Greek Economic Crisis
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In 2010, Greece had the worst problems in the Eurozone

- Very large budget deficit, 15+%
- Large debt as percentage of GDP, unable to service it
- Very large and inefficient State sector; 800,000 employees in a country of 11 mil.
- Lack of competitiveness in parts of the private sector
- **The loan agreements (MOUs) with the EU and the IMF did not cause any of these problems**

The EU and IMF dealt with the crisis by helping Greece

(1) Reduce budget deficit (reducing spending, increasing taxes)

(2) EU lent to Greece at very low interest rates

- EU loans rates 0.5-1%; IMF loans rate 4-4.5%
- Current average program rate for Greece is about 1.5%

(3) Recapitalize banks

(4) Facilitate reductions in privately held sovereign debt -- PSI ("Private Sector Involvement"), "haircut"; restructuring of official sector debt

(5) Increase competitiveness by opening markets to competition and other "structural reforms"

The measures had varying success

- While the budget gap was closed,
- Reforms that were necessary to increase competitiveness stalled
- Populist gov. elected resisting reforms

(1) Implementation of reduction of budget deficit (reducing spending, increasing taxes)

- Not enough State budget cuts, mostly increases in taxes
  - **Significant mistake** that crippled Greece
- Budget cuts were across the board; no serious attempt to evaluate civil servants and retire the ones of unneeded functions or low productivity
  - Example: famous actress Melina Mercouri, was minister of culture; died 15 years ago
  - Until a few weeks ago, two policemen were still assigned to guard her!

Grave consequence of the mistake of increasing taxes

- Created 5 years of deep recession
- The State sector (and publicly traded companies it controls) is huge and very inefficient, and it weighs down on the private sector
- Depth and extent of the recession could have been avoided if State sector was cut and taxes were <u>not</u> increased

(2) EU lent to Greece at very low interest rates

- EU lent to "program countries" including Greece at very low interest rates
- Current average program rate for Greece is about 1.5%
  - EFSF and bilateral EU loans rates 0.5-1%
  - IMF rate 3.5-4.5%
- Opportunity: very low interest rates and postponement of interest and capital payments gave "breathing room" for Greece to recover
- Unfortunately, Greece missed the opportunity and did not recover

(3) Recapitalize/Rescue banks

- Greece borrowed €50 bil from EU to rescue its banks
- Financial stability loans for recapitalization of banks appear as “state loans” – does not make sense
- Unfortunately, in 2015, Greece sold the Greek banks to hedge funds losing practically all the money it invested in them

(4) "Private Sector Involvement" (PSI) Greek Debt Not Held by the EU and IMF cut by 74% in March 2012: Debt Haircut

(5) Increase competitiveness by opening markets to competition and other "structural reforms"

- Needed structural reforms
  - Open "closed" professions and sectors
  - Allow private universities
  - Shrink the State
  - Simplify state procedures for businesses
  - Cut corporate tax rates
  - Reform tax collection mechanism and reduce tax evasion
  - Create tax courts that decide in 6 months
  - Give a zero tax period for new businesses for 5 years
  - Go forward with privatizations
- Very little of these were done

In 2014 things looked good

- Ireland recovered and left the program; Portugal was close to leaving
- Greece that had the highest budget deficit
  - In 2014 had a primary surplus (gov. budget surplus disregarding interest)
  - Participated again in international money markets, issuing new bonds in April-May 2014 at 3.5% and 4.5%
- But unemployment & recession problems remained

The situation deteriorated sharply

- after radical left (populist) Syriza's share increased in European and local elections in May 2014
- The lenders wanted more than the government at the time could deliver facing a prospect of early elections
- Syriza promised an infeasible program
  - A reversal of all reforms and privatizations
  - Increasing the State sector
  - Increasing wages and pensions, including re-establishing the 13^{th} salary
  - Cutting the nominal value of the Greek debt by 50%!
- Result: Greece was excluded from money markets

Syriza elected, refused to negotiate with lenders, and let 2nd MOU end

- Syriza wanted to reverse reforms and not implement new ones
- Varoufakis' disastrous "negotiation"
- Referendum for or against the EU resulted ("no" vote)
- Banks closed for 3 weeks in July; re-opened under "capital controls"
- Agreement (3rd MOU) 7/12/15
- Greece in a severe money crunch

Economy has deteriorated sharply after capital controls

- Growth expectations went from +1% to negative
- Losses of at least €25 billion from growth reduction
- €86 billion new loan
- Additionally, the €25 billion Greece borrowed to recapitalize the banks in 2013, are now worth almost nothing; banks sold to hedge funds

The basic dilemma: bankruptcy with Grexit, or deal with Europe and the IMF

- Grexit would be a total disaster
  - Full scale bank run
  - Large immediate devaluation, inflation, extreme poverty, shortages of basic goods, irresponsible money printing, eventually hyperinflation

Deal with the EU is by far the best outcome. Should (1)

- Reduce State sector and make it more efficient
  - Evaluate civil servants and reduce their number
- Decrease taxes
  - Reform tax collection mechanism and reduce tax evasion
- Create incentives for investment
  - Lower corporate taxation
  - Create tax courts that decide in 6 months
  - Give a zero tax period for new businesses for a few years
  - Reduce bureaucracy
  - More business-friendly environment
- Use surplus to reduce corporate taxes and increase public investment

Deal with the EU is by far the best outcome. Should (2)

- Rationalize the pension system so that pensions correspond to contributions
- Revamp corrupt government procurement through competitive auction processes
- Open “closed sectors” of the economy
- Proceed with privatization of trains, airports, ports, and energy
  - Sectors starved of investment for years
  - Private parties would provide investment as well as run them more efficiently
- Labor market liberalization is essential

New investment in Greece

- Objective: reduce unemployment from 22% to 12% in two years by creating real jobs
- Sectors
  - Tourism
  - Renewable energy
  - Infrastructure
  - Export industries
  - Specialized agriculture

Restructuring of official sector debt (has not happened – my proposal)

1. EU debt about 214 bil at interest 0.5-1%
   IMF & ECB debt 29 bil at interest 4-6%
   Privately held debt 39 bil
   Short term debt (bills and notes)15 bil
   Total interest cost 2-2.5% of Greek GDP, not paid, recapitalized
2. How to restructure the 214 bil of EU debt?
3. No direct haircut (direct gift to Greece, politically unfeasible)
4. Solution: move debt maturity further in the future
   - Move by 20 years, reduces present value by about 20%
   - Move by 40 years, reduces present value by about 33%
   - Move by 60 years, reduces present value by about 45%
5. Convert rates to *fixed* interest rate of 1%
6. This process will save Greece very significant percentages of its Official Sector debt obligations in terms of net present value
7. Keep not paying interest (except to the IMF and privately-held debt). *Invest (not consume)* the saved (postponed, recapitalized) interest (2-2.5% of GDP) to reduce unemployment

Present negotiation (2^{nd} assessment)

- Major mistakes:
  - Greece lost the opportunity to end it during the Obama administration, with the help of Jack Lew
  - Presently too close to German elections for Greece to receive major concessions
  - Greece lost the chance to capitalize on the IMF-EU difference, evident since July 2015
  - Greece should have sided with the IMF because
    - The IMF was pushing for debt reprofiling
    - The IMF has lower growth predictions for Greece and had proposed lower primary surplus targets

Now Greece ends in the worst of all worlds; huge gov. failure

- Most likely agreement:
- High primary surplus target
- No reprofiling of the debt until the end of the 3rd MOU, 2018
- No ECB quantitative easing for Greece
- No issuing of Greek bonds

My proposal: Greece needs to convince the EU to have

- **Low primary surpluses (2%) for five years** with a commitment for Greece to invest another 2% rather than spend it on salaries and pensions
- Significant reduction in corporate taxes
- Radical change in bureaucratic procedures to facilitate investment
- Significant reduction in state expenditure
- Then Greece can attract foreign investment and achieve high growth

Bottom line

- 7 years of recession, -25% of GDP
- 23% unemployment
- But
  - Very cheap loans to Greece from EU
  - Almost balanced budget
- Needs reforms
  - Smaller State sector
  - Reduction in taxes …
- Reforms will not happen under the present gov.
  - **A reformist gov. and popular support for reforms is required**