“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)

- January 1, 2002: *Euro*, Common Currency introduced throughout the 12 members
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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...

Real Exchange Rate
(Index, M1 2001=100, monthly data)

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

Relative export prices
(competitor’s export price/country’s export price,
index, 2000=100, annual data)

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

Export market shares
(Volume Index, 2000=100, annual data)

...and ranks poorly on competitiveness measures.

Global Competitiveness Rankings
2008-2009

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

Manufacturing goods exports
technology intensity shares
(percent of total exports)

World Export Growth of Sector
as % of Total Services Growth

Greece: Change in Market Share 1996-2004

Sources: ECB, WEO, World Economic Forum; IMF, BOP statistics; Eurostat; and Comtrade.
Figure 14. Greece: Product Market Performance

Greece is lagging behind on Lisbon objectives... especially on information society and enterprise environment.

Doing business in Greece is difficult...

Greek product markets are some of the most heavily regulated in the OECD.

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 amidst total collapse of public sector services
  - Evidence shows fires correlated with electoral cycle
    Christodoulakis and Skouras (2009)
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- 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.

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<tbody>
<tr>
<td>Reported Deficit</td>
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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$_t$, $b_t = \frac{B_t}{\text{GDP}_t}$, Taxes$_t$, Spending$_t$, taxes, spending. Then:

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

- So, if

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  \text{growth rate} > \text{interest rate},
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  the growth rate exceeds the interest rate on the government debt, then debt as a share of GDP can decrease, even even if

  $$\frac{\text{Spending}_t}{\text{Y}_t} > \frac{\text{Taxes}_t}{\text{Y}_t}.$$ 

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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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http://www.roubini.com.ezproxy.library.tufts.edu/analysis/pdf/Eurozone_Q2_2010_Figure... 4/25/2010
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Central role for Fiscal Policy

- 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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Panel: Giavazzi & Ioannides “The Greek Crisis of 2009— and the Future of the EMU”
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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
- Unemployment increase can be large
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What are the numbers?

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

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<td>Euro area 16</td>
<td>6.3%</td>
<td>50.7%</td>
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<tr>
<td>Portugal</td>
<td>9.4%</td>
<td>51.0%</td>
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<tr>
<td>Ireland</td>
<td>14.3%</td>
<td>48.4%</td>
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- April 23, 2010: Prime Minister Papandreou announces Greece to seek aid under the EU/IMF Plan, March 25–26, 2010
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<td>Ireland</td>
<td>14.3%</td>
<td>48.4%</td>
<td>34.1%</td>
<td>64.0%</td>
</tr>
<tr>
<td>Italy</td>
<td>5.3%</td>
<td>51.9%</td>
<td>46.6%</td>
<td>115.8%</td>
</tr>
<tr>
<td>Spain</td>
<td>11.2%</td>
<td>45.9%</td>
<td>34.7%</td>
<td>53.2%</td>
</tr>
</tbody>
</table>

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What are the numbers? Continued

- How much recession?
- Standard, “back-of-the-envelope” Keynesian calculation of the multiplier:
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- My own estimate of Okun’s law (1990–2009), consistent with previous estimates [Zonzilos (2000)]
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  \[ U.R_t - U.R_{t-1} = -0.302 \left[ \text{GDP Growth Rate} - 3.41\% \right] \]
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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
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