Untangling Greece's economic reality

Stelios Konteas talks to respected academic Yannis Ioannides, Professor of Economics at Tufts University in Boston, about the Greek economy, what happened to the country before and after the crisis years, the public debt issue and the policies that need to be implemented to allow Greece to return to growth

First and foremost

During most of the time since Greece's accession into the euro area, the Greek government collected less in taxes than it spent, as indicated by increasing fiscal deficits as a share of GDP of 4.5 per cent to 15.6 per cent during 2001-2009, and the Greek economy consumed more than it produced and had to import way above its exports, as indicated by current account deficits as a share of GDP of 7.2 per cent to 14.6 per cent during 2001-2008. As a result, Greece experienced an increase of its external public debt as a share of GDP from 103.7 per cent in 2001, to 129.7 per cent in 2009, in spite of generous help from the EU's structural funds. The Economic Adjustment Programme has been a major "demand" force in the severe contraction since 2009, but there is also a "supply" force. Greece must further improve its competitiveness vis-a-vis its eurozone partners, and debt relief itself cannot alone address the competitiveness problem. That requires a targeted approach that involves structural reforms, especially ones that improve competitiveness in the market for goods and services. Reforms are necessary to make Greece more productive, help it attract investment and develop forward-looking export industries. This will inevitably require deep restructuring of the economy, a process that typically follows crises, and is to some extent already under way in Greece. Reforms have effects over and above the impact of price and wage changes on unit labour costs. They are critical for another reason, too, namely an adverse demographic outlook of population decline that would make it harder for Greece to pay off its debt (Ioannides, 2014). Reforms involve short-term costs and are thus painful, but necessary. Targeted, "smart" reforms are under a nation's control, and it would be a tragedy if Greece did not undertake them, especially while under assistance. Debt relief alone would not solve the competitiveness problem. Yet, it could help if it is designed as an incentive to improve competitiveness.

Greece's bankruptcy:

What are the main reasons Greece was led to the brink of uncontrolled bankruptcy in 2010?

Greece's problem is purely political. A series of governments failed to take obvious measures, motivated by political advantage. This is unfortunately continuing, with no end in sight. The voters approved of patently incompetent people, people who despise knowledge in all of its forms, and put them in power. But, sadly, arrogance is not the monopoly of the Greek political milieu. Some other players also did show arrogance.

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Some political forces in our country, as well as a minority of analysts, argued that a voluntary restructuring of its public debt would be more beneficial for Greece than having recourse to the support mechanism in May 2010. In other words, it would have been better –back then– if we had declared boldly that we fail to satisfy all of our obligations to our creditors, inviting them to negotiations over the exact payback percentage. Do you share this view?

A "voluntary restructuring" would not have prevented the bankruptcy sooner or later. We know that Trichet was opposed to it, in order to save European banks that had lent heavily to Greece. Moreover, it would have been impossible to exclude Greek debt securities, one-third of the total at time, I believe, from such a restructuring. If Greek-owned debt had not been excluded, then the shock to domestic demand would have still been severe. But had the government considered it, the biggest tragedy of all would have been exposed, namely that Greek pension funds where almost entirely invested in Greek government securities, with political appointees as trustees. This has yet to be discussed in public, and cause and effect of the 2012 restructuring being totally confused in later debates. Still, did the **G. A. Papandreou** government consider it? We know that **Cleary**, **Gottlieb**, **Hamilton** and **Steen** advised the Greek government later, with Lee Buchheit as a key person. But, I am in possession of a document, dated May 7, 2010, and titled

"How to Restructure Greek Debt", by **Lee C. Buchheit** and **G. Mitu Gulati** (a Duke University Law professor), which suggests that some serious people somewhere had done some thinking. So, back to politics, did the government consider it? Did the government ask for advice? These are important questions that beg for answers.

The policies of Memoranda:

The criticism made of Memoranda focused mainly on the over-taxation imposed on the private sector. Could the target of the immediate primary surplus production have been achieved in any other way?

What Greece needs is growth, growth, growth, which is only possible by investment, investment, investment. Reliance on taxes is foolish and counterproductive. It is destroying the private economy, to the delight of Greece's current rulers, whose idea about growth and development is purely and unmistakeably statist.

What kind of measures can be implemented in our country in order to fight tax evasion and integrate the black economy into the formal economy?

A zero tolerance policy. Major tax evasion is a crime punishable by fines and incarceration. Tax returns of wealthy individuals are audited regularly and randomly by anonymous tax officials.

See: https://sites.tufts.edu/yioannides/files/2015/02/Azariadis_Ioannides_Corruption_Feb_20_2015_FIGS_Appendix.pdf

Do you consider the tax burden imposed on Greek-owned property to be a necessary evil?

Yes, I do think so, but it should be more progressive and not exclude vacant land.

What is your opinion about the fiscal measures launched by the present government under the third Memorandum?

Its fault is undue reliance on taxes.

How far is still the Greek State from making a sustainable entry into the markets;

In order for the Greek State to enter the markets seriously, it must show growth and development. None is in sight.

Greek Banking System:

According to data from the Bank of Greece, despite the imposition of capital controls by mid-year, 37 billion euros flew out of the Greek banking system in 2015 – this is the highest amount ever compared to any other year since 2009. Do you think that, under certain circumstances, this money can return to the banking system?

It depends on confidence, which is still lacking, because the economy is not growing.

The Greek State lost 25 billion euros from the recapitalisation of Greek banks in 2013, due to the collapse of their stock prices. Will the money of Greek taxpayers placed in the last recapitalisation have a different fate?

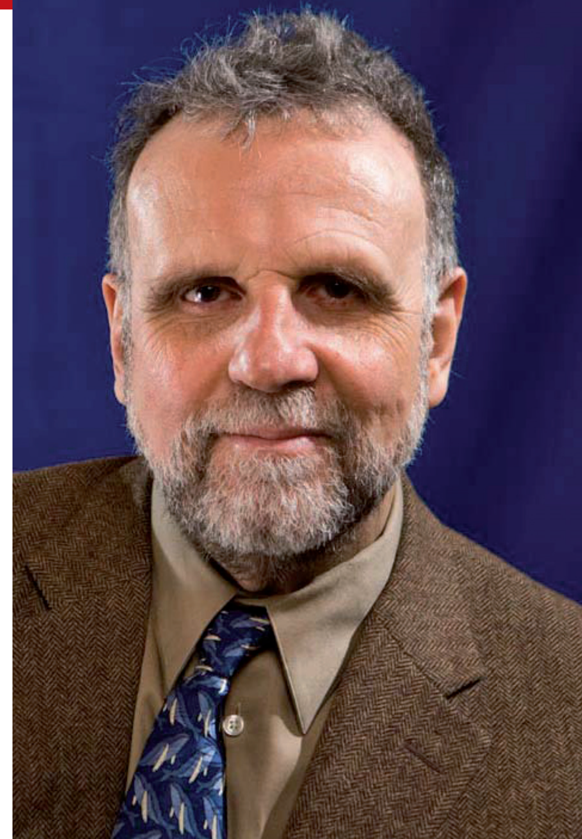
I am not sure I understand what the government is up to in dealing with the banks. Just to make sure, though, "the Greek State" that lost is the Greek public, that is being asked to shoulder and service more debt.

Economic Growth:

What are the structural changes that are necessary in order for Greece to return to high rates of economic growth?

Labour and product market reforms, attack on corruption and incompetence, reform of the pension system, support of truly modern industry, like IT ventures (Upstream comes to mind), and linking industry and universities to facilitate R&D investment.

Above all, structural reforms are not only a necessary condition for helping launching Greece into a long run growth path, they are an important requirement for Greece's participation in the Eurozone. Greece is the most protected and monopoly-ridden economy in the euro area, and no attempt was ever made to reform the economy to raise its productivity to the level of its European partners. As Draghi (2014) eloquently argues, slow-adjusting countries within the Eurozone are likely to suffer higher unemployment, which can more likely become entrenched and structural. Greece shows up as a laggard in unsettlingly many comparisons. But the fundamentals are there for a full recovery and accelerated growth, if only we let the forces that produce and sustain economic growth. These forces are human capital and good institutions.



Greek ecomony under the microscope: Professor Yannis Ioannides looks at the structural reforms needed to help tackle the country's long-term economic ills and the policies that are required for Greece to eventually return to sustainable growth

It is clear that for the long-run viability of Greece's economy and survival in the eurozone the urgent need is for structural reform. But implementing deep and effective structural reform in an economy used to protectionism and political meddling meets with resistance at every level, leading to public protest, political instability, frequent elections, and the rise of political extremism. So, although since the onset of the crisis in 2010 several rounds of legislation went succesfully through Parliament, the implementation of reform has been very poor. In practice, there is no such thing as an independent public sector that will implement the reforms impartially according to any new legislation. In private conversations, economists brought in to advise the government on reform acknowledge that once they are in office, huge pressures are brought to bear on them to make exceptions that offset the impact of legislation to the point of complete irrelevance.

See also the section in **Ioannides** and **Pissarides** (2015) and https://sites.tufts.edu/yioannides/files/2015/01/IoannidesJan242015MegaronPaperFigs.pdf

In what areas can Greece demonstrate a comparative advantage over other economies in order for growth not to rely on domestic consumption funded by borrowing once again but on exports of Greek goods and services?

Ricardo Housmann has argued that Greek production is little knowledge content, compared to other countries. Specifically, underlying Greece's competitiveness problem is that the Greek economy does not mobilise enough knowledge, as expressed through the knowledge composition of the country's exports, relative to the rest of the world. Among 128 countries, Greece has the largest gap between its level of income and the knowledge content of its exports. The same set of calculations suggest that Greece ranks second only to India in terms of how easy it would be to move to exporting more complex goods. The average over 1995-2008 domestic value added of Greek exports is at around 10 per cent of GDP lowest among all EU countries (and Turkey), which suggests huge room for improvement via a greater role for vertical supply links (Ch. 10, IMF 2014a). Greece is economic neighbour of some of the world's most advanced countries, which ought to facilitate diffusion of innovations and technologies. For more details, see my piece with **Christopher Pissarides**, BPEA, Fall 2015, here: http://www.brookings.edu/~/media/Projects/BPEA/Fall-2015/IoannidesTextFallBPEA.pdf?la=en

Yannis M. Ioannides

Yannis M. Ioannides joined the Tufts faculty in September 1995 as the Max and Herta Neubauer Chair and Professor in Economics. Previously he taught at the University of California, Riverside, 1973-1974, Brown University, 1974-1980, Boston University, 1980-1986, and Virginia Polytechnic Institute and State University, where he also served as Department Head from 1989-1995. He held an appointment as a Professor of Economics at the Athens School of Economics and Business, Athens, Greece, 1983-1986, and was a Research Associate at the National Bureau of Economic Research from 1982-1993. He received his Diploma in Electrical Engineering from the National Technical University, Athens, Greece, 1968, and his MS in Engineering-Economic Systems, 1970, and his Ph.D. in Engineering-Economic Systems and Economics, 1974, both from Stanford University. He completed elementary school and high school education in Thessaloniki, and Lyceum in Athens.

His current research interests combine social economics and macroeconomics, with special emphasis on social economics, economic growth and inequality, social interactions and networks, and housing markets. He teaches courses in macroeconomics, economic growth, social interactions and social networks, and the economics of the European Union. He is an Associate Editor of *Regional Science and Urban Economics* and served as Associate Editor of *The New Palgrave Dictionary of Economics*, second edition (Steven N. Durlauf and Laurence E. Blume, General Editors). He served as a member of the MacArthur Foundation Research Network on Social Interactions and Economic Inequality, and as a consultant to the US Department of Housing and Urban Development, the European Investment Bank, and other EU, US, and Greek institutions. He has participated widely in conferences and has published articles in numerous edited volumes and leading scholarly journals including: *American Economic Review, Journal of Economic Literature, Journal of Economic Theory, International Economic Review, Quarterly Journal of Economics, Economic Journal, Regional Science and Urban Economics, The Scandinavian Journal of Economics, Journal of Urban Economics, Review of Economics and Statistics*, and *Economic Policy*. His book, *From Neighborhoods to Nations: The Economics of Social Interactions*, Princeton University Press, appeared in October 2012. His research has been funded by the National Science Foundation and by the John D. and Catherine T. MacArthur Foundation.

He has a side interest in Modern Greek Studies and co-chaired the Greek Study Group, Minda de Gunzburg Centre for European Studies, Harvard University, 2004-2014. His hobbies include the medieval history of Greece; Linear B; the poetry of Erica Funkhouser, Yannis Ritsos, and George Seferis; and the works of Haruki Murakami and gardening.

Greek Labour Market:

Do you agree with the minimum wage reduction and the policies that enhance flexibility in the labour market?

I don't want to oversimplify here, but yes, reduction of the minimum wage will put a lot of people back to work, improving purchasing power and supporting a healthy work ethic.

Greek Public Debt:

The Agreement signed during the Eurozone Summit in June 12, 2015, clearly states that the nominal depreciation of our debt ("haircut") is impossible. To what extent can reducing interest rates and extending the official creditors' payback period be acceptable?

They can do a lot, and the key thing is growth. In the Greek crisis, debt is the lesser problem. But the current government has succeeded in derailing discussion about growth and instead trying –at the political level– to get the lenders to agree to haircuts. THEY WILL NOT. What the lenders want to see is growth.

Is the target set in the new fiscal adjustment programme concerning our debt-servicing obligations, i.e. producing primary surpluses of 3.5 per cent of GDP by 2018, feasible;

This unconditional statement is deceptive. What else is assumed here, in the way of competent management and growth friendly policies?

Why haven't we yielded the desired benefits from the front of making full use of the Greek State's property yet?

Politics and incompetence.