Is the Greek Crisis One of Supply or Demand?

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Outline

1. Facts
2. Outcomes

Crises and Recoveries

1. Real GDP (100=2008) **Greece**, Ireland, Portugal, Spain Finland (1990-1996), US (1929-1938)

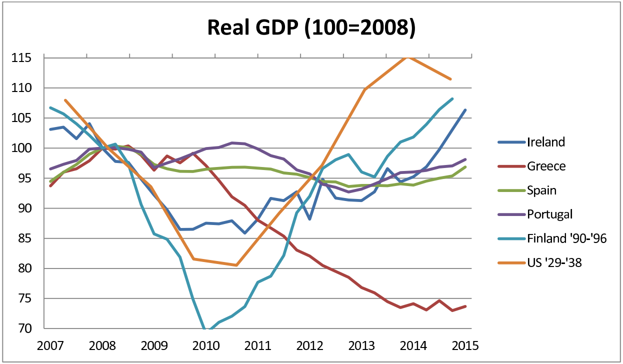

Figure 2: Greece, Ireland, Portugal, Spain, Finland (1990-1996) and US (1929-38). Source: Eurostat, US BEA.

2. Unprecedented contraction of Greek GDP

The Troika

1. Twin deficits:
   - Fiscal deficit: 15.6% of GDP, 2009
   - Current account deficit: 14.6%, of GDP, 2008
2. External public debt: 130% of GDP, 2009
3. 2001-2009, cheap credit allowed GR Government to borrow in effect to finance excess consumption.
   Borrowing fueled unsustainable boom, exposed by the Great Recession.
4. Sudden stop, 2009-10: contraction in domestic consumption, investment needed, fall in REER not fast enough, contraction through increase in unemployment.
5. Economic Adjustment Programs for Greece, May 2010:
   "Troika" $=$ {European Commission, ECB, IMF}

   .

Economic Adjustment Program

1. Fiscal deficit: from 4.5% (2001) to 15.6% (2009)
2. Loss of competitiveness since EZ accession, 2001:
    - varying estimates, competitiveness gap 20-30% (REER), more due to prices less due to wages.
    - Greece less open than, say, Portugal: exports/GDP (2008-2012): GR = 23.4%. PT = 33.2%
    - Sclerotic labor markets, stringent EPL, cumbersome bureaucracy, high regulation, oligopolies and extensive state ownership, obstacles to entrepreneurship.
3. Program aimed at allowing Greek economy to live within its means and return to the capital markets.
    - Troika loans, 240 billion Euros, during consolidation plus restructuring of privately held debt, 177 b (+28 b, holdouts).
    - Program to reduce wages, pensions, other costs to improve competitiveness.
    - Structural reform program to modernize economy and improve productivity.

Economic Adjustment Program cont'd

Program not so far fully restored price competitiveness, growth and public debt sustainability.
Fiscal contraction deepened the depression.

1. Errors in policy design? Wrong multiplier? Implementation?
2. Of greater importance: peculiarities of Greek economy.
    - GR: subject to more frictions and is less open than other EZ economies in crisis, such as Ireland and Portugal.
    - Prices do not fall and the decrease in aggregate demand that is brought about by wage decreases translates into a contraction of aggregate activity and unemployment.
    - Wages did fall by over 20%, much more than in the other program countries.
    - Associated fall in unit labor costs, consistent with the performance of exports, slow to translate into a fall in prices.
    - Wage reductions reflected in greater increases in profit margins rather than reductions in prices.

Political Turmoil

1. Ostensible (arrears), short-lived small primary surplus, by Dec. 2014
2. Gains dissipated as Greece moved onto:
    - failed presidential election (in Parliament), December 2014
    - Parliamentary election, January 2015
    - successful presidential election, February 2015
    - Program suspended, supposedly "renegotiated," February-July, 2015
    - Capital controls imposed, June 29, 2015
    - Referendum on terms of New Program, July 5, 2015
3. Political uncertainty, turmoil and *tragic, colossal mismanagement (both sides)*:
    - *new facts*, renegotiation of program July-August 2015
    - Parliamentary elections announced for September 20, 2015

Wages

1. Decline in wages, from 2010, sharper than in other program countries

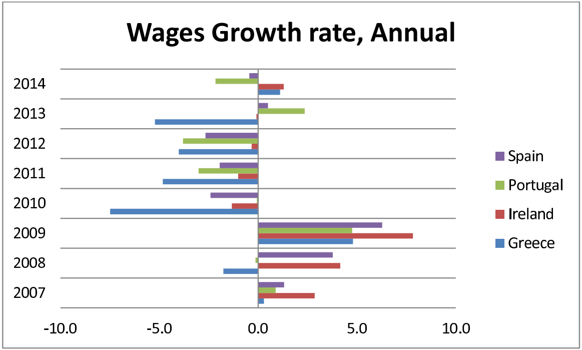

Figure 6: Greece, Ireland, Portugal, Spain 2007-2014. Source: OECD.

Prices

1. Price declines, beginning 2013, lagged behind wages

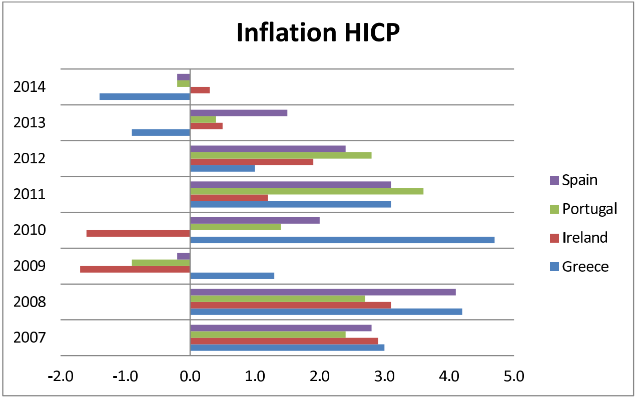

Figure 5: Greece, Ireland, Portugal, Spain 2007-2014. Source: Eurostat.

Wages, Prices, Real Wages

1. Huge decline in the real wage accentuated contraction.

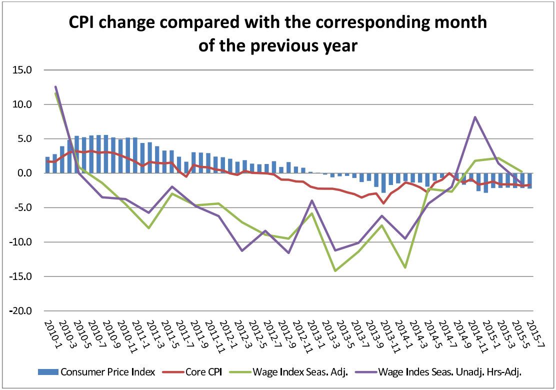

Figure 7: Greece, CPI, Core CPI, Wage indices, y-o-y Monthly Growth rates, 2010.1—2015.7. Source: ELSTAT.

2. Do we need a political economy of reform? Inconsistent perception of negotiations, leading up to Second Program.

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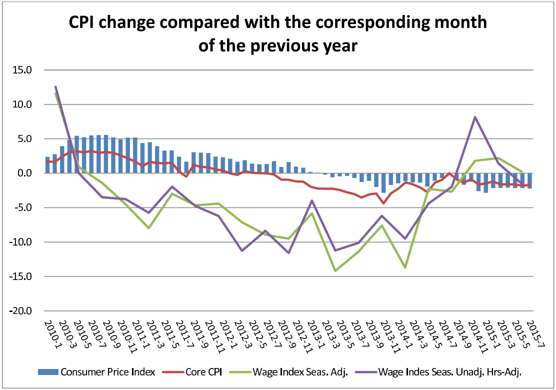

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"Green shoots"

1. During 2014: Job loss slowed down, 2014; surviving firms larger, more export-oriented. Pointed to restructuring. Turmoil since then?
2. Unit labor costs declined since 2009 –

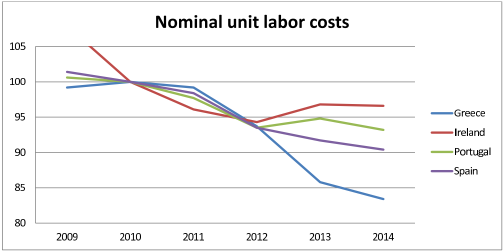

Figure 1.d: Greece, Ireland, Portugal and Spain. Nominal unit labor costs. 2009-2014. Source: AMECO

3. Trade deficit (% GDP): 11.2% (2009) $\Downarrow$ to 2.3% (2014)
Exports, % GDP: 19% (2009) $\Uparrow$ to 33% (2014)

Hourly Productivity

1. Hourly productivity, 1983-2014: Greece decrease 2007-2014

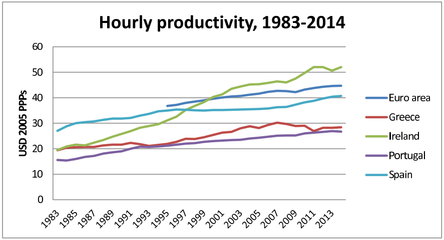

Figure 1.b: Greece, Euro Area, Ireland, Portugal and Spain. Source: OECD.

2. Real average earning, decrease: 2009-2014

Table 1.c: Greece, Euro Area, Ireland, Portugal and Spain. Source: OECD.

Real average earnings (2009=100)					
Year	Greece	Spain	Ireland	Italy	Portugal
2009	100	100	100	100	100
2010	93	98	99	101	100
2011	88	96	98	99	97
2012	85	93	97	96	93
2013	80	94	97	96	95
2014	81	93	99	97	93

TFP Growth

1. TFP Growth, 2007-2014: downward trend, shift greater for GR than IE, PT, ES.

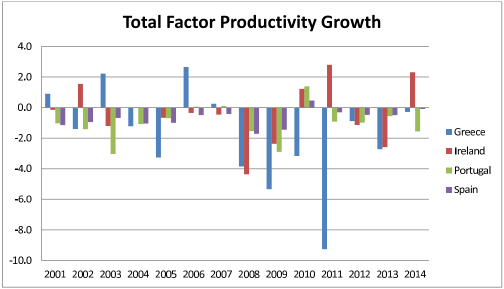

Figure 4.b: Greece, Ireland, Portugal, Spain 2001-2014. Source: The Conference Board.

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2. Market reform improves efficiency by eliminating rents, improve flexibility, ease adjustment to technology frontier. But, does it improve TFP Growth?

Competitiveness vs. Debt Relief

1. The debt overhang affects perceived wealth, policy space, hence *demand*.
2. Sustained improvement in TFP growth via reforms, *supply*. *absolutely necessary* to maintain competitiveness.
3. Lack of political commitment to reforms, failure to buy-in by public: huge obstacles.
4. Recovery will be slow.
5. Will the electoral campaign help persuade the public of the *need* for reforms?
6. Only way forward, a broad coalition of parties meaning to reform.
7. Feasibility of coalition government dominates campaign: *At last!*

Thank You!

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