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Greece's successful death

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Dr. Nikos Chrysoloras

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Greece’s successful death

Nikos Chrysoloras

Abstract

The nature of the "Greek problem" has now ceased to be fiscal. Hence, the Troika's insistence on the adoption of new austerity measures, in 2014 and 2015, is based on an arbitrary (if not metaphysical) assumption regarding the "120% of GDP" public debt sustainability threshold, and delivers a toxic policy mix. The correction of macroeconomic imbalances is not achieved through the creation of a new sustainable growth model, but through the amputation of the economy. The old "Greek way" of doing things is dying, but there is nothing to replace it, because nothing can grow in the asphyxiating environment of manic consolidation, and simultaneous cash and credit crunch. An emergency European investment program could increase the chances of averting a Greek implosion.

Key Words:

Austerity; Grexit; Procyclical policy; Eurozone; Growth

Greece's successful death

"The operation has been successful, but the patient died", is a catchphrase Greeks often use, and it perfectly describes the reality in the country in late 2013. In many ways, the Eurozone/IMF-backed economic adjustment program has been successful: Greece achieved the largest fiscal consolidation of any other country in modern history, and its budget deficit this year will be lower than the deficit of Portugal, Ireland, Spain, the UK, the US and many other advanced economies.[1] Also, Greece almost zeroed its current account deficit, it has markedly improved its global competitiveness rankings, and it has become a global leader in the implementation of structural reforms, according to the OECD, the World Bank, and the Lisbon Council.[2] But the cost of this unprecedentedly rapid adjustment has been so heavy, that Greece may not hold on enough to enjoy its fruits, since the danger of total implosion is imminent.

Table 1: Overall budget balance (Percent of GDP)

Country	2013	2014
Greece	–4.1	–3.3
Ireland	–7.6	–5.0
Portugal	–5.5	–4.0
Spain	–6.7	- 5.8

Source: IMF Fiscal Monitor Projections, October 2013. Excludes one-off payments for banks

This warning does not echo the market mood. Over the last few months, a speculative rally has been unfolding in the Greek stock and bonds markets, fueled by triumphal reports in the international media that the country is on its way out of the woods. But this rally is completely out of touch with the reality on the ground, and it masks a dire, and potentially destabilizing, total crisis. My analysis is based on the following evidence:

- **Unemployment** is at 27.6%[3] and, most importantly, no one can pinpoint a source of new jobs and growth. Greek exports, one of the two potential sources of new jobs, have remained stagnant throughout the crisis,[4] and unlike what happened in the rest

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[1] IMF, *Fiscal Monitor*, October 2013, available online: http://www.imf.org/external/pubs/ft/fm/2013/02/fmindex.htm

[2] World Economic Forum, *2013-14 Global Competitiveness Report*, available online: http://www.weforum.org/reports/global-competitiveness-report-2013-2014; OECD, *Economic Policy Reforms: Going for Growth 2013*, available online: http://www.oecd.org/eco/growth/going-for-growth-2013.htm; and World Bank, *Doing Business Report 2013*, available online: http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-full-report.pdf

[3] Eurostat, *September 2013 Unemployment report*, available online: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-31102013-BP/EN/3-31102013-BP-EN.PDF

[4] ANSA, "Greek Exports on the Wane", October 28, 2013; available online: http://www.ansamed.info/ansamed/en/news/sections/economics/2013/10/28/Trade-Greek-exports-the-wane-2-6-fuel_9531356.html

of the crisis hit countries, current account adjustment has only been achieved because of the cataclysmic slump in imports, i.e wartime-like Depression. Similarly, recorded productivity gains "are mainly due to a much stronger decrease in employment than in output".[5] More worryingly, the latest "Quarterly Report on the Euro Area", published by the Directorate General of Economic and Financial Affairs of the European Commission (DG ECFIN) shows that the profitability in the internationally tradable goods sector of the Greek economy is falling faster, and it is much lower, than in the non-tradable goods sector. Greece is unique of all the crisis-hit countries in this respect. According to the same report, both employment and "value-added in the tradable sector has contracted significantly against the 2006 level"[6]. And while unit labor costs in Greece fall (-6.2% in 2012, according to the EU Commission's September 2013 Social Situation Review), like everywhere else in the European periphery, there is a "limited pass-through of falling wage costs into export prices".[7]

Even if exports had increased though, the starting point was exceptionally low, and it was unreasonable to expect that Greece would become an export-powerhouse in three years. If that was the plan, then it is doomed to fail.

- **Tourist industry**, the second potential source of jobs, is projected to reach a record of 18 million arrivals this year, but if the political situation stabilizes in the wider Mediterranean region, this number will fall again. Greece has not made enough efforts so far to develop year-round tourism, attract tourists in its capital (national capitals are the major source of tourist revenues throughout Europe), or attract foreign direct investment in tourist-related activities. In any case, tourism alone cannot pull Greece out or recession, and, interestingly enough, it is an industry, which could, potentially, benefit the most from "Grexit".

- **Economically active population** in Greece is now much smaller than the total number of unemployed, pensioners, and NEETs and keeps falling (about 3.6 million economically active, against around 4.7 million inactive).[8] This is not sustainable. Of those economically active, only 1.8 million are salaried workers in the private sector. The rest are either civil servants or independent professionals and businessmen. Most of the latter ones either evade some of their taxes, or their businesses do not produce enough revenue anymore to pay any taxes. Out of the 1.8 million salaried workers, only 1/3, i.e. 700,000 people are being paid on time by their employers, according to the Greek authorities.[9] The rest get their salaries after severe delays,

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5 European Union (September 2013), *Employment and Social Situation Quarterly Review*, available online: http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=1974&furtherNews=yes

6 European Union, (2013), "Labour costs pass-through, profits and rebalancing in vulnerable Member States", in *Quarterly Report on the Euro Area*, Volume 12, No. 3, pp. 1-34.

7 Ibid.

8 See, Hellenic Statistical Authority (June 2013), *Labor Force survey*, available online: http://www.tovima.gr/files/1/2013/09/12/erg.pdf

9 See, *Efimerida ton Syntakton*, "Χωρίς επίδομα αδείας 1 εκατ. εργαζόμενοι", citing data from the Greek pension fund IKA, available online: http://www.efsyn.gr/?p=102100

reaching up to 12 months. Hence, tax arrears have doubled, to 60 billion euros,[10] over the last four years and they continue to rise, by tens of millions each month. No surprise here: people who are not being paid by their employers cannot pay their dues to the tax authorities. What this means is that the burden of the gigantic economic adjustment has mostly fallen on those 700,000 people, who are still being paid, but have also seen their compensations fall more than anywhere else in Europe.[11] The result is that state revenues, compared to GDP, are still lower in Greece than the EU average,[12] but most of these revenues come from a very small number of people, whose resources have now been almost completely depleted and their desperateness has reached a boiling level.

- **People burn cash to survive**. Greek banks have lost about 1/3 of their deposits during the crisis years (around 90 billion out of the 260 billion). Deposits started flowing back into the system after June 2012 elections, but this trend was reversed after the deposits' "haircut" in Cyprus, in March 2013. Now, Greek banks report that their continuous bleeding (around a billion per month)[13] is not caused by uncertainty, but it is mainly due to the fact that people use their savings to live and pay taxes. This outflow of deposits exacerbates the crisis in the cash-strapped banking system, which cannot even absorb funds channeled from the European Investment Bank, in order to finance the Greek economy, due to the lack of loans-generating capacity.

Table 2: Indicative Absorption Rates of EIB Programs (until September 2013)

Program	Total Allocation (mil. €)	Absorption (mil. €)
Jeremie (FRSP)	228	92
Jeremie (Venture Capital)	49	6
Jessica	257	4

- **Non-Performing Loans now exceed 65 billion euros**, or 1/3 of total loans and mortgages in Greece.[14] The total amount of deposit outflows and non-performing loans is about three times as much as Greek banks are due to receive through the Eurozone-backed recapitalization program (50 billion euros). Rising NPLs mean that Greek commercial banks simply do not have enough capital to back new loans and provide credit to the economy. This creates a vicious circle, since lack of credit

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[10] Suzanne Dalley, "Greece's Aggressive Pursuit of Tax Evaders Appears to Collect More Anger Than Money", in *New York Times*, October 28, 2013, available online: http://www.nytimes.com/2013/10/29/world/europe/greeces-aggressive-pursuit-of-tax-evaders-appears-to-collect-more-anger-than-money.html?_r=0

[11] European Union (September 2013), *Employment and Social Situation Quarterly Review*, available online: http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=1974&furtherNews=yes

[12] Eurostat, *Taxation Trends in the European Union*, 2013 edition, available online: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-DU-13-001/EN/KS-DU-13-001-EN.PDF

[13] *To Vima*, "Μειώθηκαν κατά 1 δισ. ευρώ οι τραπεζικές καταθέσεις στην Ελλάδα", October 25, 2013, available online: http://www.tovima.gr/finance/article/?aid=536733

[14] *Kathimerini*, "NPLs swell to 65 bln euros, says PwC report", October 31, 2013, available online: http://www.ekathimerini.com/4dcgi/_w_articles_wsite2_1_31/10/2013_525721

exacerbates recession, which, in turn, exacerbates the credit crunch. It is no wonder that access to finance and skyrocketing corporate lending rates, are the most pressing problems reported by Greek companies, and undermine the effort to expand the country's productive base and increase exports.[15]

- **The Troika review is at a dead end**. Greece has achieved the largest fiscal adjustment in modern history,[16] and now runs the highest cyclically adjusted surplus in Europe and the second largest cyclically adjusted primary surplus in the world, according to the IMF.[17] But the Troika, in a vulgar display of fiscal sadism is asking for more austerity measures, in a country which is on the brink of total implosion, while, at the same time, the continuing competitive adjustment in the core of the Eurozone undermines Greece's efforts to recover.[18]

Surely, the government can deliver marginal savings in next year's budget, and most Greeks can still pinpoint to secondary sources of waste. But it is politically impossible to adopt the new massive round of cuts that the Troika demands (the initial request was for 2.5-3 billion euros of new cuts). The government simply does not have the votes to get such a bill through parliament and even if it does, Greeks will not have the resources to foot the bill anymore. Hence, political stability is once again an open issue.

A changing problem

Obviously, when the crisis started, in 2009, Greece's fiscal situation was unsustainable, if not catastrophic. But since then, the country has adopted corrective measures amounting to 30% of its GDP (!), as DG ECFIN's Deputy Director General, Servaas Deroose, recently admitted.[19] Running a double-digit fiscal deficit, back then, was undoubtedly irresponsible, but asking a country, which has lost 25% of its GDP, to run a double digit cyclically adjusted primary surplus, now, is also bordering on the insane.

The Troika says that these new savings can come from further shrinking of the public sector and lay offs. But more dismissals from the public sector would add a further burden to the country's "ground-zero-like" social security system, through additional unemployment benefits and pensions. In the absence of credit and investment, the private sector cannot create enough jobs to absorb those dismissed from the public

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[15] European Central Bank (2013), *Survey on the access to finance of SMEs in the euro area (SAFE)*, available online: http://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201304en.pdf?60898720eeff7420c0a7c03f977e086a

[16] International Monetary Fund (June 2013), *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*

[17] International Monetary Fund (October 2013), *World Economic Outlook*

[18] Jan in 't Veld (October 2013), *Fiscal consolidations and spillovers in the Euro area periphery and core*, European Commission, DG ECFIN Economic Papers, No. 506.

[19] During a hearing at the European Parliament over Troika crisis management, November 5, 2013.

sector. Hence, the social crisis will be further aggravated, and the bill will only be moved around, not avoided.

In short, Greece's budget balance is now much better than in many other EU countries. The size of its once inflated public sector is also approaching the EU average, through a shrinking amounting to more than 150,000 civil servants, in the period between 2010 and 2015. The purpose of the Memorandum of Understanding, signed with Greece's emergency lenders, has been achieved in these respects. But enough is enough. Unlike other crisis-hit countries, Greece is not suffering from prolonged recession. It is at the brink of a total catastrophe, because of the depth and pace of its economic adjustment, and the fact that no provision was made for a cushion to mitigate its effects on economy and society. For example, most of the people who left, or are going to leave, the public sector will still be subsidized by state coffers, either through pension funds, or unemployment benefits. Hence, an ever-shrinking number of working-population is asked to fill these coffers, since very little was done to create jobs in the private sector and increase the production of wealth. Given this picture, Troika's insistence that Greece's main problem continues to be fiscal in nature constitutes a gross misreading of the available data:

Table 3: Budget Balance Projections for Greece and Germany, in 2013

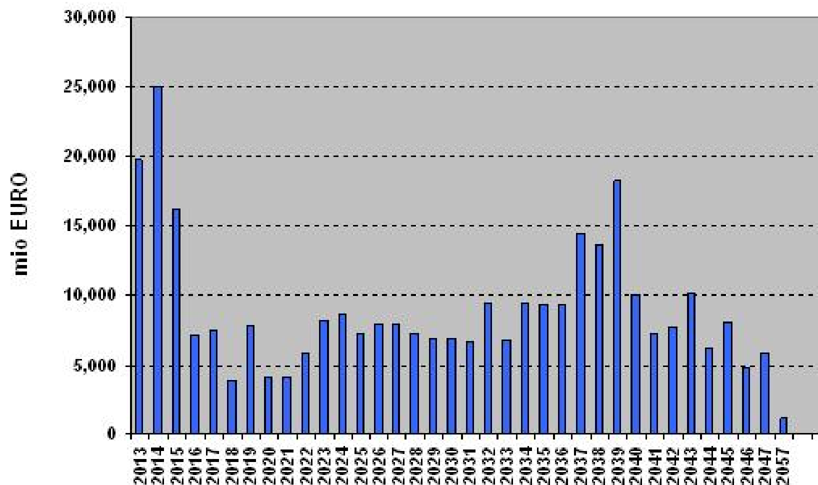
(Percent of potential GDP)	Greece	Germany
Cyclically Adjusted Balance	0.6	–0.1
Cyclically Adjusted Primary Balance	4.2	2.0

Source: IMF Fiscal Monitor, October 2013

Conclusions: Enough Already!

Fiscal consolidation was a necessary component of Greece's adjustment program, since, in 2009, the country's deficit skyrocketed to unsustainable levels. But fiscal balance has now ceased to be the main challenge. Instead, "Greekovery" requires immediate action on two fronts: first, a credible plan to reduce the burden of debt servicing costs for the Greek economy. This plan does not necessarily mean a debt haircut. Public debt sustainability depends on how much does a country need each year to service its obligations. Extended maturities and low interest rates can easily "do the trick", no matter the absolute number of Greece's debt. Hence, the Troika's fixation with the arbitrary "120% of GDP" threshold is, totally incomprehensible. This fixation leads to more demands for spending cuts, which do even more damage to an already shattered economy.

Figure 1: Maturity Profile of Greek Central Government Debt



Source: Public Debt Management Agency

So, the second thing Greece needs is not further fiscal consolidation, but a plan of emergency European investment, in order to expand the country's productive base, increase wealth production, and alleviate the social crisis, until the ongoing structural reforms bear fruits. It is worth clarifying, here, what do we mean by reforms: Greece does not need more "reforms with a positive fiscal impact", a euphemism for more cuts. Mismanagement or misallocation of public resources can now be addressed in an *ad hoc* basis, for each public entity. The kind of reforms that is really necessary may be fiscally neutral, at least in the short term: real reduction of bureaucracy and red tape; an overhaul of the electoral system; streamlining of information technology resources used by the public sector, in order, *inter alia*, to create economies of scale; generalized use of open source software; a stable tax regime; a legislative framework that favors medium - export oriented - enterprises, instead of independent professionals, and very small companies, whose income depends solely on internal consumption; a revamp of secondary and professional education. In other words, what is needed, is to make sure that all the necessary steps are taken, so that Greece becomes a more innovative and attractive economy. Such reforms will also function as the necessary checks and balances, which will prevent the misuse of the suggested "investment plan" funds by the clientelistic networks that ruined the country.

In any case, let us be realistic: no country can change its productive model without credit and liquidity. Greece deserves to get this "investment" plan, since its people have paid more than their dues to prevent contagion of the European periphery and correct the dire mistakes of the past. Moreover, Eurozone companies and states will get their money back from such potential investment, which would build on Greece's competitive wages, highly trained human capital, decent infrastructure, and ideal geographical location. Otherwise, they risk losing all the money they have provided, in the form of loans, to Greece, because the danger of implosion will persist. Unfortunately, this option is not even discussed in Brussels or Berlin. So the Troika insists on more fiscal measures, since there are no other options available. But

administering chemotherapy to a patient suffering from high sugar levels, just because insulin is not readily available, will not prevent a diabetic coma. To the contrary, it will probably make things worse.

The only cause of optimism is that the Greek people, so far, have shown remarkable resilience to the dramatic contraction of their economy, loss of wealth, and deprivation. And it is true that if the Greek government survives this winter, then more than 90% of the adjustment envisaged in the MoU, will be over. But surviving the winter and the Troika's demands without a catastrophic crash is far from certain. Even if Greece makes it in the end, it will not be because of what the Troika demands in late 2013, but despite that.

About the Crisis Observatory

In the context of the worst economic crisis in the history of post-war Greece and the wider European debt crisis, initiatives for the systematic and scientific documentation, study and analysis of the crisis in both Greece and Europe are sorely needed.

The Crisis Observatory aims to answer this call. The Crisis Observatory is an initiative of the Hellenic Foundation for European and Foreign Policy (ELIAMEP), with the support of the Stavros Niarchos Foundation.

Its primary objective is to become a central hub for information, research and dialogue for both the Greek and European crises. The Crisis Observatory's guiding principle is the presentation of new research, policy proposals and information, which are based on solid arguments and empirical evidence, with a view to improving the level of public discourse about the crisis. In order to achieve this objective, the Crisis Observatory's work is organized around three central pillars:

- The provision of educational material with a view to enhance the ability of the average citizen, who often does not have a good hold on economic issues, to understand basic parameters of the crisis.
- The provision of serious, evidence-based and representative, in terms of subject focus and theoretical/political approaches, information about the crisis.
- Intervention in the public discourse about the crisis, through the creation of a venue for the free expression of different views and policy proposals promulgation of new research about the crisis.

The team of the Observatory is:

Head of the Observatory

- Dimitris Katsikas, Lecturer, Department of Political Science and Public Administration, University of Athens [International and European Political Economy]

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