“The Greek Crisis of 2009”

Yannis M. Ioannides

April 30 2010

Chronology Greece and the EU

Blame?

Greek Crisis

"Exchange rates"?

Central Role for Fiscal Policy

Quantitative Aspects of Fiscal Policy

Fiscal Adjustment

Will Austerity Measures Work?

Greece and the EU

- 1981: Greece enters the European Economic Community (2nd Enlargement)
- 1992: Maastricht Treaty, Economic and Monetary Union in Europe
- January 1, 1999: *Euro,* Common Currency introduced (electronically); exchange rates set
  Greece did not qualify at once, but was formally admitted in 2001: 340.75 Drachmas = 1 Euro (probably overvalued)
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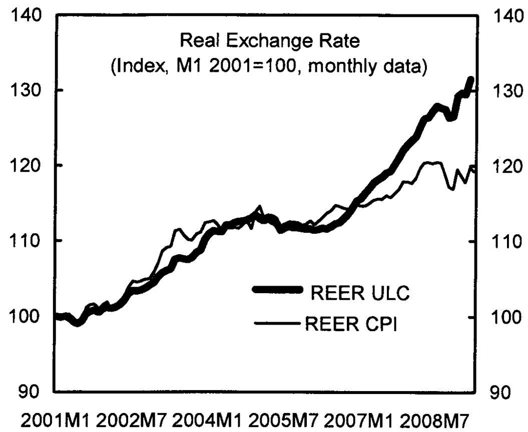
Who Is to Blame for the crisis?

MISMANAGEMENT, ON A COLOSSAL SCALE

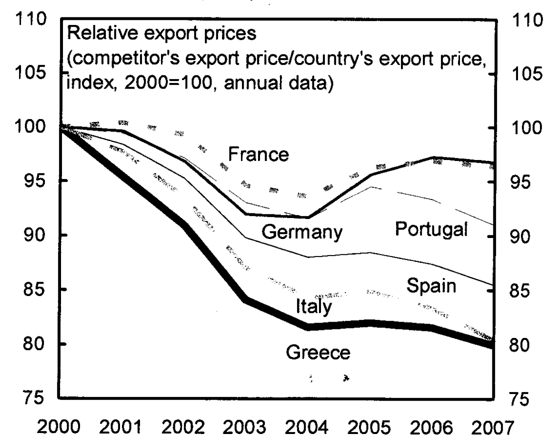
- "Real exchange rate" appreciating, 2001–2008, by 20–37%
- Greek exports 25% more expensive, 2000–2007
- Strong wage growth, appreciation of the Euro
- Dramatic loss of market share
- Low ranking in global competitiveness, product markets highly regulated
- Some success in technology-intensive manufacturing and in some services (sea transport)
- Doing business in Greece is difficult, because of bureaucracy
- Lagging in meeting Lisbon objectives.
  IMF Article IV Consultation, Staff Report, Aug. 2009, Fig. 13, 14.

Figure 13. Greece: Competitiveness Indicators

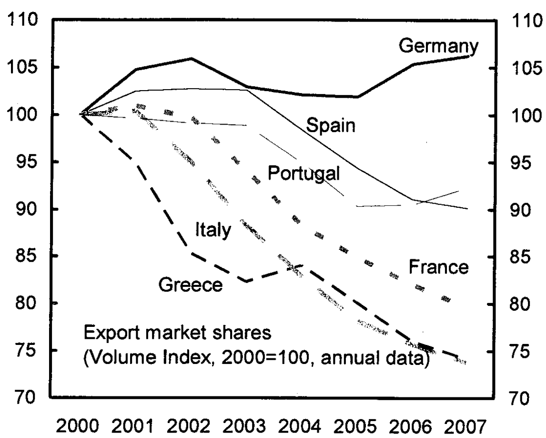
Greece's real exchange rate has been appreciating...



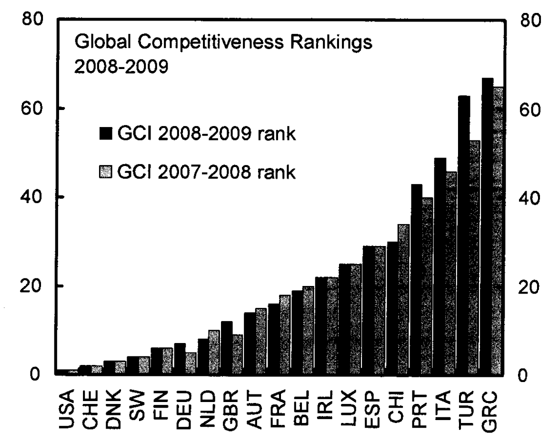
...its relative export prices have deteriorated...



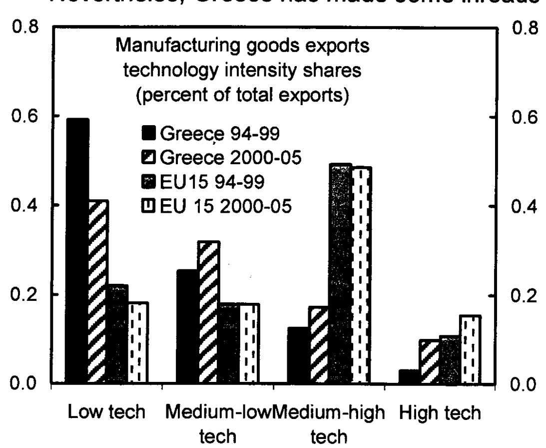
... it has lost market share relative to peers...

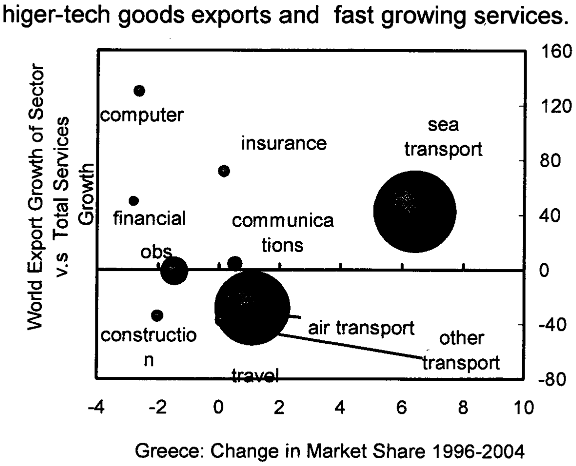


... and ranks poorly on competitiveness measures.



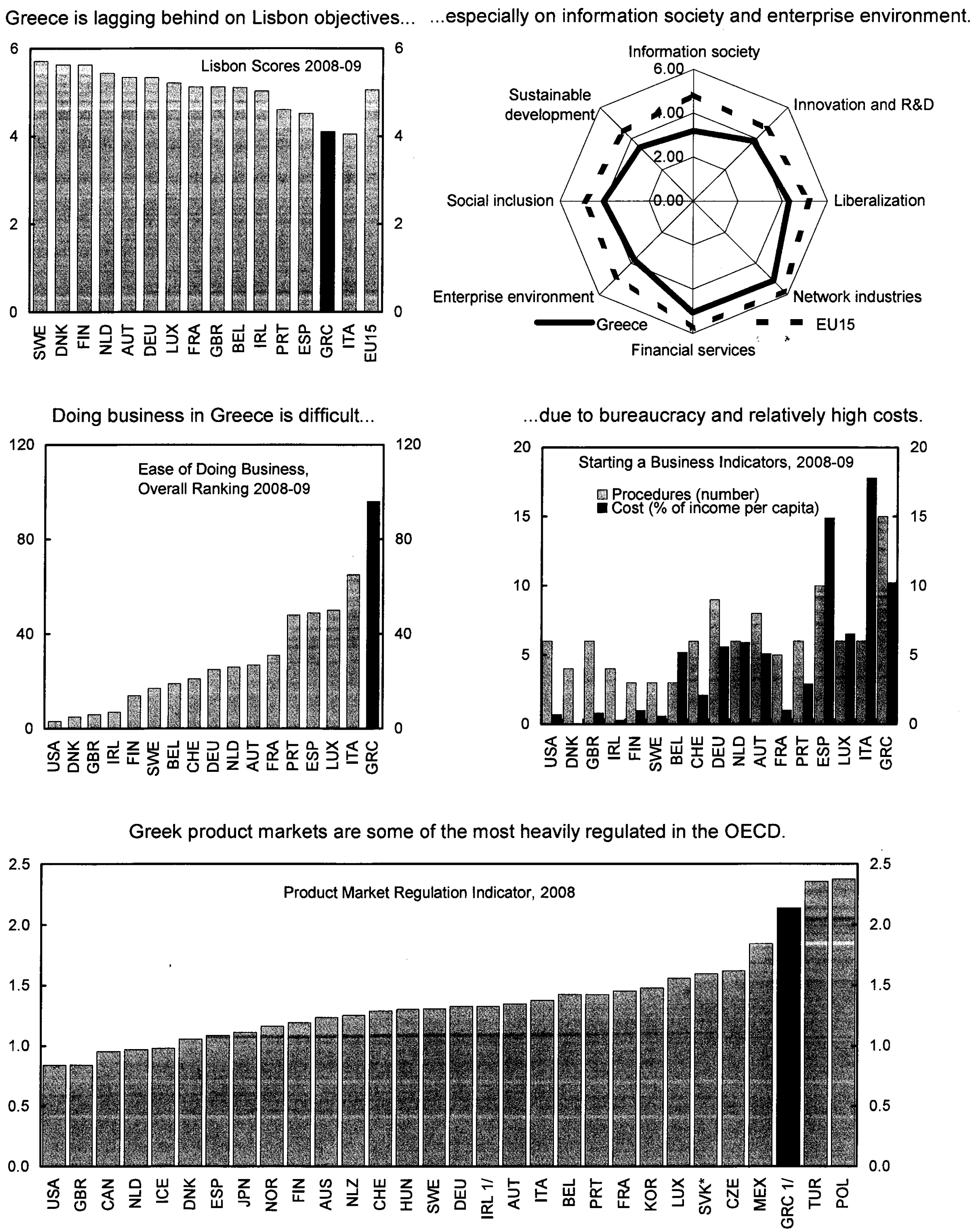
Nevertheles, Greece has made some inroads into higer-tech goods exports and fast growing services.





Sources: ECB; WEO; World Economic Forum; IMF, *BOP statistics*; Eurostat; and Comtrade.

Figure 14. Greece: Product Market Performance



Sources: OECD; World Bank; World Economic Forum; and IMF staff estimates.
1/ 2008 data are unavailable so 2003 data are used instead.

Chronology of the Crisis

- 2000: Pasok wins election
- 2002: Greece enters the Eurozone
- March 2004: New Democracy (N.D.) wins election
- August 2004: Olympic Games
- September 2007: N.D. wins second mandate,
  under shadow of vast frightening fires
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- Evidence shows fires correlated with electoral cycle
  Christodoulakis and Skouras (2009)

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Greece admits faking data

- N.D. Finance Minister Alogoskoufis proposes fiscal census
- Greece (and Eurostat) revise faulty data, found in violation of Excessive Deficit Procedure:
  Deficit $>$ 3% of GDP.

	2000	2001	2002	2003
Reported Deficit	2.0	1.4	1.4	1.7
Actual Deficit	4.1	3.7	3.7	4.6
Actual Debt	114.0	114.7	112.5	109.9

- New plan of fiscal consolidation, but:

	2006	2007	2008	2009
Actual Deficit	3.6	5.1	7.7	13.6
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Elections and Data Revisions

- January 2009: Finance Minister Alogoskoufis resigns
  "Cant win elections with him"
  Politicized tax collections, tax evasion galloping with impunity
- October 2009: Pasok wins in a landslide; revises Deficit/Debt figures
  Pasok promises "there is money;" N.D. blames the global financial crisis
- Devastating report:
  REPORT ON GREEK GOVERNMENT DEFICIT AND DEBT STATISTICS EUROPEAN COMMISSION, Jan. 8, 2010

Macroeconomic Policy with common currency

- *Euro* members can no longer print their own currency
- They may manipulate spending and taxes, borrow and lend, but not print money.
- I.e. they may use only *fiscal policy.*
- National interests represented via the European Central Bank governance structure,
- Still, ECB monetary policy is "one size fits all."

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Exchange rates and competitiveness

- No longer exchange rates, but nations are trading entities, with different prices, wages, costs of production
- and, different rates of productivity growth: more productive economy, cheaper to produce
- *Shadow* exchange rates: high inflation in Greece, low inflation in Germany: balance out in the Union, but
- Greece will end up with higher costs, *lose competitiveness*

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A little bit of math on the dynamics of fiscal policy

- Let b_t be public debt B_t as share of GDP_t, $b_t = \frac{B_t}{\text{GDP}_t}$, $\text{Taxes}_t, \text{Spending}_t$, taxes, spending. Then:

$$b_t - b_{t-1} = (\text{interest rate} - \text{growth rate}) b_{t-1} + \frac{\text{Spending}_t}{Y_t} - \frac{\text{Taxes}_t}{Y_t}.$$

- So, if

$$\text{growth rate} > \text{interest rate},$$

the growth rate exceeds the interest rate on the government debt, then debt as a share of GDP can decrease, even even if

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This is the simple logic of the Greek financial problem

- For Greece, $\frac{\text{Debt}_t}{\text{GDP}_t} = 1.20$: Borrowing at say 6.00% means the economy must grow at least that much for it to be able to make a dent into its debt.
- Unless, it can run a surplus: $\text{Spending}_t < \text{Taxes}_t$
- and numerically large enough to make a difference.
- and/or grow faster.

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How can it grow faster?

- By producing and selling more goods.
- For which it must be competitive.
- But has lost competitiveness, relative to Germany and the other big exporters in the EU [Graph RGE Re Exch Rate 1999–2009]
- How can it regain competitiveness?
  - By restraining its cost increases, that are caused by wage and price increases.
  - Adopting productivity improvements in an accelerated pace.
  - When you think of the frightening state of Greek education — all levels — this is not so easy, nor readily implementable.
- This puts fiscal policy in a central role.

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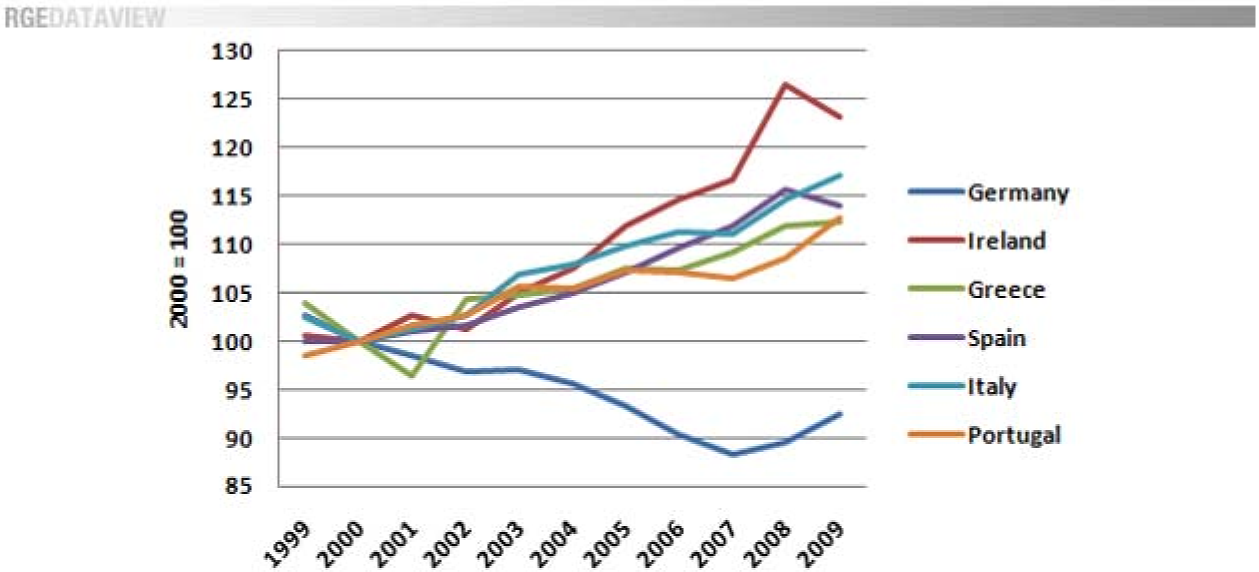
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- By reducing aggregate demand, wage and price increases are dampened and more output is directed to investment and away from consumption.
- But, this also reduces total output and income, and may exacerbate deficit problem,
- Less output, less income, less taxes, but some spending may be difficult to cut, for social insurance and services
- Harder to pay borrowers.
- HELP!!!!!!

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- Help with restructuring debt, *refinancing* it, so that Greece can carry out the necessary adjustments
  Greek public debt, fairly short maturities — see graph [RGE Greek Debt Maturity].
- Self-help by reforming domestic economy via:
  - reform of public finances, i.e., collect more taxes, rationalize spending
  - incentives for the population to work more and produce more. Like postponing retirement,
    - whereby more is produced — the denominator increases,
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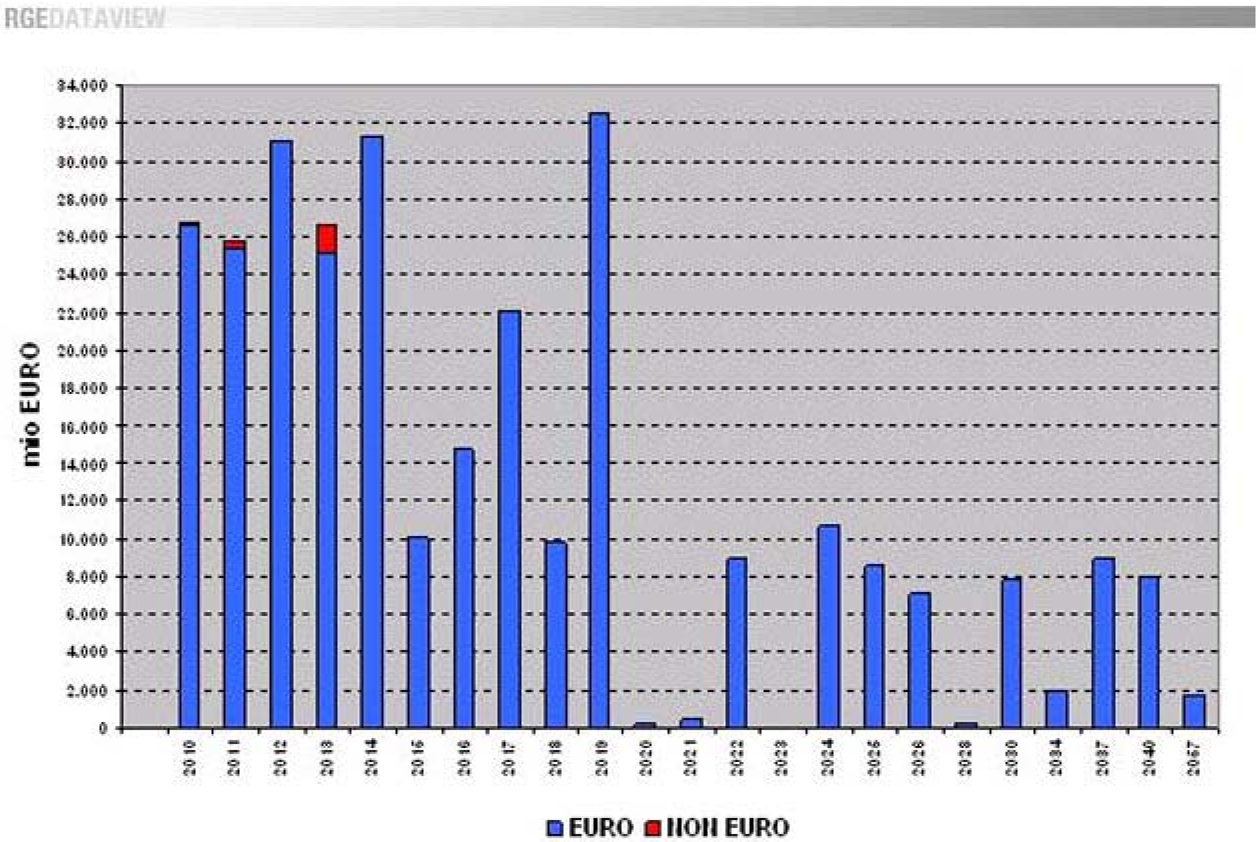
- But this is not business as usual!
- and Most important problem: decrease in spending creates/exacerbates recession.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How much? How long? What are consequences?

- Need help until the good things, cost reductions, which includes income reductions, take effect.
- Unemployment will go up
- Reforms cost when they also involve investment, social safety nets, retraining. Takes time.
- Needed fiscal policy is huge — better to spread it over longer time horizon
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What are the numbers?

- *Eurostat Newsrelease* 55/2010, April 22, 2010: Data for 2009, All magnitudes share of GDP

Country	Deficit	Spending	Revenue	Debt
Greece	13.6%	50.4%	36.9%	115.1%
Euro area 16	6.3%	50.7%	44.4%	78.7%
Portugal	9.4%	51.0%	41.6%	76.8%
Ireland	14.3%	48.4%	34.1%	64.0%
Italy	5.3%	51.9%	46.6%	115.8%
Spain	11.2%	45.9%	34.7%	53.2%

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What are the numbers? Continued

- How much recession?
- Standard, "back-of-the-envelope" Keynesian calculation of the multiplier:
  Reduction in spending reduces demand, reduces production, reduces income, which in turn reduces consumption ... and also reduces imports (which is leakage) which dampens the impact:
- Multiplier, Greece: $\frac{1}{\text{savings rate+import (\% GDP)}} = 2.5$
- large! Much larger than PT: 1.7; IT: 1.5; IE: 1.3; Spain: 2.0

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Fiscal Adjustment

- Debt as share of GDP $= 1.2$.
- During boom, needed primary surplus of 3.9% to offset increase in debt.
- Up till 2007, growth in GDP of 7.00%, sufficient to prevent increase in debt as share of GDP, even with a deficit of 3–4.00%.
- Now, real GDP growth down to -1.96, nominal 0.60%. (IMF)
- Greece needs a primary surplus of at least 6.00%
- Previous scenario very optimistic, assumed trend growth of 3.00%.
- More realistic, entire cumulative reduction of 26.00%, implying an increase in unemployment of 7.9%.

Austerity Measures: will they work? – A pessimistic scenario

- Many reasons to believe they will not.
- Greece failed to modernize, while vast resources were made available
- Measures have to induce modernization: read P. Tsoukalas, *NY Times*, op ed. April 25, 2010:
  "A Family Portrait of a Greek Tragedy."
- Biggest casualty of all: European political integration, set back!!!
- How likely is it that we shall see a federal fiscal policy in Europe?
- Why? Read Kaplan, *NY Times*, op ed. April 25, 2010 — geography and history combine to make Greece a test case.
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- After a rough few years
- IMF-inspired reforms will improve incentives to produce.
- GDP will start going up, not down.
- Greece can sell assets; all kinds including the Olympic Games real estate
- The country can come out of this with a chance at sustainable growth, and lessons of humility learned.

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