An Update on the Greek and the European Crises

Yannis M. Ioannides

Tufts University

EPIIC Institute for Global Leadership
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Four Parts

1. Part 1:
   The Greek and the European Crises; an Overview.
   Ioannides and Pissarides, "Is the Greek Crisis One of Supply Or Demand?"
2. Part 2:
   The Greek Crisis on the Way to Recovery
3. Part 3:
   Political and Economic Meltdown; Agreement No. 3.
4. Part 4:
   EU/EZ, Lessons from the Crises and Prospects for the Future.

Four Parts: sources

1. Part 1: Ioannides and Pissarides, "Is the Greek Crisis One of Supply Or Demand?" https://sites.tufts.edu/yioannides/files/2015/09/Ioannides-Pissarides-BPEA-Conference-draft-Sept-12-upd.pdf

2. Part 2: Ioannides, "Why Productivity Enhancing Reforms Will Help Greece Exit the Crisis and Usher in Long Run Growth." https://sites.tufts.edu/yioannides/files/2015/01/IoannidesJan242015MegaronPap
3. Part 3: Leetaru, "A New Way to Read the Crisis in Greece." *Foreign Policy.* http://foreignpolicy.com/2015/07/31/greece-debt-syriza-tspiras-google/
4. Part 4: Ioannides, "Large versus Small States in The Eurozone, The Democratic Deficit, and Future Architecture." https://sites.tufts.edu/yioannides/files/2012/09/Ioannides-Small-vs-large-Countries-June-9-2015_FIGS.pdf

   Voxeu.org ebook, Baldwin and Giavazzi, eds. *The Eurozone Crisis: A Consensus View of the Causes and a Few Possible Solutions* http://www.voxeu.org/content/eurozone-crisis-consensus-view-causes-and-few-possible-solutions

Outline: PART 1

EU, EZ, Greece

1. European Union (EU): 28 countries
2. Eurozone (EZ): 19 countries $\subset$ EU
3. Common currency, the Euro, administered by the ECB, a supranational institution
4. Countries admitted when qualified: interest rate, exchange rate, deficit ($\leq 3\% GDP$), debt ($\leq 60\% GDP$)
5. Financing of national deficits by ECB "prohibited."
6. Onset of Great Recession, Dec. 2007–June 2009: hit EZ with a lag.
7. Fall 2009, GR crisis starts: Greek fiscal deficit hit 15%, 2008. GR: "out of the capital markets."
8. May 2010: GR signs Economic Adjustment Program: "Troika" $=$ {European Commission, ECB, IMF}
9. Loan under conditionality: sustain Greece while reducing deficits (fiscal tightening), soften adjustment reforms, supervision, targets.

EU, EZ, Greece, Portugal, Ireland, (Spain, Italy)

1. Portugal, May 2011: Adjustment Program, with Troika. Exits May 2014.
   Can borrows from banks, no longer needing Troika loans, repays IMF
2. Ireland, October 2011: Adjustment Program, with Troika. Exits Dec 2013.
3. PT, IE crises: little in common with GR.
4. Even less so with Spain and Italy (leaving them out).
5. Portugal: very slow growth. Ireland: banking crisis led to a fiscal crisis.
6. No currency to devalue, no independent central bank, large and legally protected welfare states that are hard to reform. No European institutions set up to deal with a crisis of this type and magnitude. Adjustment programs: improvised, unique in their features, questioned about effectiveness from the start.

EZ and interest rates

1. EZ members borrowing at same rates as Germany, until crisis hit.
2. Once crisis hit, EZ countries find out: borrowing as if in a foreign currency.

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Crises and Recoveries

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

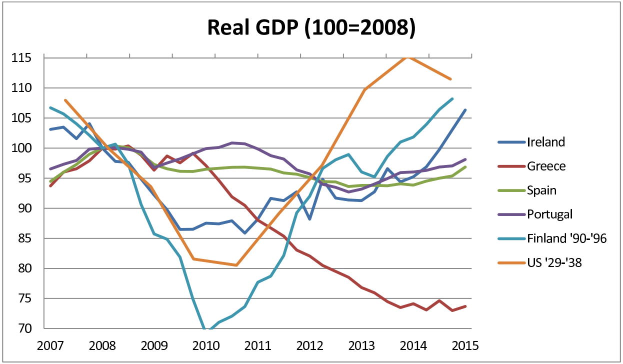

Figure 2: Greece, Ireland, Portugal, Spain, Finland (1990-1996) and US (1929-38). Source: Eurostat, US BEA.

2. Unprecedented contraction of Greek GDP

Overview of GR, 2010 – 2015

1. May 2010–November 2011: GR managing
2. GR government cannot cope: coalition "interim" Government (Papademos) November 2011–May 2012
3. Unprecedented restructuring of GR debt: 2012
4. June 2012: New coalition government: ND, Pasok, Dimar
5. May 2014: government coalition performs poorly in European Parliament elections.
   Upstart leftist "fiery" Syriza: does well. Next opportunity: parliamentary election of President of the Republic
6. ND + Pasok government panics, slows down reforms, as conditions were improving. Troika review incomplete.
7. Presidential election fruitless, elections follow, Jan 25 2015, Syriza forms government (with a rightwing party).
8. What followed was a nightmare of incompetent negotiations, leading up to bank run, bank closure, new agreement (and debt), Syriza loses majority, new elections Sept. 20, 2015

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. May 2010–November 2011: GR managing. "Interim" Government (Papademos) November 2011–May 2012. Huge "haircut" of GR debt: 2012. Gov/t ND, Pasok, Dimar: 2012. Performs poorly in European Parliament elections. Leftist "fiery" Syriza: does well. Next opportunity: parliament to elect President.
2. Ostensible (arrears), small primary surplus, by Dec. 2014
3. Gains dissipated as Greece moved onto:
   - failed presidential election (in Parliament), December 2014
   - Parliamentary election, January 2015.
   - successful presidential election, February 2015
   - Program suspended, "renegotiated," February-July, 2015
   - Capital controls, June 29, 2015
   - Referendum on terms of New Program, July 5.
4. Political uncertainty, turmoil and *tragic, colossal mismanagement (both sides)*:
   - *new facts*, program renegotiation July-August. Elections September 20.

Wages

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

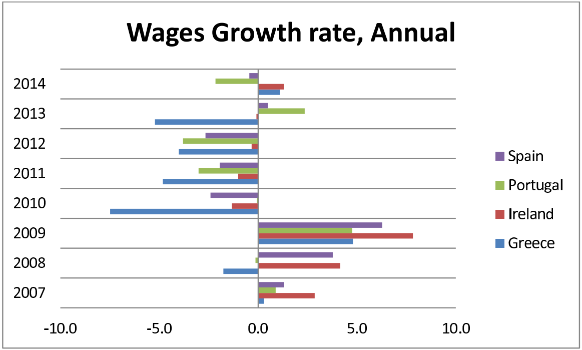

Figure 6: Greece, Ireland, Portugal, Spain 2007-2014. Source: OECD.

Prices

1. Price declines, beginning 2013, lagged behind wages

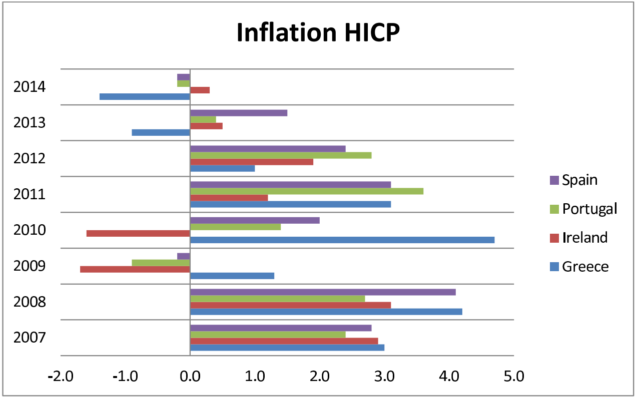

Figure 5: Greece, Ireland, Portugal, Spain 2007-2014. Source: Eurostat.

Wages, Prices, Real Wages

1. Huge decline in the real wage accentuated contraction.

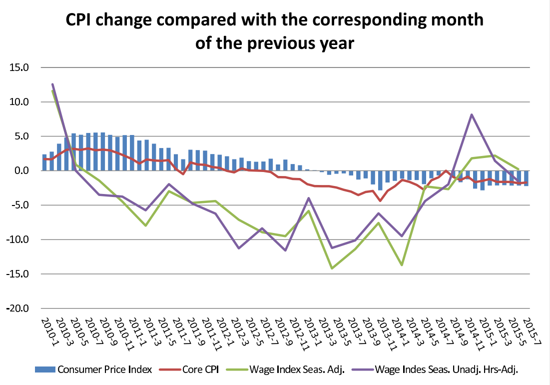

Figure 7: Greece, CPI, Core CPI, Wage indices, y-o-y Monthly Growth rates, 2010.1—2015.7. Source: ELSTAT.

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

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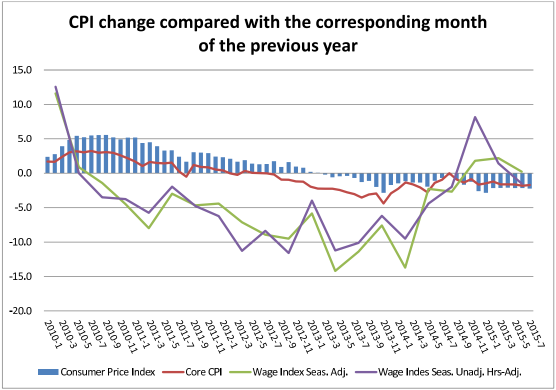

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"Green shoots"

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 –

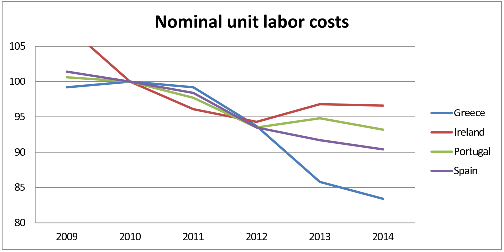

Figure 1.d: Greece, Ireland, Portugal and Spain. Nominal unit labor costs. 2009-2014. Source: AMECO

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

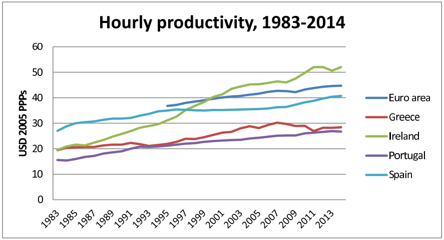

Figure 1.b: Greece, Euro Area, Ireland, Portugal and Spain. Source: OECD.

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.

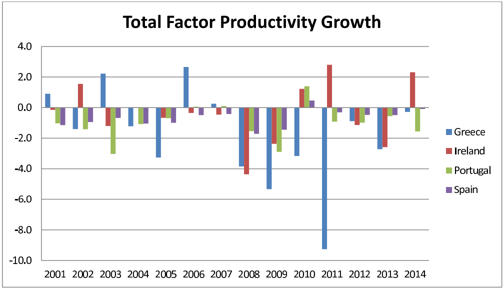

Figure 4.b: Greece, Ireland, Portugal, Spain 2001-2014. Source: The Conference Board.

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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: a good thing of lasting value, *At last!*

What is at stake: Greece

1. Greece repeat defaulter, 4 times since modern state.
   Huge foreign loans to fund war for independence, started existence with a large debt burden. Brutal episodes of external indebtedness followed by debilitating debt overhangs, default, loss of sovereignty: 1820s, 1880s, 1920s and again today.
   Can this go on?
2. Latest agreement is "Take-it-or-Leave-it!"
   Put up or shut up!
3. Unfortunately, not clear in the election campaign.

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What is at stake: European Union

1. Future of Europe: Political will to cooperate further restore balance in economic performance?
   "Haphazard decision making, last-minute late-night decisions to avoid catastrophe.
2. National ("self-interest") vs. supranational (union of sovereigns).
3. Legacy of Greek crisis, assertion of national interests on both sides:
   - Protect national banks (and Greek pension funds) when Armageddon was at stake, 2010?
     No haircut IMF, EZ loans to Greece.
   - Should Slovakian nurses pay for Greek minimum wage?
     Allow default (Haircut) of Greek debt?
   - Should GR be forced to leave EZ/EU, issue own currency, recover?
     Should GR give up sovereignty, allow EZ bail out, and run its policy?

What is at stake: European Union, cont'd

1. Whose problem are refugees, illegal immigrants to Greek islands?
2. Germany initiatives on asylum crisis: cooperating or pretending?
3. Hungary: "it's Germany's problem, that's where they want to go, not ours"
4. Hungary blames Greece for letting them in and out of GR territory.
5. Spontaneous, smooth transfers of power from national to supranational entities: politically hard.
   - In the past, through war and violence. So far, Europe manages through nonviolent conflict, political crises, harsh negotiations, and suffering, observed by a *European Demos*.
   - Held together by realization cost of defection and collective failure very high? Perhaps.
6. Don't you think this is evidence European project is working?

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On to Part 2:
The Greek Crisis on the Way to Recovery