Business File ASKS

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Is this the end of crisis?

Is this the beginning of recovery?

Entering the last year of the programme, due to end August 2018, these two questions puzzle government and political parties, and most of all the Greek citizens, exhausted by the austerity, the endless fiscal measures, the low perspectives in labour market, the anaemic dynamics of investments. Yet the Greek economy is slightly moving ahead, thus creating high and hasty expectations to the government faced with many thoughts, doubts, and preconditions for recovery set by the majority of academics, economists, analysts etc.

Business File asks these two questions to Nikos Vettas, General Director, Foundation for economic and Industrial Research (IOBE) and Professor, Athens University of Economics and Business, and Dimitri Vayanos, Professor of Finance, Director of the Paul Woolley Centre for the Study of Capital Market Dysfunctionality, and Fellow of the British Academy London School of Economics business.

Co-authors and co-ordinators (with Costas Meghir and Christopher Pissarides) of the book "Beyond Austerity: Reforming the Greek Economy" (MIT Press Cambridge, Massachusetts, 2017), they present a very small but most interesting extract from the book.

The end of the programmes and the end of the Greek crisis

By Nikos Vettas*

Almost ten years in recession and eight years in successive rescue and adjustment programmes, of unprecedented magnitude and nature, is really a long time. During this period, the environment has changed. The Eurozone has created mechanisms to minimise the effect of crises stemming from economic and financial imbalances. Europe appears ready to deepen its integration, including a banking union and fiscal coordination, while its economy is progressing well, despite the Brexit decision. Global growth is strong, if anything with excessive appetite for risk and new debt, and the protectionist rhetoric in US politics does not appear a force that can reverse the global trade and innovation dynamics.

The Greek crisis was triggered by the 2008 financial crisis initiated in the US, which soon after put into question the viability of the Eurozone. Competitiveness in Greece was weak for the preceding two decades and more, primarily due to perverse incentives and introvert business activity, reflecting the excessive State control. Coupled with irresponsible fiscal policies, it implied high twin deficits that made subsequent growth and access to finance impossible. When the problems could no longer be masked by the global euphoria of the 2000s, Greece became the centre of attention, despite the small size of its economy, exactly because of the global implications of a possible outright default. In the context of three successive programmes, Greece was given access to an extremely high loan from the official sector.

The 2017 data and 2018 projections indicate that the Greek economy is on a recovery path, with annual real GDP growth around 1.5 to 2%. In addition to

starting from a very low base and the impact of policies implemented during the programmes, especially labour market reforms, the main drivers for the recovery are two. First, in sharp contrast to the past and especially the 2010-2015 period, there is an agreement between the government and the main opposition about the need to go through the adjustment programmes and to avoid conflict with the debtors. Second, strong growth in the external environment, and especially in Europe, increases demand for tourism and exports of goods. So, is this the end of the crisis? Will Greece need another rescue package or will it gain regular access to the world capital markets? Is the Greek economy at the start of a growth path?

One can argue that the objective conditions exist for the Greek economy to enter a period of growth. At the same time, one cannot overemphasize the severe related risks and that the road ahead may be bumpy. Yes, the twin deficits have been fixed and a number of structural reforms implemented. Also the danger of departure from the euro-zone, a key factor keeping investment away during the past years, is currently extremely low. However, severe challenges require attention, including a vulnerable banking system (under capital controls since 2015), uncertainty about the public debt dynamics in the middle and longer-run, as well as the management of private non-performing loans. More crucially, however, one needs to ask if the core structure of the economy has changed enough to guarantee a sustainable growth and even resilience to possible future crises. The public sector may have shrunk in absolute terms, but not relative to the productive economy, and direct or indirect State control has not decreased. Exports have been increasing lately but their overall performance is weak, partly due to the anaemic path in investment.

In some ironic way, therefore, the Greek economy is back at the crossroads, similar in nature with the start of the crisis. While external risks should not be underestimated, the main concern is that the opportunity for a drastic transformation of the economy during the crisis appears to have been wasted. Even if those who currently control economic policy in Greece, both the government and the debtors, appear content that Greece is back towards normalcy, the fact is that if the pre-crisis habits remain dominant, growth rates will be systematically lower than those desirable, and in fact necessary.

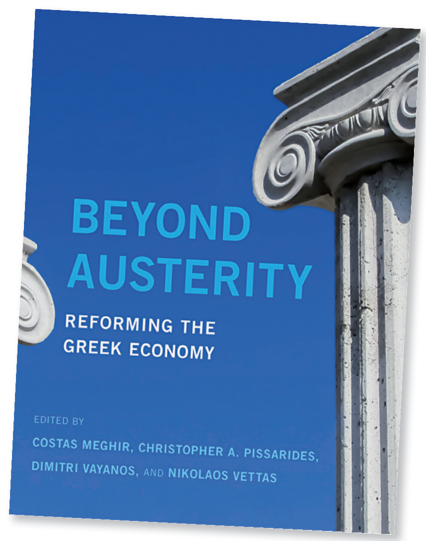
As if really no lesson has been learned, some sides cultivate the idea that, with the end of the third programme this summer, Greece will free itself up from the constraints that have been imposed by the programme and can continue its natural route, where it left it ten years ago. This includes politicians, who may not wish to give up their excessive control on the economy, businesses that seek to benefit from special treatment and a dysfunctional public administration that creates entry barriers in their markets, as well as special interest groups eager to participate in a rent extraction game. The end of the current programme directly implies less protection. The Greek economy will need to be gaining the trust of the markets by becoming a more open and less centrally controlled system. If it does not follow such a path, its current recovery will surely prove only temporary. bf

** General Director, Foundation for economic and Industrial Research (IOBE) and Professor, Athens University of Economics and Business*

Beyond austerity
Reforming the greek economy

In this 720 pages book BEYOND AUSTERITY: REFORMING THE GREEK ECONOMY professors Costas Meghir, Christopher A. Pissarides, Dimitri Vayanos, and Nikolaos Vettas, coordinating a number of prominent contributors take a broader and deeper view of the Greek crisis and its pathologies, and offer possible directions for policy in the years to come after the end of the current Programme

Business File presents some extracts of this very important work



Policy Options Going Forward

The Long Run

To organize our discussion of Greece's policy options going forward, we start from the long run: where Greece should aim to be 20 years from now (with "now" being 2016) [...]

[...] In a nutshell, a desirable long-run state for Greece is one where all types of markets are more open, the public administration is more efficient, transparent, and nonpolitical, and significant emphasis is given to education and human capital [...] Greece lags behind most EU and OECD countries on these dimensions. For example, it scores close to the bottom (within these groups of countries) in rankings measuring the ease of doing business, the quality of product market regulation, the efficiency of courts, the performance of the education and health care systems, the investment and outcomes in innovation and R&D, the quality of social protection, and so on. The degree of control that the political party in government has over the public sector and economic activity more generally is also particularly large in Greece.

Improvements on all these dimensions are critical for Greece's long-run growth. Indeed a large body of academic research has shown that countries' long-run growth depends to a significant extent on their human capital and ability to innovate as well as on the quality of their institutions. So while Greece is likely to recover some of the large drop in GDP that it suffered during the crisis, it is also likely to experience long-run stagnation if it does not improve on the dimensions noted above. Long-run stagnation would bring about a significant decline in Greece's relative standing among EU countries in terms of GDP per capita. A decline has taken place during the past 30 years: Greece dropped from 13th among the EU28 in 1985 to 19th in 2015 in terms of its GDP per capita, and was surpassed not only by Ireland and Spain (as mentioned earlier in this chapter) but also by former communist countries such as the Czech Republic, Estonia, and Slovakia. That relative decline could become a foretaste of things to come.

Many of the chapters in this volume describe in greater detail aspects of the desirable long-run state for Greece [...]

[...] *Chapter 4* argues that Greece should formulate a national competition and competiveness policy. Among other things, that policy should include the establishment of a new public agency tasked with evaluating the effects of new and existing regulations—with a view to abolishing regulations that do not promote entry and competition. Agencies with such a remit and the required political independence exist in many advanced countries.

Chapter 6 proposes the abolition of most labor market regulations, except for those pertaining to health, safety, and discrimination. Chapter 6 also emphasizes that the deregulation of the labor market should be combined with the establishment of a robust system of social insurance that protects workers from the consequences of unemployment and low pay.

Social protection is taken up not only in chapter 6 but also in chapters 10 (on taxation) and 11 (on pensions). A theme common to all three chapters is that Greece can improve social protection while also providing more powerful incentives for wealth creation in markets. Improvements for social protection are necessary both to address the current poor state of social protection in Greece (section 1.2.4) and to ensure that the wealth created by opening up markets in the future will be spread more evenly throughout the economy.

Chapter 10 proposes the establishment of a simple and integrated tax and welfare system to replace Greece's fragmented tax system and essentially nonexistent welfare system. All three designs that are considered involve a minimum guaranteed income. Their main differences concern the relative weight of consumption versus income taxes, and the possible introduction of a negative tax rate ("earned income tax credit") that subsidizes work by low-paid individuals.

Chapter 11 proposes the establishment of a multipillar pension system similar to those adopted by many advanced countries. Under that system, the state would provide a minimum pension to protect against old-age poverty, as well as a pension that would depend on contributions but be significantly smaller relative to current levels. The state pension would be complemented by individual retirement accounts with tax incentives, and possibly by occupational pensions that, unlike in the current system, would not carry state subsidies. Because pension contributions would be significantly smaller under the proposed system, the implicit tax on labor would be small. That would stimulate job creation and discourage contribution evasion. Additional benefits of the proposed system are that it would boost household savings and promote the development of capital markets. The cost of capital for firms would thus decrease, and corporate investment would increase. Realizing these benefits would also require improvements in financial regulation and enforcement[...]

Chapter 14 proposes reforms to the public administration that include making the evaluation and disciplinary processes for civil servants more rigorous and less formalistic, benchmarking the performance of public agencies against key performance indicators that can be monitored publicly, and devolving more powers and accountability to lower levels of the administration.

Chapter 12 proposes an across-the-board reform of the Greek justice system that is based on some of the same principles. The proposals include changes to the rules governing the evaluation and promotion of judges so to better reward performance and reduce political influence, devolution of powers to courts to manage their resources, more investment in infor-

The reorientation of the Greek economy

By Dimitri Vayanos

Professor of Finance, Director of the Paul Woolley Centre for the Study of Capital Market Dysfunctionality, and Fellow of the British Academy London School of Economics business

The Greek economy is gradually reorienting itself towards producing more tradeable (exportable) goods and services, and fewer non-tradeables. This process, which reverses the shift towards non-tradeables following Euro entry, is unavoidable given that Greece must begin to make net repayments on its external debt. Greece's growth rates over the medium term will depend on how quickly it makes that shift. In particular, a growing tradeables sector holds the key to reducing the large unemployment rate.

Exports are likely to grow over the next 2-3 years, and so are investment and GDP. Positive factors include some of the labor- and product-market reforms implemented as part of the adjustment programs, the near-elimination of Grexit risk, and the Eurozone's recovery. Negative factors include backtracking and ambivalence on reforms, and the high levels of taxation and other costs of doing business. Because of these factors, GDP growth in Greece is likely to lag the EZ average, despite the large under-utilization of productive resources in the economy. An indication of these weaknesses is that exports declined in value both in 2015 and 2016.

Over the longer term, Greece's growth rates will depend on its ability to innovate and to compete internationally in high value-added sectors. The current prospects for this are mediocre given the state and direction of the education system and of other costs to innovating and doing Professor of Finance.

mation technology, more emphasis on judges' training in business-related disciplines, the establishment of specialized tribunals to handle cases where special expertise is needed such as in tax evasion and bankruptcy cases, and improvements to the system producing new legislation.

Improvements in incentives and accountability, together with less centralized control by the relevant government ministries, are central to the reforms proposed in chapters 8 (on education) and 9 (on health care) Chapter 8 proposes reforms that include evaluating schools and universities more rigorously based on students' performance in the former case, and research output and quality of teaching programs in the latter; giving schools and universities more autonomy, such as in selecting teachers and man- aging budgets and curricula for schools, and full operational responsibility for universities; and making more resources available to attract and reward individuals with high academic achievements, as this will help improve the* overall *quality level and reduce Greece's brain drain.

Chapter 9 proposes reforms that include the rigorous implementation of contracting mechanisms, whereby the single health care fund (EOPYY) negotiates supply contracts with hospitals and pharmaceutical companies, and leverages the competition among them to reduce cost; the devolution of more budgetary and operational independence to public hospitals; and a more arm's-length relationship between EOPYY and the Ministry of Health.

The Transition

A transition to the long-run state would require a sustained effort lasting for many years. Greece has not only to catch up with (or do better than) the EU average on various dimensions of institutional quality but must also do so in an adverse macroeconomic environment. Indeed its economy has been shrinking every year from 2008 to 2015, with the exception of a small positive (real) growth rate in 2014[...]

Proceed with Key Structural Reforms

A gradual but systematic effort should be devoted to pursuing the structural reforms. Priority in the short run should be given to opening up product markets, and improving the education system, the justice system, and the public administration more broadly [...]

Stay in the EZ

Staying in the EZ is important for Greece, both for the short and the long run. In the short run, an EZ exit would create huge adjustment problems relating to Greece's banks, foreign trade, output, and employment. The dramatic events in the summer of 2015, when Greece came close to exiting the EZ, provide a glimpse into these problems. In the long run, staying in the EZ would provide the critical discipline and encouragement for continuing with the reforms. Indeed, EZ institutions will continue to pressure Greece and other EZ countries to reform and make their economies more efficient because this is viewed as necessary for the monetary union as a whole. Moreover staying in the EZ but not reforming will be painful for Greece: Greece would be constantly losing competitiveness relative to the other countries, and would have difficulty exporting and creating jobs. These issues are discussed in greater depth in chapter 2 (on the macroeconomy) where it is also argued that any beneficial effects of EZ exit on Greece's trade surplus are likely to be small.

Uncertainty about Greece's position in the EZ is damaging for investment and growth. A broad political consensus exists in Greece in favor of staying in the EZ (although this may change if Greece is unable to reform its economy in the next few years and the economy keeps shrinking or stagnating). Greece's EZ partners should also do their part to remove the uncertainty by not encouraging Greece to exit the EZ, as they are better off with a reformed Greece inside the EZ than with an unreformed Greece outside the Union. Removing the uncertainty requires the EZ, in particular, to provide Greece a clearer path for debt relief. Debt and Greece's EZ position have become connected because a default on the debt by Greece has been viewed as a trigger for an EZ exit.

Agree on a Path for Debt Relief

Greece did not benefit from debt relief in 2010, when it lost market access. Relief on the debt held by private investors came in 2012 in the form of the PSI. There was also some relief on the debt held by EZ taxpayers because that debt came with long maturities and below-market interest rates. Moreover there has been a grace period on interest payments for most of the latter debt (ESM loans) until 2022. As a consequence of these actions, interest payments on Greece's debt are relatively small in the short run, and the debt's high value in nominal terms overstates its value in present-value terms . Yet the interest payments on the debt can become large in the more distant future, since much of the debt comes with floating interest rates that can increase if global rates increase. This creates uncertainty, and thus suppresses investment. Also, on the grounds of fairness Greece has a strong case for debt relief: the relief that it has obtained is smaller than what it would have gotten had it defaulted in 2010, and the main reason why it was not allowed to default at that time was to safeguard the stability of the EZ (and the global) financial system, benefiting thus other EZ countries.

Debt relief should take the form of extending maturities and locking in interest rates at their low current levels. This would keep interest payments manageable and would reduce uncertainty. Such changes could be agreed on the part of the debt that is held by EZ taxpayers, since it constitutes the majority of the debt and can be restructured more flexibly than the part held by private investors.

At the same time, debt relief should be used as a tool to incentivize reforms, which are necessary for Greece's long-run prosperity within the EZ. Relief should occur gradu- ally and be made conditional on measurable reform efforts. Incentives based on debt relief are likely to be more effective than threats of EZ exit because they provide a positive path for the economy going forward: the end goal is an economy that is both reformed and has a sustainable level of debt. Debt relief could also serve as a powerful signal: by providing relief the creditors could be signaling to the markets and other- third parties their commitment to support the Greek economy, as long as progress is being made with structural reforms [...]