practices

Tax reform and sound public finance management

- ✓ Strengthen auditing and tax collection services and e-governance
- ✓ Introduce programmatic budgeting
- ✓ Strengthen fiscal internal control mechanisms

Judicial reform

- ✓ Speed up process
- ✓ Promote full computerization of courts
- ✓ Strengthen transparency of legal processes and decisions

From Austerity to Prosperity: What can be done?

A. Promote technological and productive restructuring through active investment policies and pro-growth structural reforms

Governance reform

- ✓ Strengthen e-governance
- ✓ Reorganize public sector, simplifying procedures, clarifying processes , specify responsibilities
- ✓ Monitor and evaluate outcomes

....as well as.....

- ✓ Channel public and private investment funding to integrated regional development programs and project financing
- ✓ Enable “Invest in Greece” to mature projects, assist private sector and “fast-track” investment.
- ✓ Develop sectoral policies for agri-food, energy, tourism, real estate development, transport, health, education and culture
- ✓ Build development partnership for value-added and job creation with national entrepreneurs

From Austerity to Prosperity: What can be done?

B. Restructure debt for adequate financing and pursue sound fiscal management

- Restructure debt and reduce debt burden through multiple means (eg interest rate reduction, extension of debt payments, debt-equity swaps etc.)
- Restructure domestic loans by law (eg. L3816/11)
- Develop, in collaboration with EIB and EIF, innovative financial instruments (eg development bonds, crowd financing etc)
- Pursue sound, transparent and fair SFM to attain realistic primary surplus (eg monitor and reduce indirect subsidies, health management etc.)
- Remove loopholes and distortions to fight social security evasion

From Austerity to Prosperity: What can be done?

C. Restore liquidity to market and purchasing power to households

- Extend loan and microfinance to SMEs
- Strengthen ETEAN and initiate Social Economy Fund
- Strengthen venture capital funds and equity participation

D. Create jobs and a minimum social protection floor

- Strengthen social economy initiatives
- Enable municipalities to develop basic social provision services and introduce appropriate financial instruments

From Austerity to Prosperity: What can be done?

E. Strengthen transparency and inclusive institutions

- Monitor and evaluate policy outcomes through appropriate Observatories
- Monitor and evaluate carefully privatization and deregulation processes
- Expose, name and shame “extractive” institutions and practices
- Strengthen “open-government” practices (eg Diavgeia)
- Institute “conflict-of-interest” provision for hiring
- Introduce direct-voting procedures for important policy issues

IT CAN BE DONE