Greek Privatizations and Long-Run Growth: Doing it Right?

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The Greek crisis, now 3.5 years since it was publicly recognized and with its all too familiar images, originally of violent street demonstrations, burning buildings and cars, and now soup kitchens and harrowing pictures of elderly people looking aloof while passing by shutdown store fronts full of angry graffiti, is Greece's most serious crisis since the the Greek Civil War. It is more serious than 1967–1974, the junta years and July 1974. The country's national income continues to decline for the fifth year, unemployment has risen from 10% to 27%, youth unemployment has reached 58.6%. There is no end in sight. The suffering is unambiguous; it cannot be dismissed as temporary or passing.

The Greek crisis is a complex outcome of two profound economic crises. With external and internal deficits, Greece has been consuming more than it is producing, it buys more from abroad than it sell abroad. The government spends more than it can pay for out of the taxes it collects. By and large, this has been going on for a while, and the Greek government has been borrowing large amounts, on behalf of its citizens and itself, to facilitate this behavior. At some point, In November 2009, lenders were no longer prepared to lend to Greece anymore, simply because they could not see in the foreseeable future how they would be repaid. When this happens, we see it as extraordinary increases in interest rates lenders wish to charge for Greek borrowing, which are registered indirectly in the implied interest rates from the sales of financial instruments, bonds, that are obligations of the Greek government. See graph. This so-called *spreads* are reported by the financial press relative to the benchmark rates at which Germany borrows for comparable lengths of time, similar maturities. One can follow a crisis by observing such spreads, and one can compute associated probabilities of bankruptcy from the cost of insuring against defaults (also reported by financial markets). See graph.

One can see that lenders used to think Greek borrowing carried the same risk than German borrowing!

Growth matters!

If the total debt of a government is not too large, it can pay back its lenders provided that it can collect in taxes more than what it spends. If there is growth, then a given amount of debt is easier to "service," that is to pay back interest plus principal. If a government can tax more than it spends, then it can get by. If its economy is growing faster than the rate of interest it is charged, it can tolerate even moderate primary deficits, that is the excess of spending over taxes. The worst-case scenario is when the debt as a share of GDP is large, requiring a large slice of the country's income to keep paying back the debt, the growth rate of GDP is small, and thus what the government owes along with accruing interest cause the debt as a share of GDP to grow, and taxes fall short of spending. An economy that can persuade its lenders that healthy growth in the works in the long run could easily weather such shocks, arguably like the US economy at the present time. So, the key issue here is growth. With robust growth, debt as a share of GDP will stop being a problem. I will come back to that.

Greece indeed faced a *nightmare* scenario when the crisis erupted. The Greek government showed stunning inability to come to terms with the seriousness of the crisis, all the while sending to its EU partners in Brussels plans to deal with the crisis that simply fell short of the seriousness, further precipitating their confidence as well as the confidence of the lenders about whether the government was prepared to take the measures that were called for by the seriousness of the crisis.

Crises always occur. What can a country do in such situations? A democratic government should inform both its citizens and its legislators of the seriousness of the crisis and explain how it proposes to deal with it. Inability to borrow is serious, it means being forced into autarky, real autarky in terms of goods and denial of trade credit and of finance.

A sovereign country can always stop paying its lenders, and the privilege of sovereign immunity can protect it from its lenders. But that, however tempting, might not be a good strategy. A country that runs its own currency and which has financial obligations denominated in its own currency can always pay back by printing money. Again, that might not be a good idea for other reasons.

Greece does not have its own currency, and in effect borrowing in the currency it shares with others works almost like *borrowing in foreign currency*. So, the only option for Greece was to cut back on its spending, increase its taxes, and seek an agreement with its lenders, to restructure its debt in order to facilitate repayment. These things happen all the time. Lenders are unhappy with that, but not too unhappy, because they would rather get something rather than nothing! In fact, they are quite aware of the additional difficulty they would be imposing on the country's ability to recover if they were to insist that they needed their money right then! Fiscal tightening, also known as fiscal consolidation, causes a contraction, that is it causes a decrease in a country's income, other things being equal, thus making it harder for a country to grow during a crisis. In fact, throughout the crisis the Institute for International Finance, the international lenders' organization, has taken the most dovish views on the crisis relative to many other parties, insisting that Greece had to be helped in order to solve its problems.

When faced with such a crisis, the only solution often is to appeal for help to multilateral aid agencies, such as the IMF, which were set up to help countries facing crises like that. BTW, in the case of Greece, I would insist, the World Bank, too. We associate the World Bank with less developed countries, and indeed it was designed as one of the Bretton Wood institutions for exactly that purpose. Although conventionally speaking, Greece is not a less developed economy, in fact its problems are very much of those of such economies; it is a first-world country with third-world institutions.

Whereas the fiscal problems are huge, the competitiveness problem is arguably more fundamental. Greece at present isn't able to sell competitive products on the world economy. Its products at the time the crisis erupted had become very expensive, its unit labor cost were greater than those of other countries within the EZ. That is because improvements in productivity in the average had fallen behind those of other countries and behind the increases in wages. Its internal markets are dominated by non-competitive practices of all kinds; for example, its pharmaceutical sector has been run at the behest of a small number of domestic manufacturers and foreign importers — one example, generic drugs were unknown in Greece, one could not even buy generic aspirin, only Bayer at a higher price! This weakness was recognized by Greece's partners, was known to the IMF and thus to the government itself [IMF (2009)]. When the negotiations with the Troika started, liberalizations of labor and product markets became the key priority.

There are many examples of countries that have implemented extensive reforms. Canada in mid 1990s is one such case [IMF (2009), p. 26].

Specifically, the logic of the stabilization programs, designed by the so-called Troika consisting of the ECB, EZ/EU and the IMF, is to lend Greece enough to cover its needs, helping Greece out for as long as it cannot borrow, "shut out of the markets," while it is restructuring its economy, and indeed its society. Lending resources to Greece helps with the budget, external deficit, and loan repayments while programs are being implemented to reduce its deficits and be able to stand on its own forces. This has meant, in particular, that Greece would pay back its outstanding obligations, that is loans and interest coming due, to foreign and domestic lenders. Thus, the other side of the agreements is that the Troika is inevitably assuming an increased share of the debt, rendering the process in turn more political than economic. It is EZ national parliaments, shepherded by the European Commission, that have had to approve of the agreements along with the multilateral intergovernmental decisions-making structures of the ECB and the IMF. Such an expressly political environment has made everything trickier.

It was projected that the debt would grow before it would start declining — see chart — but ultimately allowing Greece to borrow again. The Greek stabilization program, after an initial fiscal success, came up against increasingly difficult choices; the government was unable to meet the program targets, the unemployment was rising, downturn widening and deepening, and the Greek people increasingly protesting about the pain. The EZ political leadership changed its tack. It decided that the only way forward would be to force private lenders to accept losses, "haircuts," before the official lenders themselves could even countenance it. Deauville 2010 was followed by the incomplete summer July 2011 negotiations, the more substantive October–November 2011 ones, the February 2012 agreement that was followed by the two rounds of Greek elections, May and June 2012, and the further relaxation of borrowing terms that were negotiated in Fall 2012. See graph.

As it became increasingly more expensive for Greece's partners to handle the needs of the Greek economy, let alone the emerging risks of politically unsustainable developments in Greece, a plan was hatched to have Greece contribute by means of *asset sales* via privatizations. Privitizations should have been more central to the process, not only to generate revenue but also to reduce the public sector and bring in private entrepreneurship.

The Greek government owns a lot of assets, ranging from government property housing government agencies to real estate acquired either nationalizations or bankruptcies of public enterprises. This is an outcome of the extensive involvement of the Greek government in the economy, esp. since the return of Parliamentary rule in 1974 and accelerated during the years of Pasok government. The New Democracy government of 1990-93 did try a bit to privatize and so did the Pasok governments that followed it, but the Greek government continues to hold substantial assets.

No serious thought was given to privatization early on, and views differ on why. One theory is that the ECB suggested this first in Fall 2010, as an idea that would likely be politically appealing to Greece's partners, with silly discussion in the German press ensuing, just prior to the first agreement of May 2010 that help would be exchanged with sales of islands or even of the Acropolis! The figures floating around were never really plausible and I will explain why. But let me give a sense of the numbers. The first figure noted was 50 billion Euro! I have not been able to track down the origin of the figure, but this appears to be close to an estimate for total Greek public capital in 2000.[1]

The IMF reports in March 2012 the following:

"Privatization is projected to bring E 46 billion over 2012–20, with fairly modest inflows during 2012–14 (E 12 billion). Receipts are projected to gradually increase with the resump-

[1]This is given by given by Kamps (2006) at 50% of Greek GDP, or $10900 \times 5,412 = 59$billion\$(PPP). [Kamps (2006)]

tion of growth and improvements in the perception of economic prospects, before settling at a rate averaging about 2 percent of GDP per year. The projections — unchanged from the final review of Greeces previous program — remain ambitious, but not unprecedented in international context." [p. 88, IMF, March 2012]. Then: "If the primary balance gets stuck below 1 percent of GDP (a level it will only marginally exceed in 2013), then debt would be on an ever-increasing trajectory. Significant shortfalls in privatization proceeds (only E 10 billion of 46 billion realized by 2020), would raise the level of debt appreciably, and slow its projected decline, leaving it at 130 percent of GDP by 2020 " [p. 90, *ibid.*].

These assumptions are way off the mark. In its January 2013 report, the IMF reduces the expected receipts to a more modest E 20 billion or so [p. 66, IMF (2013)]:

"privatization targets were revised down, reflecting poor market conditions, but also revised bottom-up estimates and an adjusted timeline for what will be a complex process, in the face of strong resistance from vested interests [p. 11, ibid.]

"Privatization rhetoric needs to be matched with results."

"Expected proceeds from privatization for 2012–2020 have been revised downwards from E 45 billion to E 22 billion. With annual proceeds still sustained in the 1–1 1/2 percent of GDP range for several years, this target will also be challenging, but remains within the range of international experience."

The IMF cites three key reasons behind the revision:

"(i) heightened implementation risks and more notable euro exit fears are expected to depress demand for privatized assets, weighing on sales volumes and prices;

(ii) an updated bottom-up assessment suggests that fewer real estate assets are good prospects for sales (reflected in the authorities' own forecasts for proceeds); and

(iii) in light of more evident political constraints, which come in addition to now more-visible regulatory and judicial barriers, the process for bringing assets to the point of sale are likely to be longer and more drawn out."

I believe that these numbers are still very optimistic and at the same time endanger considerable political risk and missed opportunities. I will explain why.

Privatizations could function as a massive shock that would help dislodge the Greek economy from its current equilibrium. But they have to be designed appropriately and need to engage the public in a meaningful way. Just as the multiplier associated with fiscal consolidation works in an adverse way, that is, decreased spending decreases GDP by more — see talk by Thanasis Stengos — massive inflow of capital as a result of privatizations will have positive multiplier effects. The Greek government-owned assets are actually geographically dispersed all around Greece, thus allowing for foreign investment inflows to affect many different regions simultaneously.

In addition to the cash from privatizations, reducing the government's borrowing needs, additional inflows will follow in order to support the investments. As most of the value of Greek government-owned assets are essentially land, buyers of public assets will plan on such investments in order to benefit fully from their purchases.

An *optimistic* view of massive privatizations is that they facilitate a proverbial "Big Push" that many countries need at critical stages of their development. A *pessimistic* view is that valuable assets pass to the "control of foreigners," God forbid, or as many Greeks see it, to the control of special interests, wealthy individuals and firms poised to take advantage of the country at such a difficult time of its history. I will come back to this politically sensitive subject.

What should we expect about privatizations? There is a recent experience, namely the efforts to privatize the Athens 2004 Olympic Games real estate assets. This has not gone very well! We know, however, that Athens 2004 venues, aside from being concentrated basically in Athens, had not been planned with dual uses in mind, making it difficult to offload them.

Nonetheless, the crisis provides a unique opportunity to recast the approach taken and learn from that experience. A new entity, Hellenic Republic Asset Development Fund (HRADF), `http://www.hradf.com/`, is entrusted with managing 70,000 properties on behalf of the Greek state.

From the various privatization projects, I wish to focus on two. First, a successful one, the Pireaus Port Cargo Facility, roughly half of Greece's largest port, has been taken over COSCO Pacific, a large Chinese company with particular expertise in this area and a 7% of Global Terminal Operators business, under a 35 year concession, for 4.3 billion euro. The second, pending at the moment, is the Hellinikon site, the land of the former Athens International Airport. The deal with COSCO appears to be have been a good decision [but see Psaraftis and Pallis (2012)], which also happens to be one that is much easier to evaluate. The scope is much narrower, the activity can easily be evaluated in terms of profit figures, the spillovers can be easily assessed, and they can be large. Some labor frictions have been reported, but COSCO appears to have gotten on top of things. The Hellinikon site, which aside from the immediate problems created by hundred of current tenants of different types, offers both enormous challenges as well as extraordinary opportunities. See slide.

The Hellinikon site, with an actual size of $6.2km^2$, and location, $8km$ from the Athens city center, offers the rare opportunity to enable a process of extraordinary revitalization of the Athens metropolitan area, which is itself long overdue. Vacant urban land on that scale so close to a metropolitan center is rarely available. When such an opportunity comes, it requires being looked at from the angle of the impact on the entire urban economy in ways which can help account for spillovers of all kinds. These are economic, social, cultural; some of which are planned, others serendipitous. They are best defined in terms of facilitating social interactions, that is byproducts of deliberate economic activities that magnify the effects of the original investments. Sometimes we think of them as adverse, like noise, congestion, pollution and the like, which are factors of urban life; at other times, the byproducts are critical inputs to the creative process, which are inherent in cities. In order to evaluate the impact of proposed development for a site of that magnitude, alternative scenaria must be examined complete with their implications on the entire metropolitan area, which are likely to be far reaching. Naturally, abutting communities and associated activities are most affected. One must try to assess how the new activities are likely to function at an equilibrium of the new pattern of economic and other activities.

Although Athens does have a historical center, an urban development intervention on the Hellinikon site is likely to foster creation of new subcenters, and the agglomeration of activities, especially in a city with few effective planning controls, could go far beyond what a revitalization of an existing center can do. The thorough analysis required goes much beyond the normal approach that real estate developers take. Planning for major urban interventions is not at all uncommon, but architectural edifices in and on themselves rarely suffice to invite and sustain the kind of mix of activities that is necessary for sustained revitalization.

Evaluating proposals for development on the Hellinikon site must involve community input, in other words, review by the public of the proposals. At the present juncture, such an initiative would herald a new era in planning for public projects in Greece. If at all, any public review of proposed projects takes place, private or public, is often in reaction to initiatives. Public review of large projects is not institutionalized, in the way it is in many other countries, taking the form of public hearings. While we can imagine that political party-driven and instigated initiatives may capture the attention of the press, we could equally imagine ad hoc citizen-organized initiatives that would make possible to channel the public's reaction and the articulation of viewpoints that are often not heard. Such a public review process may be positively influenced if the authorities in charge were to provide detailed information about what might be feasible, like presenting the public with alternative scenaria that are based on informed input about the technical feasibilities of different mix of activities. Worse yet, I have not seen in the press any assessment of the central logic of the intervention.

Since it is such a large area, it is important to see how the entity will function, either on its own, or in interaction with the existing surrounding communities. Too many urban renewal projects regularly miss the decisive role of interactions and the social element and as a result they ended up destroying communities. Social interactions flourish with urban density, and in turn invite more density. So, contemplating extensive gated communities in this lovely area with a few public use areas thrown in would be a nightmare scenario for me. Granted, it took time for economists to start thinking about the centrality of interactions and make it the heart of urban redesign. Architects, on the other hand, are more interested in physical aspects of things. Perhaps this modern economics view has not yet filtered through to how engineering calculations are being made.[2] It is a challenge and yet profoundly important to see how interdependence among the different part of the metropolitan area's social and economic life would affect the valuation of different alternative scenaria for the Hellinikon site.

Unfortunately, none of this has happened. The plans on the basis of which bids were solicited have been shrouded in secrecy. By decision of the Interministerial Committee for Restructuring and Privatization, the shares of Hellinikon SA were transferred to Hellenic Republic Asset Development Fund (HRADF). HRADF is charged with designing and carrying out the site development process.[3] The process is in pursuant to Law 4062/2012[4] on Hellenikon, according to which the entity which will win the bid will have to obey certain minimal specific criteria regarding green space and the like. HRADF states that "the full development of the Hellinikon site is expected to enhance Greek GDP by 0.3% per year and to create over 10,000 new jobs on a yearly basis for the next decade."

The public is entirely in the dark about the logic of the intervention since, as it stands right now, the private investor will take the land and do whatever they want with it. No one knows how these numbers have been arrived at! Based on the logic that the private sector knows best, the parties that have been pre-qualified will submit their business plans and investment proposals and a winner will be chosen. Considering the potential impact of this project, this is really tragic. A missed opportunity writ large!

But there is an even broader concern about all privatizations being contemplated now, and it has to do with the basis for the assessments made by potential investors when they consider purchasing Greek assets. Asset value reflect the *expectations* of returns to be generated in the future, and they are definitely influenced by the widespread pessimism permeating Greek life, economic and non-economic right now. Still, however serious the crisis is, it is unlikely (wishful thinking, perhaps?) that Greece will remain permanently depressed. So, at some point a recovery will start and slowly take hold. Expectations have a self-reinforcing

[2] See Ioannides (2013), Ch. 5.

[3] The details of where things are at the moment is at: http://www.hradf.com/uploads/files/20130115-press-release-hellinikon-en1.pdf

[4] http://www.hradf.com/uploads/files/Law_4062_2012_ELLINIKON.pdf

quality, namely pessimistic expectations that feed back into the valuation of assets help confirm those same valuations. This is a well known phenomenon that bubbles can feed on themselves. It is possible to craft a simple but perfectly respectable economic model that allows for such a feedback role of expectations and leads to multiple, alternative equilibria. Consequently, pessimism emanating from the political sphere is having large and negative effects on perceptions of how valuable assets are. E.g., when the major party of the opposition states that privatizations would be reversed, should it come to power, the effect on such valuations is colossal. Thus, any privatizations that do take place would be at very depressed asset values, hardly contributing to the government's cash position. The pessimistic equilibrium is confirmed, and the public can rightly complain that Greece's public wealth is being expropriated at fire-sale prices, and so they would be. Just think of how prospective investors feel when they read that a new government will reverse the major privatizations. The associated risk is enormous and they would rather not invest in Greece.

How do we break out of all this? There is only one way out: If all political parties find enough common ground to support carrying out reforms which will cause the economy to start growing again. Reforms are necessary in the product and labor markets, and in facilitating investment, public and private, in reforming education at all levels. Recognizing the importance of building social capital and establishing social peace, are critical also for the values of large assets to be privatized, like Hellinikon and others. If such projects are valuable, they can be even more valuable in a world of social peace. Pessimistic expectations will turn to optimistic.

Coming back to the Hellinikon site example, conceding a bit of action at the planning stage and inviting the public to be involved will both in and of its itself help reduce social strife and increase the actual pie in its entirety. And, the large multipliers that are being blamed for causing large contractionary effects of the fiscal consolidation program would work in a beneficial direction this time. The political sensitivity mentioned above may easily be addressed by means of carefully designed warrants that guarantee the rights of all parties and index payoffs on actual developments.

Only if Greek growth resumes will employment growth return. When incomes grow and the debt to GDP ratio starts a downward trend, all privatized projects would be much more valuable.

Thank you!

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