

Greece in the Euro Era: From Crisis to Growth

Gikas A. Hardouvelis

*Professor of Finance & Economics, Un. of Piraeus
Chief Economist, Eurobank Group*

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Maliotis Cultural Center

50 Goddard Avenue, Brookline, Massachusetts
USA

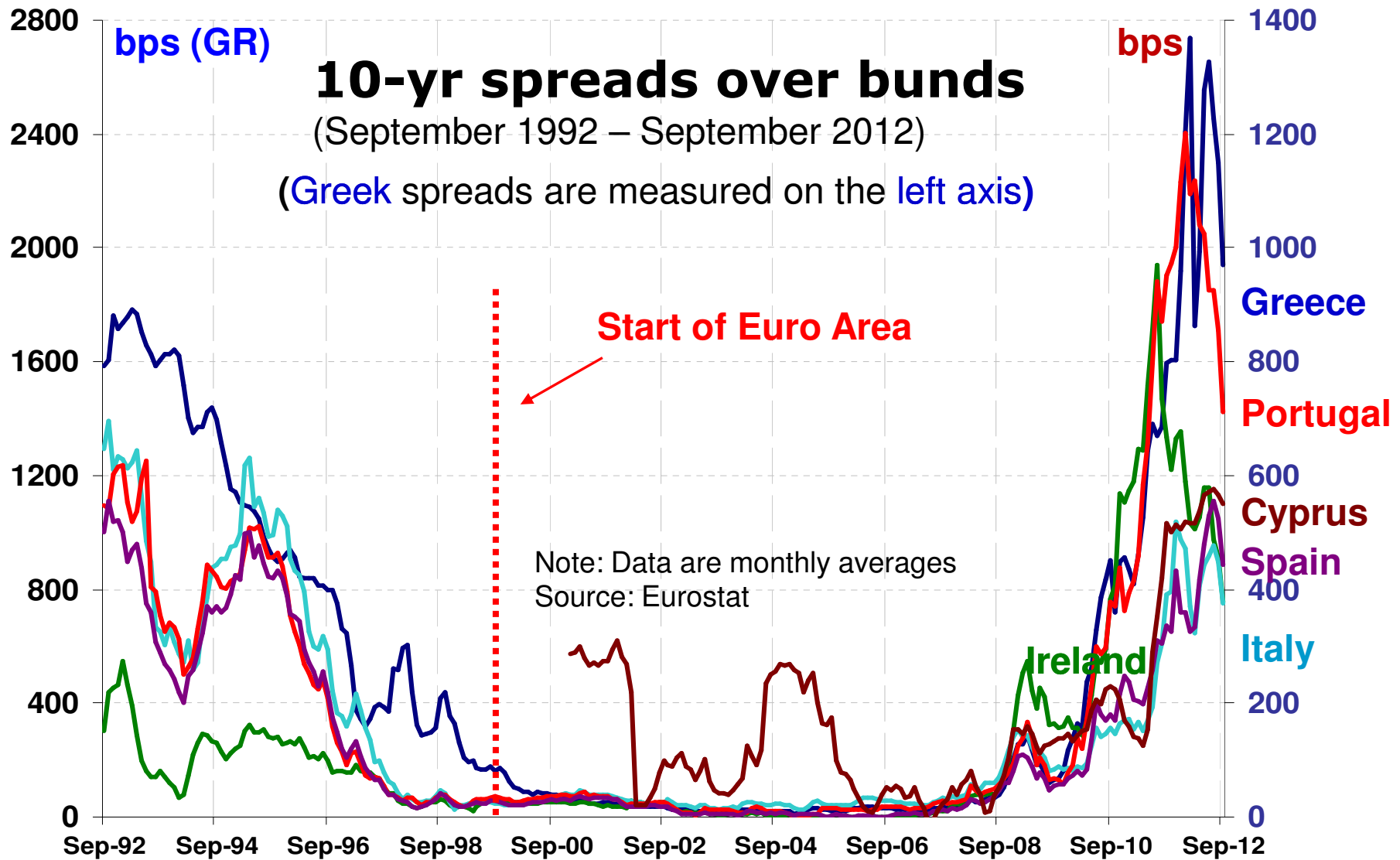


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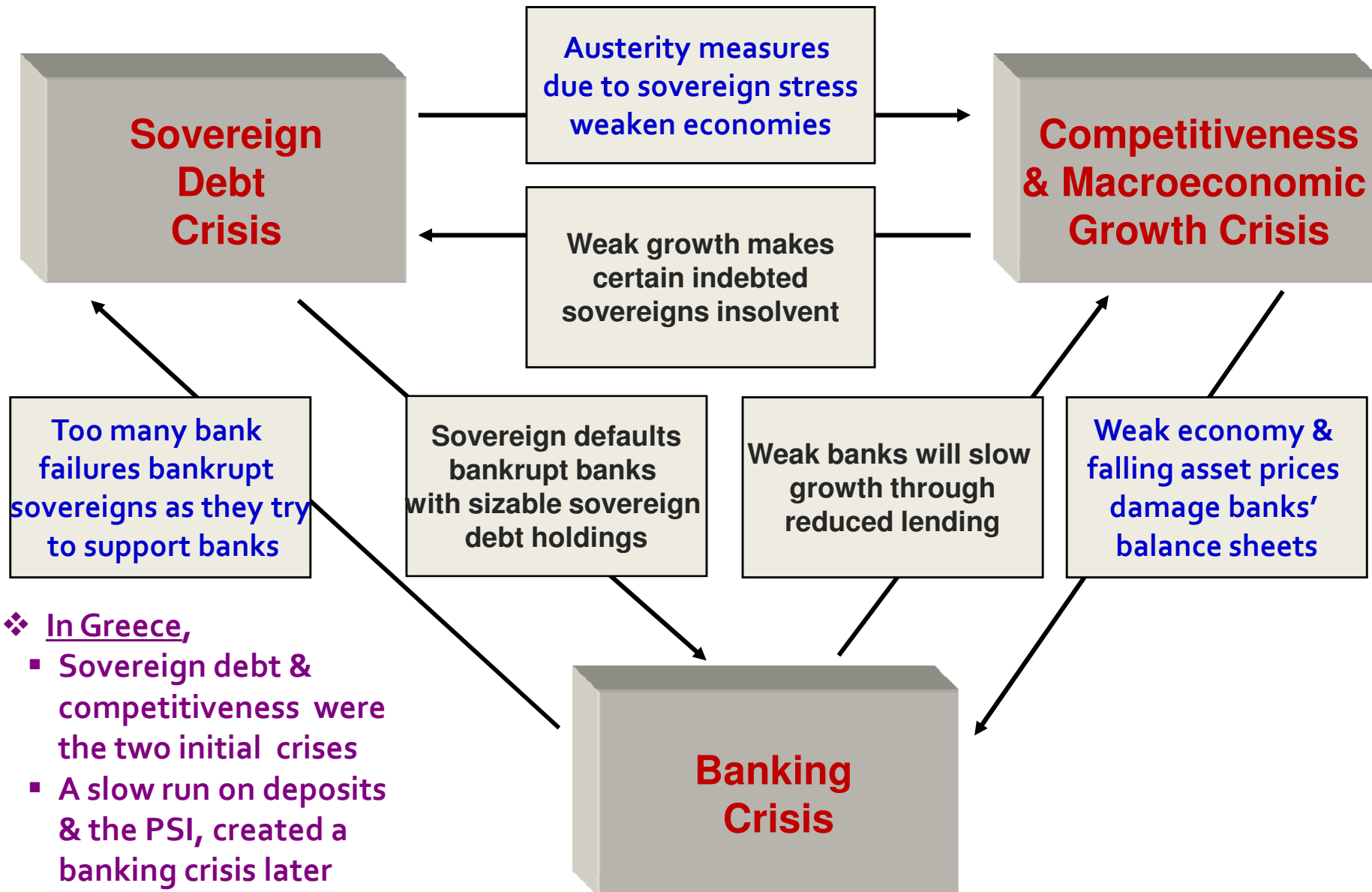
- I. **The EMU crisis:
Overview**
- II. Earlier times of
euphoria
- III. Greek accomplishments
in the midst of crisis
- IV. Can growth come back
in a period of austerity?



I. MARKET VIEW OF THE CRISIS: BACK TO THE FUTURE BUT DRESSED UP IN EURO



I. THE UNHOLY TRINITY: THREE INTERRELATED LEGS OF THE EMU CRISIS

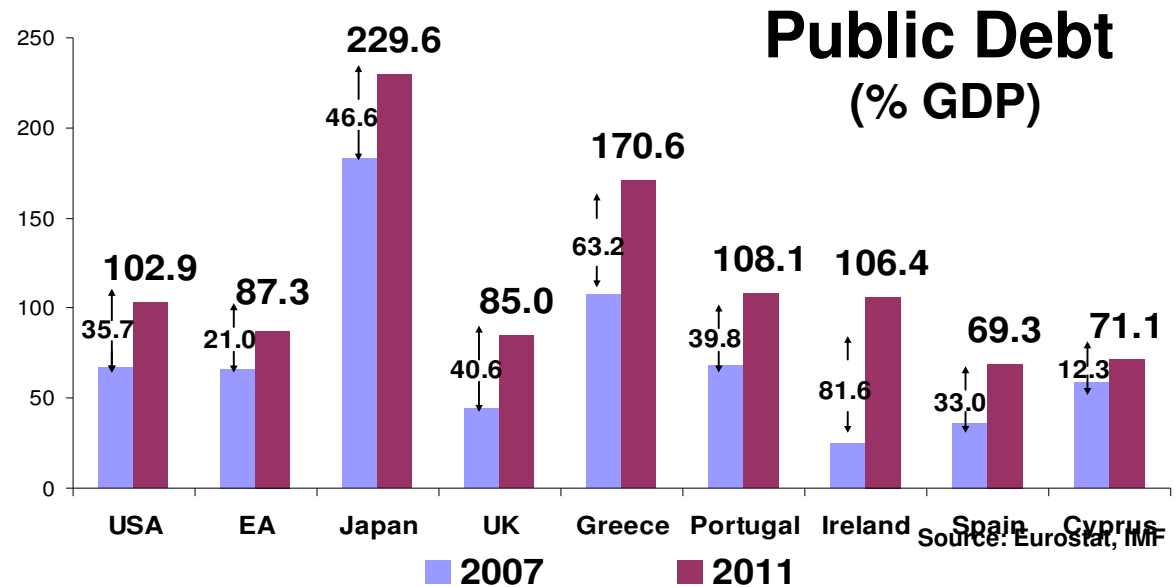
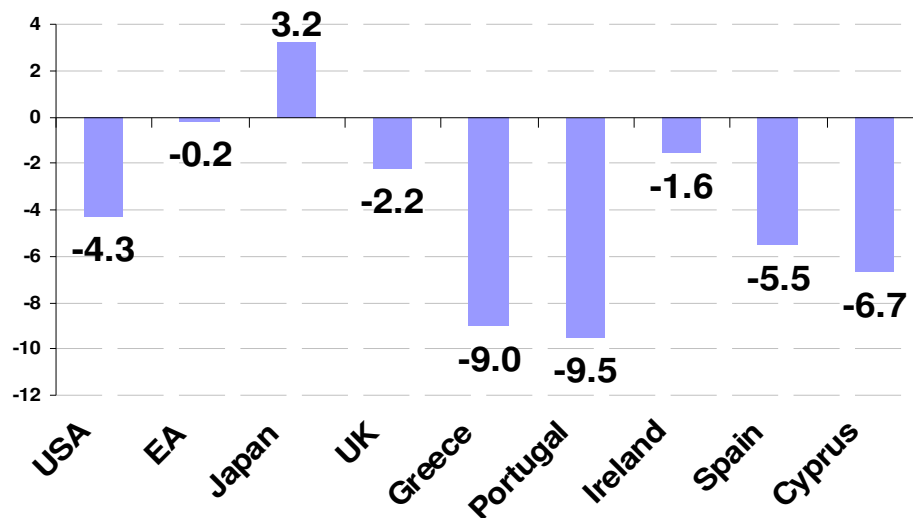


- ❖ In Greece,
 - Sovereign debt & competitiveness were the two initial crises
 - A slow run on deposits & the PSI, created a banking crisis later

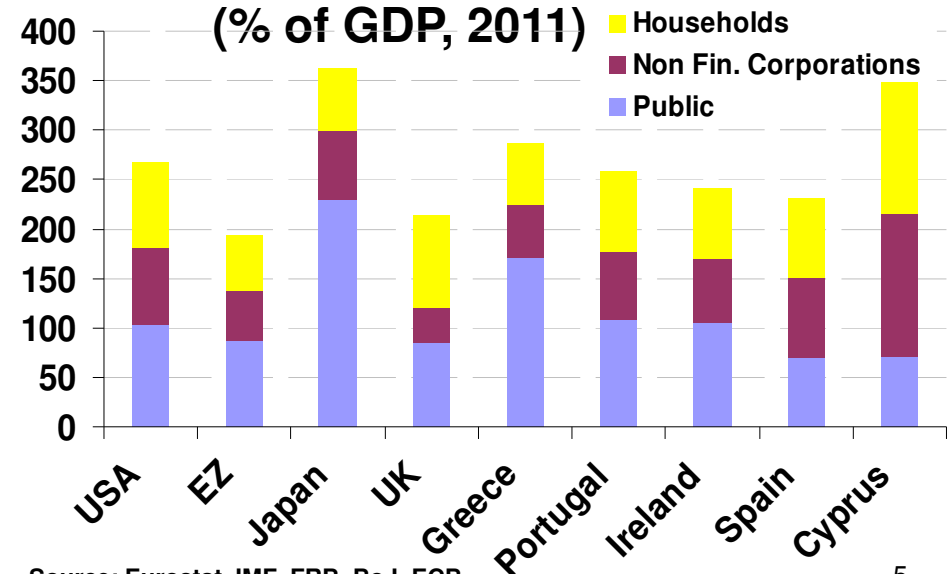
I. AGGREGATE EMU IMBALANCES NOT NECESSARILY WORSE THAN IN USA

- ❖ The crisis takes place in the Euro Area, not in the US, despite the facts that
 - US Public Debt/GDP is worse
 - US current account balance is negative
 - International banking crisis started in the US

Current Account Balance (% of GDP, 1999-2011 avg.)



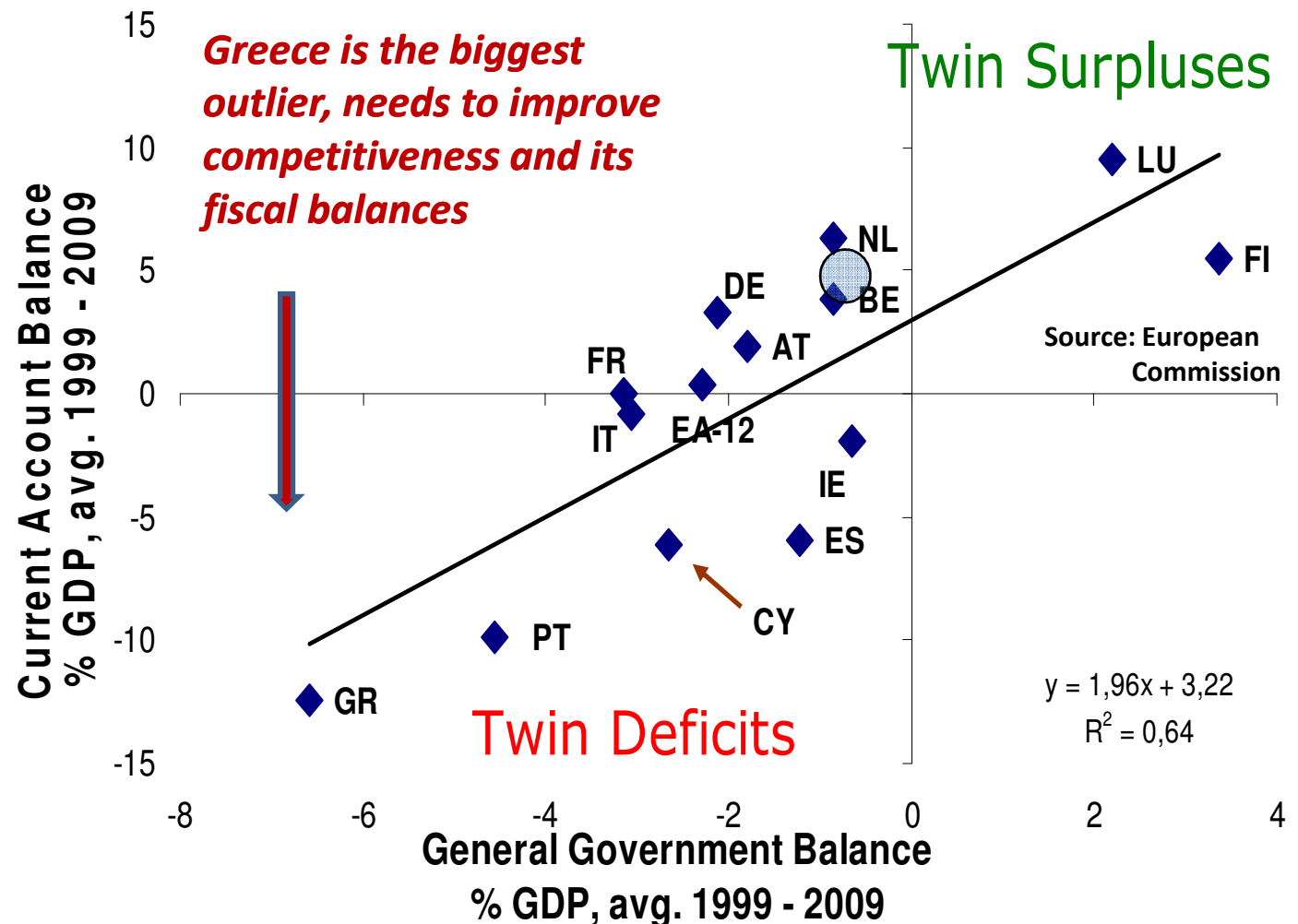
Public & Private Debt (% of GDP, 2011)



I. IMBALANCES DIVERGE WITHIN EMU

- ❖ Greece suffers from lack of fiscal discipline and competitiveness as shown in the Figure
- ❖ The third leg, the banking crisis in Greece was caused by the state's PSI and the continuing recession that drives up NPLs
- ❖ Post-EMU, a competitive North and an uncompetitive South emerged

Average annual external and fiscal balance in EA-12 before the Greek/EMU crisis hit in early 2010



II.

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HAPPINESS ISNT GOOD
ENOUGH FOR ME! I
DEMAND EUPHORIA!



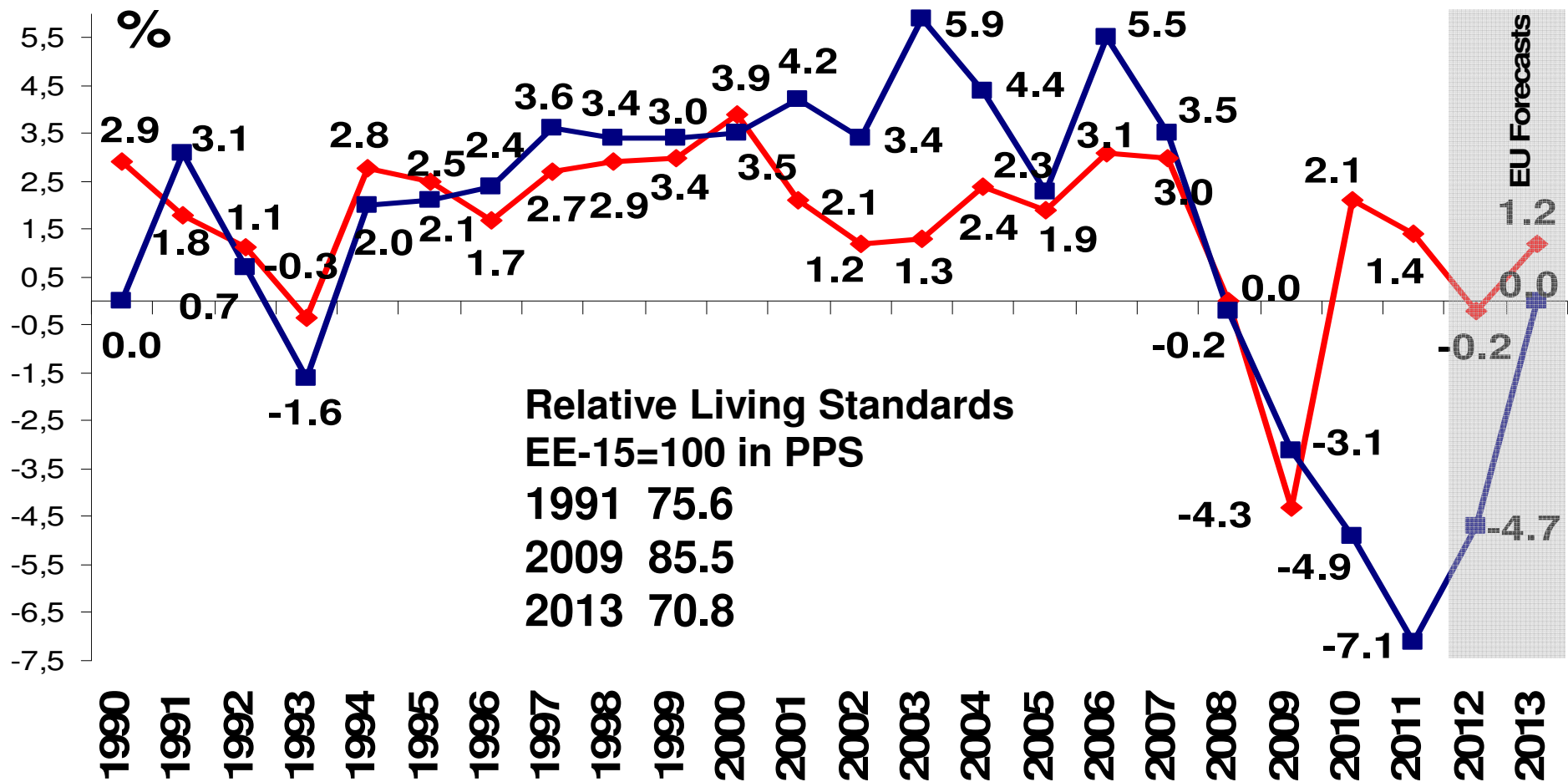
II. GREECE: POLULATION & ECONOMY

	2010	Greece	EA17	World
Population (mil.)		11.3	331.4	6,840.5
Geographical Area (thousand km²)		132.0	2,624.0	148,940
GDP per capita (€)		19,019	27,600	6,971
Living standards (UN ranking among 194 countries)		22		
Life expectancy (years) (2009)		80.2	80.5	69.4
Motor vehicles per 1000 inhabitants (2007)		560	602	
Suicides / 100 thousand inhabitants (2009)		3.0	9.1 (EU-15)	
Primary Sector (% GDP)		3.2	1.7	3.2
Secondary Sector (% GDP)		18.8	25.1	26.1
Tertiary Sector (% GDP)		78.0	73.2	70.7
Tourism (Total contribution, % GDP)		15.4	7.9 (EU-27)	9.1
Construction (% GDP)		5.3	6.2	
Public Sector (Gen. Gov. Exp. % GDP)		50.1	50.9	
Exports (% GDP)		21.5	40.9	
Imports (% GDP)		30.4	39.6	
Private Consumption (% GDP)		74.5	57.5	
Gen. Gov. Debt (% GDP)		144.9	85.6	

III. HIGH GREEK GROWTH RATES ... YET BASED ON AN IMBALANCED ECONOMY

Greece: From boom to bust. How come?

Answer: Not an equilibrium growth

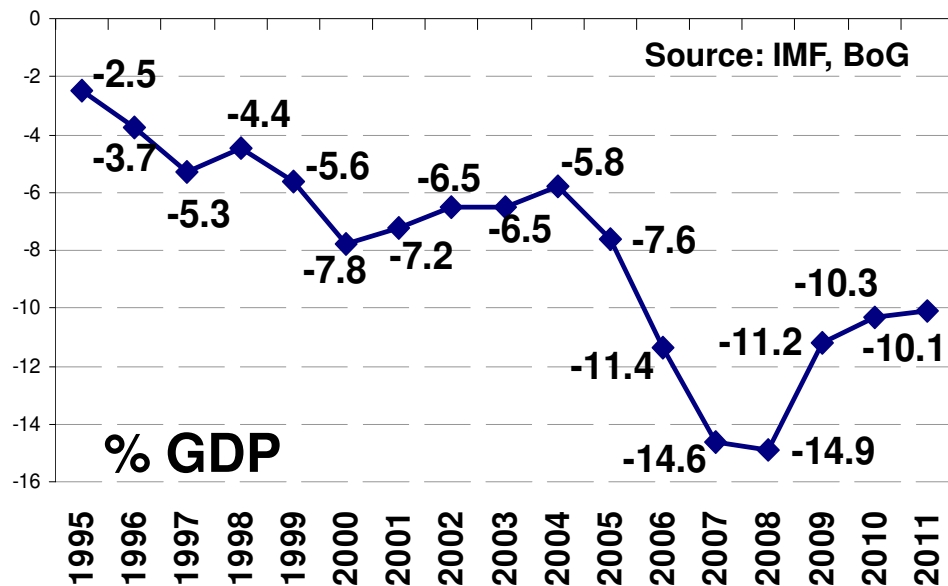


❖ Real growth rates in Greece were higher than in EU-15 from 1996 through 2007

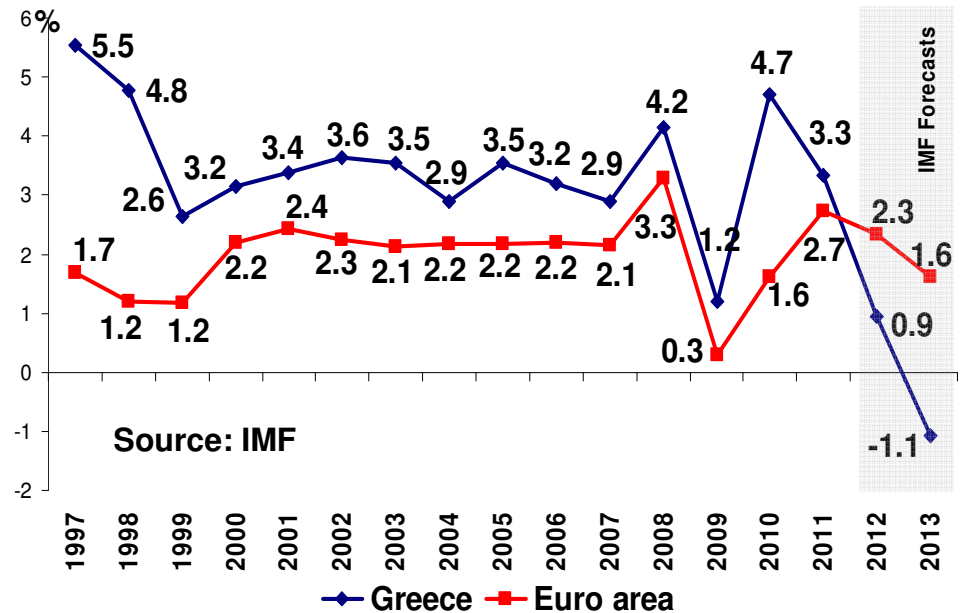
Source: EU

II. THE CRISIS IS ABOUT LOSS OF COMPETITIVENESS EXACERBATED INSIDE THE EURO AREA

Current Account Balance

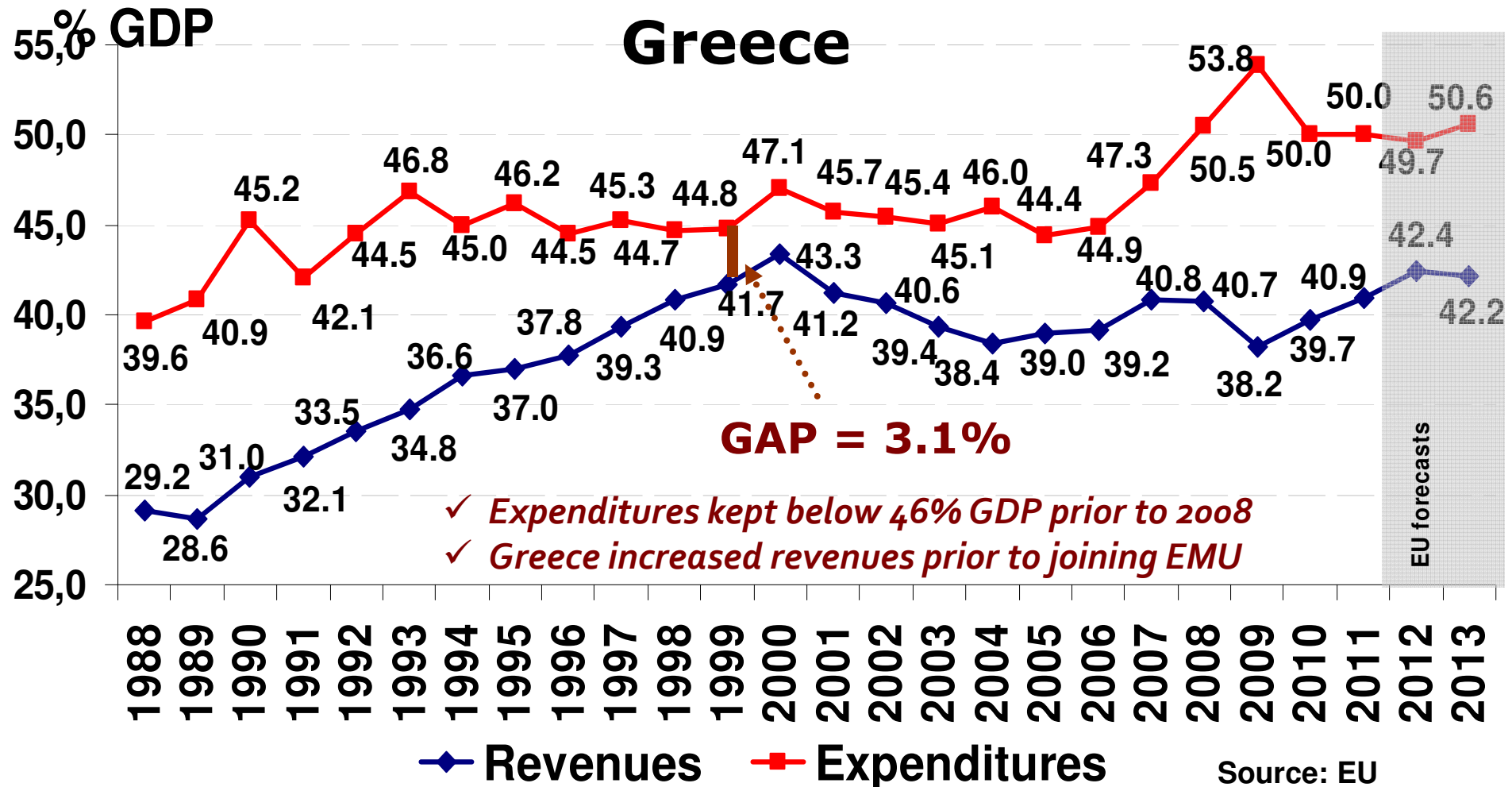


Inflation



	€ mill.	% GDP
2011		
Current Account	-21.096,1	-10.1
Goods	-27,221.2	-13.0
Services	14,630.8	7.0
Income	-9,066.5	-4.4
Current Transfers	560.8	0.3

II. FISCAL DEFICITS GREW WORSE AFTER 2006



- ✓ Greece was almost always in fiscal trouble, but the fiscal mess grew prior to the onset of the 2008 recession

II. THE BREAKDOWN OF RUNAWAY EXPENDITURE

General Government, € bn

Source: European Commission

	2001	2009	2011	2012	% Δ 2001-09	EU27 - %Δ 2001-09	% Δ 2009-11	EU27 - %Δ 2009-11
Total Expenditure	66.4	124.7	107.6	101.1	87.9	35.6	-13.7	3.4
- Interest	9.5	12.0	14.9	12.8	26.1	-6.6	24.4	19.6
Primary Expenditure	56.9	112.7	92.7	88.3	98.2	39.0	-17.7	2.5
- Employee Comp	15.2	31.0	26.1	24.0	104.2	31.1	-15.9	2.8
- Social benefits	22.5	49.0	47.0	43.3	117.7	35.5	-4.0	5.6
- Interm. Consumption	9.1	17.1	9.7	10.7	89.1	45.4	-43.2	3.3
- Other Expenditure	1.6	3.6	2.6	2.8	120.3	45.8	-27.9	2.3
- Capital expenditure	8.5	12.0	7.3	7.4	41.6	49.4	-39.2	-14.3
Total Revenue	59.8	88.6	88.1	86.3	48.1	21.3	-0.6	8.6
- Direct Taxes	12.5	19.1	17.9	19.9	52.8	13.7	-6.3	8.8
- Indirect Taxes	19.4	26.2	26.6	26.1	34.8	20.5	1.7	11.6
Primary Balance	2.9	-24.1	-4.7	-2.0	-916.5	-365.1	80.7	61.1
GG Balance	-6.5	-36.1	-19.6	-14.8	-451.9	-460.9	45.8	30.1
GDP (nominal)	145.1	231.6	215.1	203.5	59.6	22.5	-7.1	7.5

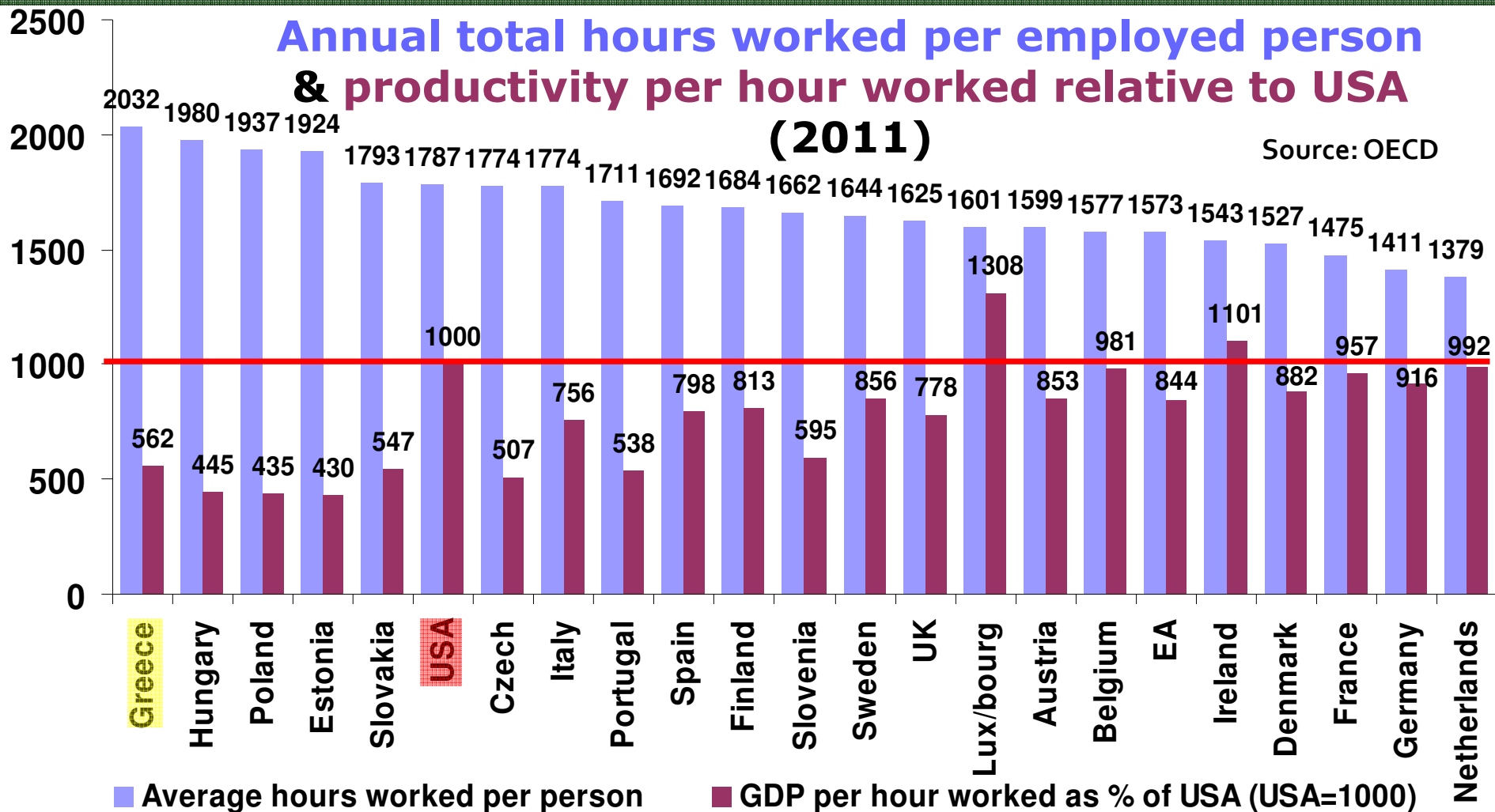
- ✓ The adjustment in expenses over 2009-2011 was large but could not undo a decade of runaway expenses
- ✓ Social transfers grew enormously, Intermediate consumption is already cut substantially and Capital expenditure has declined

III.

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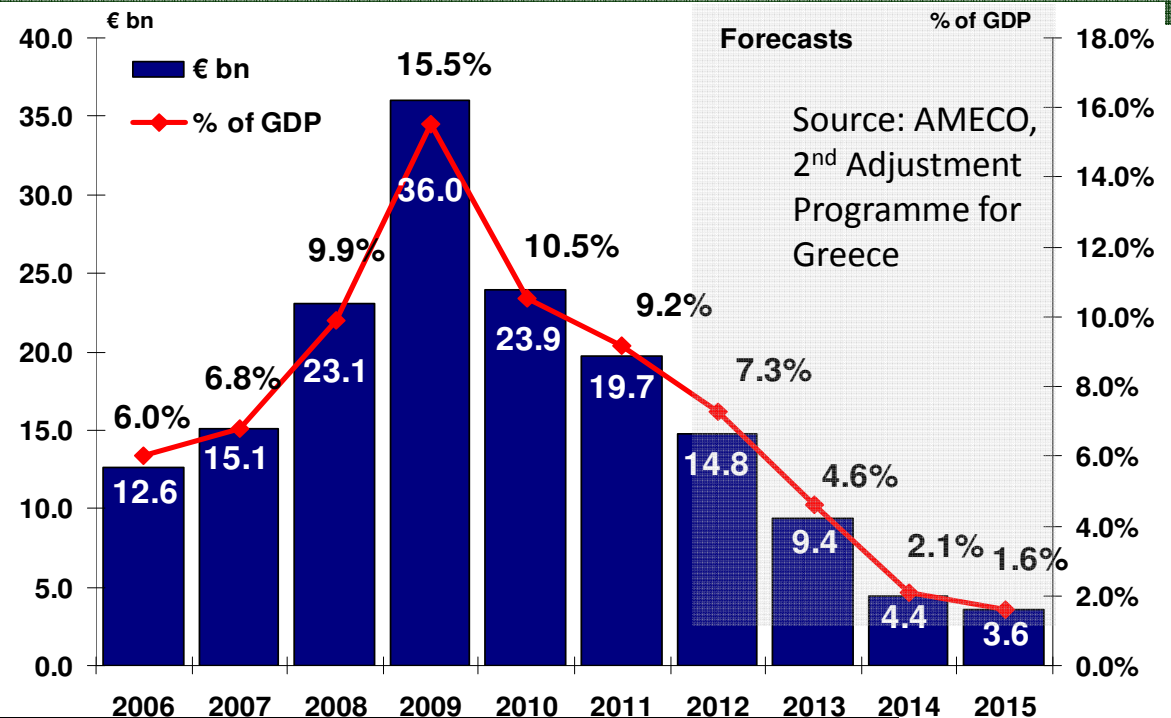
III. THE CRISIS IS NOT ABOUT LAZY GREEKS: THEY ARE THE HARDEST WORKING IN EUROPE!



Note: 1. Assuming a 40-hr work-week, Greeks work 50.8 weeks per year, 13.7% more than Americans (44.7 weeks), and 44% more than Germans (35.3 weeks)
 2. In Greece, productivity per person is at 70% (= 56.2 + 13.7) of US productivity

III.1 DRASTIC FISCAL CONSOLIDATION AFTER 2009

- ❖ From 2009 to 2012 expenditure was cut drastically
- ❖ Revenues managed to remain high despite the ~20% cumulative recession
- ❖ Primary balance improved by 9.6 pp of GDP
- ❖ Yet taxes have fallen on the usual suspects, the law-abiding citizens

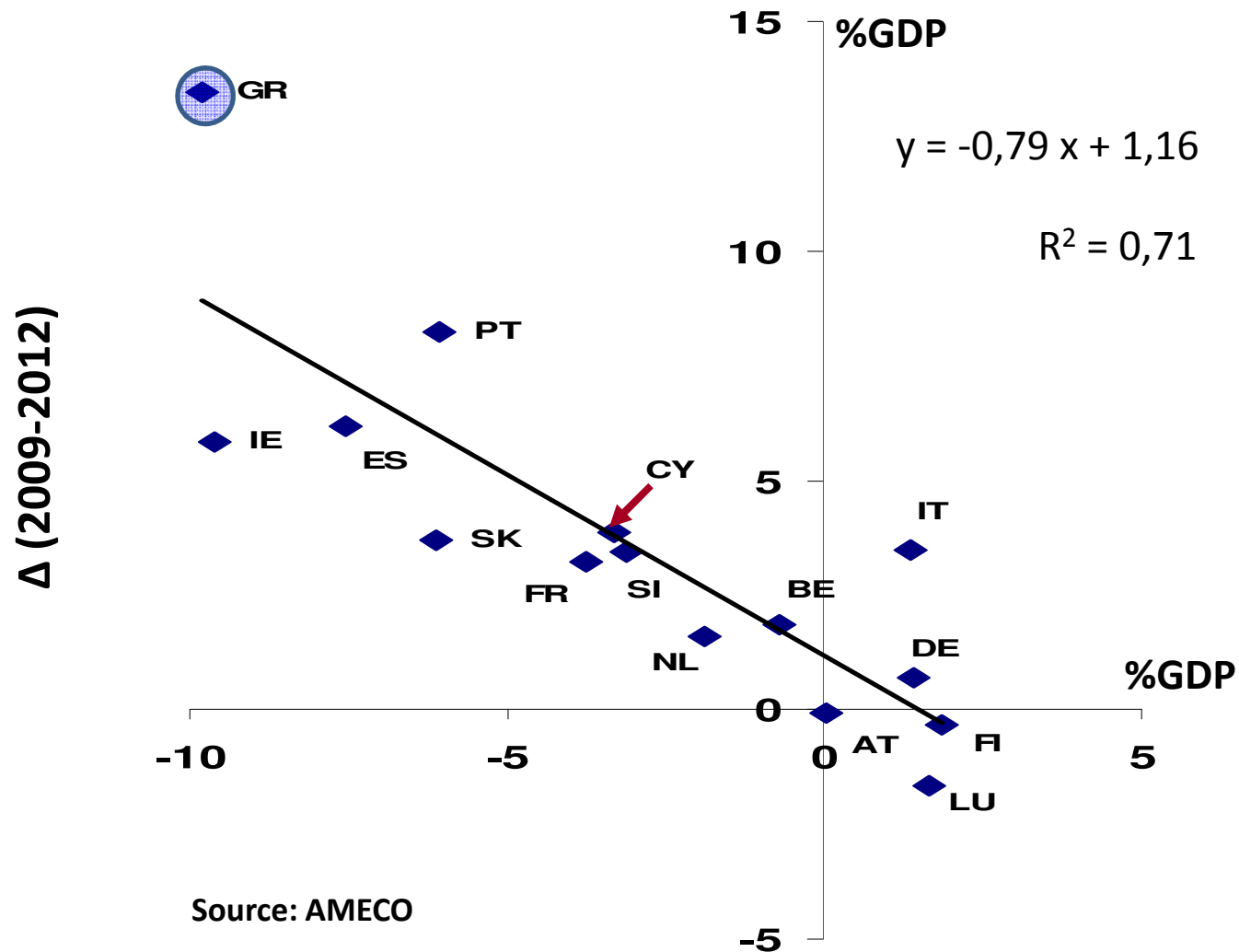


Greece: General Government, Fiscal Progress					
	Revenue (€bn)	Primary Expenditure (€bn)	Expenditure – Wages, Pensions, Benefits (€bn)	Primary Balance (% GDP)	Deficit (% GDP)
2009	88.6	112.7	80.0	-10.6	-15.7
2010	90.2	100.9	75.0	-4.7	-10.8
2011	88.1	92.7	73.1	-2.1	-9.3
2012	86.3	88.3	67.3	-1.0	-7.3

III.1 DRASTIC FISCAL CONSOLIDATION COMPARED TO OTHER COUNTRIES

❖ Compared to other countries, the Greek fiscal adjustment in the three years between 2009 and 2012 is huge, both:

- in absolute terms as % GDP
- and in relative terms, as a function of the starting point, i.e. above the regression line



2009 Cyclically Adjusted Primary Balance

III.2 SUCCESSFUL REFORMS

LABOR MARKET REFORMS

- ❖ **Adjustment / Reduction of wage floors:**
 - 22% reduction in the minimum wage
 - 32% reduction in the minimum wage for employees under the age of 25
- ❖ **Structural measures to level the playing field in collective bargaining**
 - Shortening the length of collective contracts and reduction of their 'after effects' time.
 - Removal of 'tenure' (contracts with definite duration defined as expiring upon age limit or retirement) in all existing legacy contracts in all companies.
 - A freeze of 'maturity' (referring to all automatic increases in wages dependent on time) until unemployment falls below 10 percent.
 - Elimination of unilateral recourse to arbitration
- ❖ **Adjustment to non-wage labor costs:**
 - Close earmarked funds engaged in social expenditures (OEK, OEE)
- ❖ **Open Issues: Reduction of severance payments, Abolition of automatic (3-year) wage increases**

PENSION & (initial) HEALTH CARE REFORMS

- ❖ Future rise in public pension expenditure not to exceed 2.5 % of GDP or the EU-wide average of 14% - (5/2010)
- ❖ Retirement age in line with life expectancy; benefits linked to lifetime contribution; disincentives for early retirement
- ❖ Health expenditure not to exceed 6% of GDP (2nd MoU)
- ❖ Social security funds merged into one (EOPYY), equalizing benefits and contributions
- ❖ Overhaul of the list of difficult and hazardous occupations, Disability criteria and rules revised (since Sep. 2011)
- ❖ Pharmaceutical expense reduction (2nd MoU)

PUBLIC SECTOR REFORMS

- ❖ **Single Payment Authority** established
- ❖ **Wage grid** adopted aimed at creating simplified uniformed remuneration system
- ❖ **Census of civil servants** (717,792 employees on public payroll)
- ❖ **Local government reform**
 - Municipalities reduced from 1034 to 325
 - Local authority entities reduced from 6,000 to 1,160
 - Decrease of elected officials from 30,795 to 16,657

III.3 Doing Business 2013: Greece ranks 78th from 89th in 2012

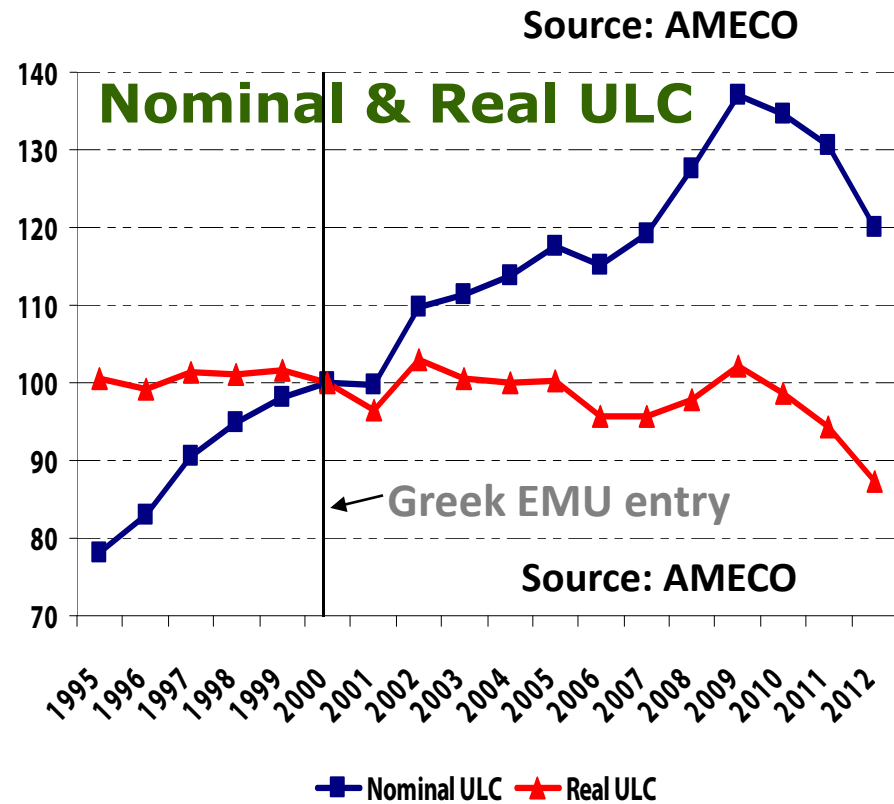
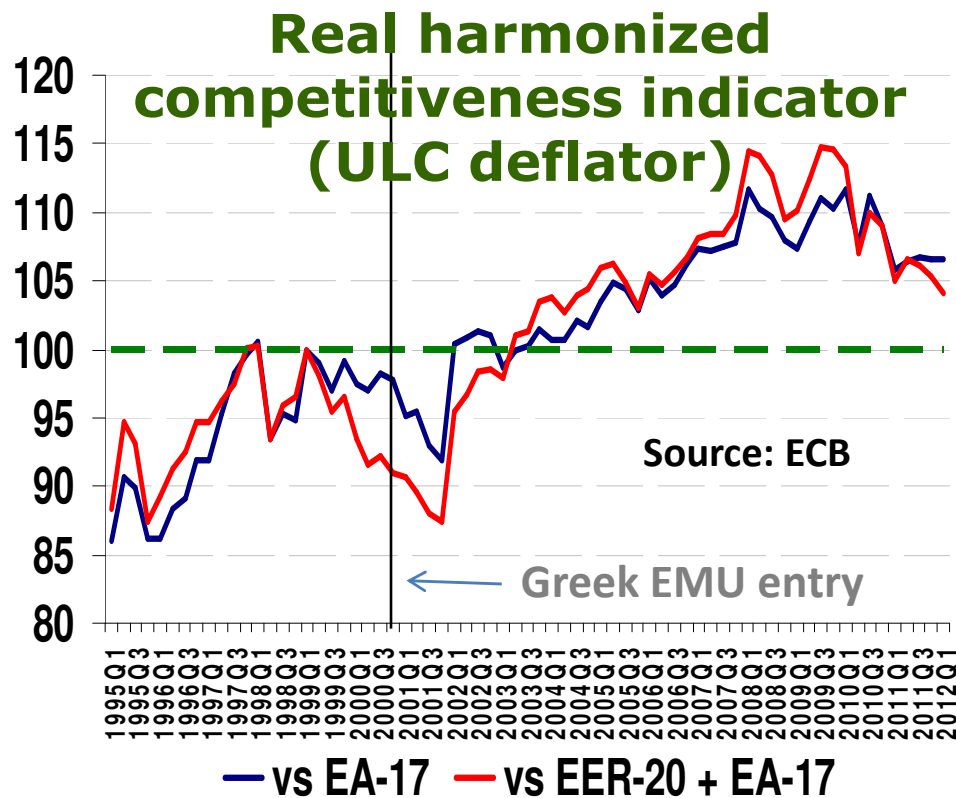
	Rank	$\Delta(2011-12)$	Starting a business (days)	Protecting Investors (0-10)	Exporting Goods (days)	Resolving insolvency (years)	Paying Taxes (hours/year)
OECD			12	6.1	10	1.7	176
US	4	0	6	8.3	6	1.5	175
GR	78	11	11	4.7	19	2.0	202
CY	36	1	8	6.3	7	1.5	147
DE	20	-2	15	5.0	7	1.2	207
FR	34	-2	7	5.3	9	1.9	132
IT	73	2	6	6.0	19	1.8	269
ES	44	-2	28	5.0	9	1.5	167
IE	15	1	10	8.3	7	0.4	80
PT	30	0	5	6.0	13	2.0	275

- ❖ The first improvement in years in a competitiveness index. Columns include results from selected questions that compose various sub-indices
- ❖ Greece is among the 10 economies globally that improved the most
- ❖ The DB 2013 covers 185 countries and describes the regulatory environment of each country measured from June 2011 through May 2012.

III.3 A GRADUAL IMPROVEMENT IN GREEK COST COMPETITIVENESS HAS BEGUN

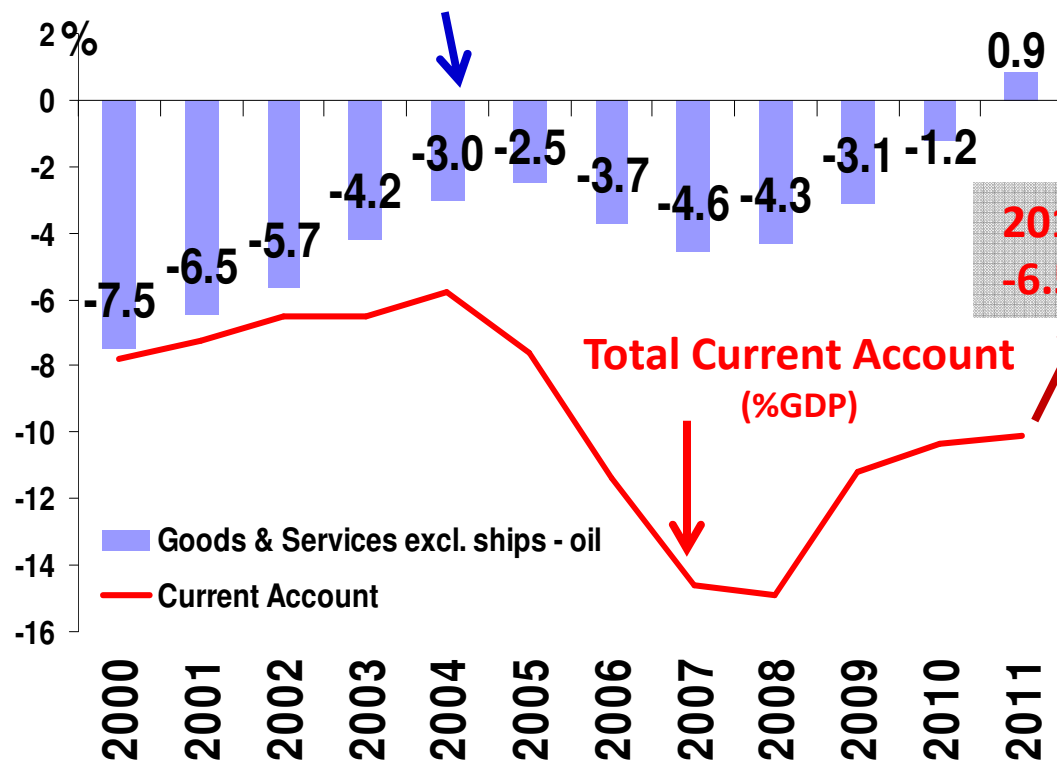
NOMINAL UNIT LABOR COSTS

% Δ	GR	CY	DE	FR	IT	ES	IE	PT	US	EA17	EU27
2000 - 2009	36.9	34.6	5.5	21.8	31.4	32.6	38.2	26.8	4.1	20.8	23.2
2009 - 2012	-16.8	-1.1	3.4	5.6	3.2	-8.2	-17.2	-6.8	23.0	1.8	2.8



III.3 EXTERNAL SECTOR ADJUSTMENT

Balance of Goods & Services excl. Ships and oil (% of GDP)



Source: BoG, Eurobank EFG Research

	2011	€ bn	% GDP
Current Account (I+II+III+IV)	-21,1		-10,1
I. Goods	-27,2		-13,0
Exports	20,2		9,7
Imports	47,5		22,7
Oil Balance	-11,1		-5,3
Trade Balance excluding oil	-16,1		-7,7
Ships' Balance	-3,3		-1,6
Trade Balance excl. oil - ships	-12,8		-6,1
II. Services	14,6		7,0
Travel	8,2		3,9
Transportation	6,9		3,3
Other services	-0,5		-0,2
III. Income	-9,1		-4,4
Compensation of employees	-0,3		-0,1
Investment income	-8,8		-4,2
IV. Current Transfers	0,6		0,3

III.4 BANKS CONTINUE TO PROVIDE INTERMEDIATION

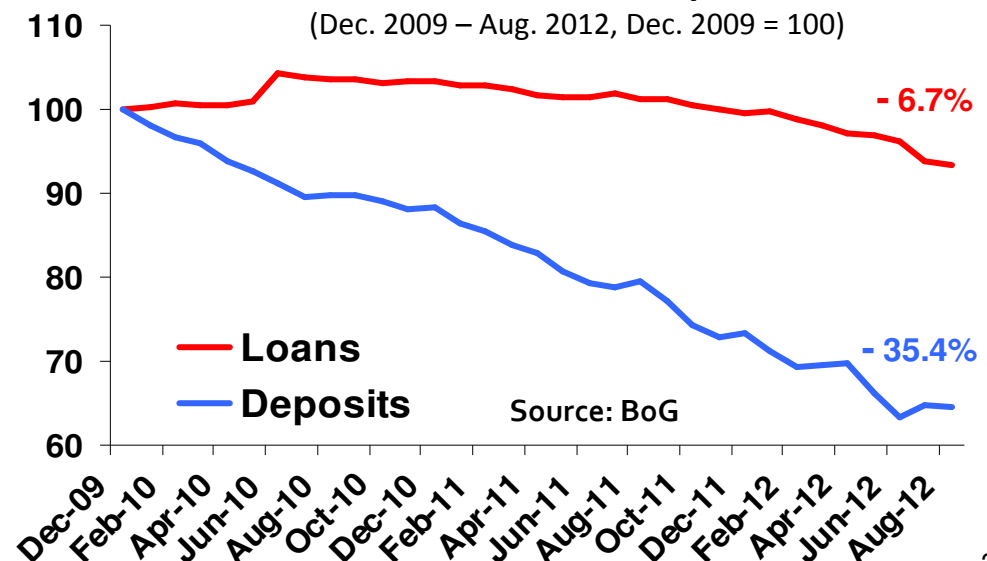
- ❖ Loans fell by less than deposits as banks continue to **restructure loans**, keeping low the NPL increase
- ❖ **Deposit withdrawal** stopped after June 2012 elections
- ❖ **Bank liquidity support from the State** around **€150bn**, mostly in the form of State guarantees (not a cost for the State Budget), utilized (along with other bank assets) for obtaining **ca €130bn** in Eurosystem liquidity (ECB & ELA facility), so as to cover
 - deposit withdrawals (> €80bn since 2009)
 - buy Greek government bonds & bills

Domestic Private Sector

(€ bn)	Loans	Deposits		Loans	Deposits
2007	215.1	197.9	Jan. 2012	248.7	169.0
2008	249.3	227.6	Feb. 2012	246.5	164.4
2009	249.3	237.5	Mar. 2012	244.7	165.4
2010	257.5	209.6	Apr. 2012	242.3	166.0
2011	248.1	174.2	May 2012	241.7	157.4
			Jun. 2012	239.8	150.6
			Jul. 2012	233.9	153.9
			Aug. 2012	232.6	153.4

Source: BoG

Domestic Private Sector Deposits & Loans



III.4 EUROSISTEM PROVIDES LIQUIDITY SUPPORT ... BUT NOT A LENDER OF LAST RESORT

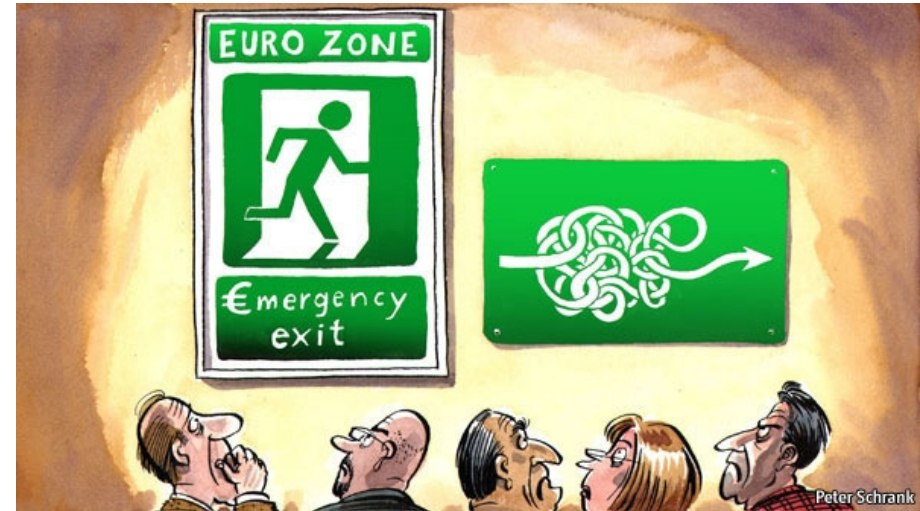
- ❖ ECB intervened to provide liquidity to the banking system, thus averted the typical *Sudden Stop* in financing imports to Greece, which usually accompanies a country crisis
- ❖ Yet ECB does not act as proper lender of last resort as the ELA mechanism is more costly (extra 2pps). **Periphery suffers from restrictive monetary policy at a time of restrictive fiscal policy!**

Bank Borrowing from the ECB

	EA			Greece			
	<u>a</u>	<u>b</u>	<u>c</u>	<u>a</u> *	<u>b</u>	<u>c</u>	
Jun-07	464.6	28,026	1.7	4.3	353.4	1.2	(a) Total Lending from the ECB (€bn)
Jun-08	483.0	30,839	1.6	11.6	424.7	2.7	(b) Total Banks Assets (€bn)
Jun-09	896.8	31,804	2.8	54.0	491.2	11.0	(c) % ratio a/b
Jun-10	870.4	32,578	2.7	94.3	544.7	17.3	
Jun-11	497.5	31,736	1.6	103.1	502.5	20.5	* plus lending from the BoG through ELA
Jun-12	1,260.9	34,181	3.7	135.8	437.6	31.0	
Aug-12	1,209.8	34,158	3.5	131.8	438.5	30.1	
			CY	13.3	134.7	9.9	

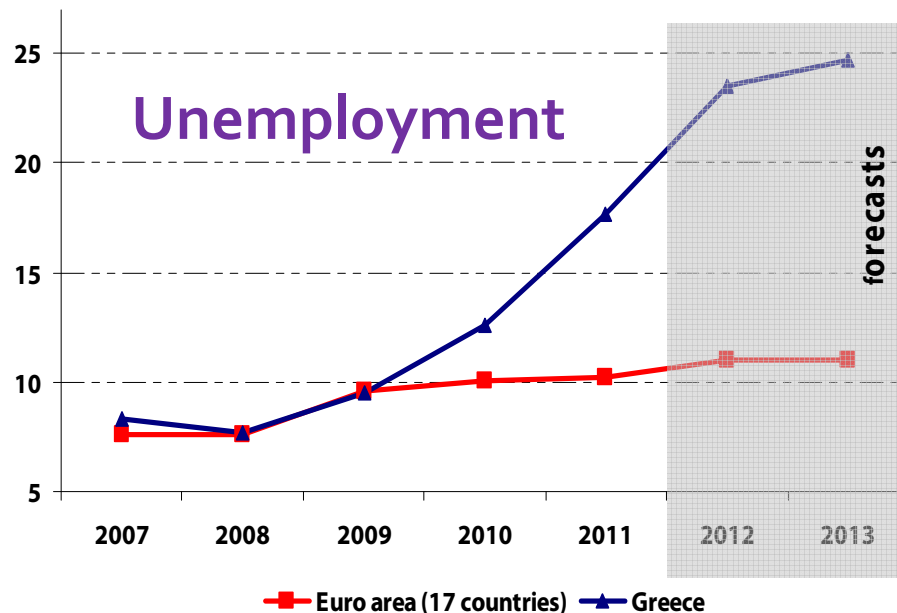
IV.

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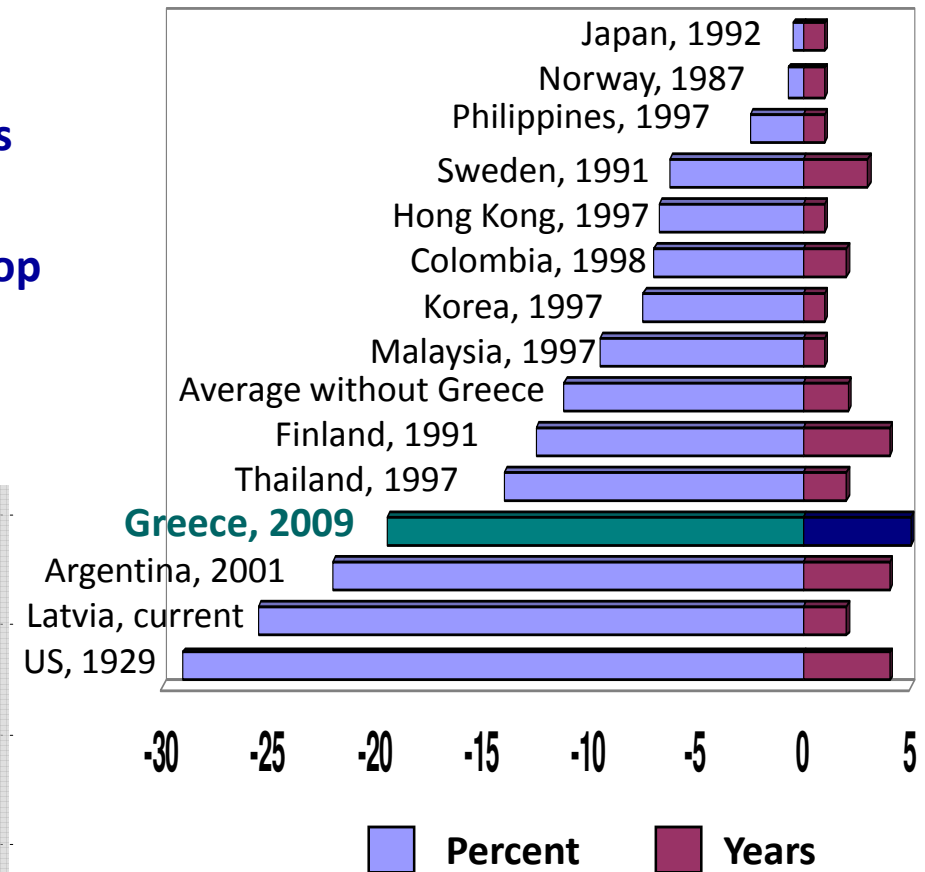


IV. CUMULATIVE RECESSION REACHES RECORD LEVELS

- ❖ The cumulative recession will continue into 2013 and is one of the worst in global history over the last 80 years
- ❖ Risk of social upheaval rises as incomes collapse and unemployment worsens
- ❖ The most important policy task is to stop the recession



Historical Crises: % Cumulative loss in Output & Duration



Source: IMF (2010), Reinhart & Rogoff (2009)

IV. MORE DEFICIT REDUCTIONS TO COME

POLICY TARGET	2009	2010	2011	2012	2013	2014	2015	2020
Primary Balance (€ bn)	-24.7	-11.3	-5.1	-2.0	3.7	9.4	9.7	11.4
Primary Balance (% GDP)	-10.6	-5.0	-2.4	-1.0	1.8	4.5	4.5	4.3

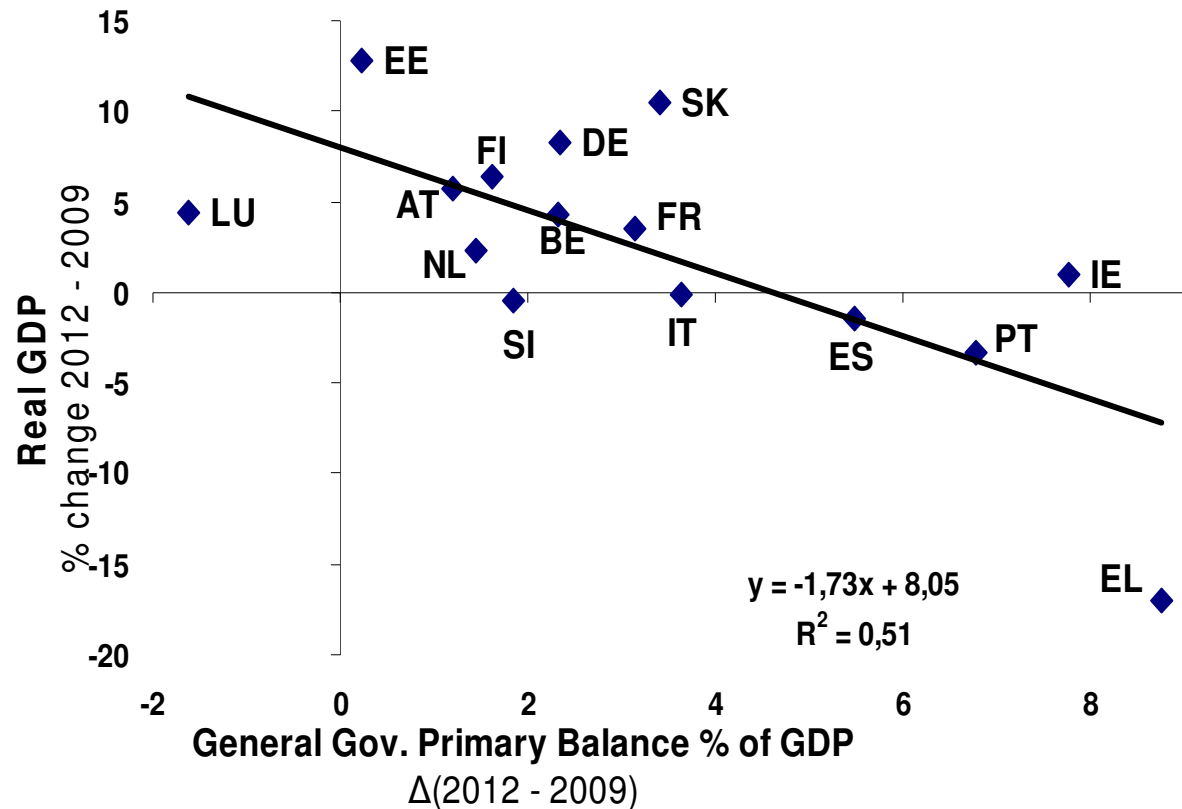
Source: IMF Country Report No. 12/57 (March 2012)

- ❖ The cut in the primary deficit by over 9% of GDP from 2009 to 2012 is scheduled to be followed by a further cut of additional 5.5% of GDP
- ❖ This further consolidation is expected to prolong the recession

Austerity Package , 2013-2014		€bn
1.	Expenditure cuts ($\alpha+\beta$)	11.0
	α . Wages, Pensions and Benefits	7.8
	β . Other Expenditure cuts	3.2
2.	Revenues	2.5
Total (1+2)		13.5

IV. FISCAL AUSTERITY PROLONGS THE RECESSION

- ❖ A vicious cycle is in progress, with more fiscal austerity causing a deeper recession
- ❖ An apparent fiscal multiplier close to 2 as a reduction in primary deficit of 9% GDP resulted in a drop of 17% in real GDP
- ❖ Recent IMF and Eurobank studies confirm that the fiscal multiplier is larger during recessions
- ❖ Hence, a further reduction in the primary balance of 6% GDP could possibly add another cumulative contraction of 10%



THE MILLION DOLAR QUESTION: Is there a better policy prescription?

IV. REQUIRED REBALANCING IN THE COMPOSITION OF GDP

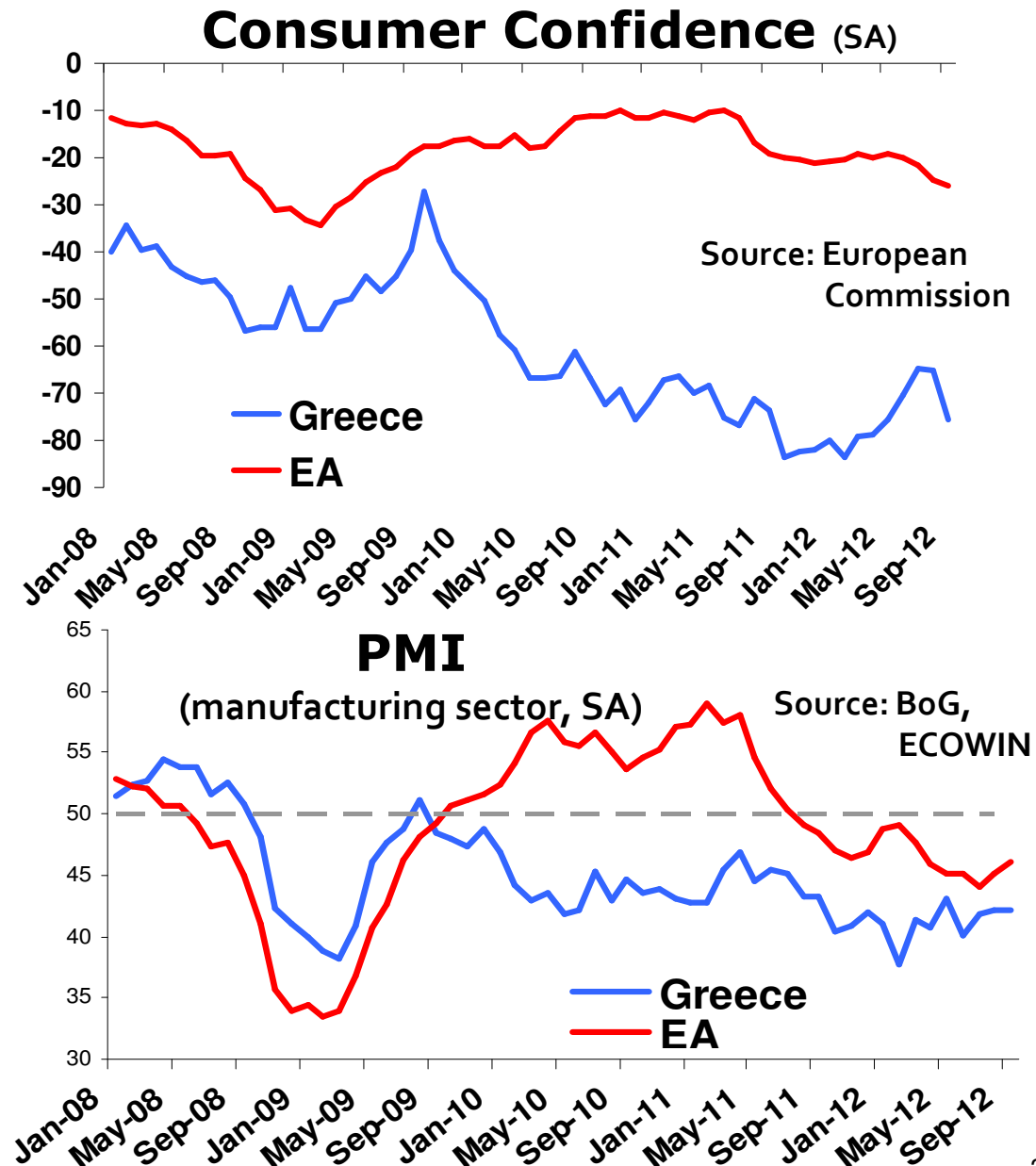
- ❖ Greek society over-consumes and under-produces, as evidenced by the large share of private consumption in output and the large gap between exports & imports
- ❖ The reduction in the share of consumption in output is necessary, yet it has to proceed smoothly to avoid an economic crash

(2011, % of total GDP)	Greece	EA-17
Private Consumption	74.6%	57.4%
Public Consumption	17.4%	21.6%
Private Investment	11.3%	17.1%
Public Investment	2.9%	1.7%
Exports	25.1%	44.0%
Imports	33.1%	42.6%
GDP (€ bn) - 2011	208.5	9420.6

- ❖ The investment share is dangerously small, around 14% of GDP from 25% a decade ago. In 2011, depreciation was larger than new investment, resulting in negative net investment and a destruction of capital stock
- ❖ Public investment declined instead of going up to counter the recession
- ❖ Exports ought to continue their rise but liquidity constraints bite

IV. AT TIMES OF AUSTERITY, FOR THE RECESSION TO STOP, A NUMBER OF PREREQUISITES EXIST

- ❖ **Credibility,**
 - Would improve if Troika gives green signal
 - Yet, closure of negotiations with Troika delayed
 - Front-loading the fiscal adjustment will deepen the recession in 2013
- ❖ **Liquidity** is a suffocating constraint even for exports
- ❖ **Delivery of Reforms** at a fast pace is a must, particularly taxation of self-employed & the underground economy
- ❖ **Inflow of external funds**
- ❖ **Sentiment and reversal of investment pessimism**
- ❖ **Political stability**



IV. FIGHTING TAX EVASION LAGS BEHIND

TAX REFORMS IN PROGRESS:

- ❖ **Merger and centralization** of tax offices in process, with **new IT system** interconnecting all tax offices by January 2013
- ❖ “**Fast track**” (90 days) administrative tax dispute resolution mechanism legislated shortening judicial procedures for tax cases
- ❖ **Reducing the backlog** of tax cases in the court system
- ❖ **New unit for large tax-payers** activated to monitor, audit and collect tax payments and debts
- ❖ **Big rise in audits and new risk-based audits** for high-net-worth and self-employed individuals identified by the anti-evasion task force
- ❖ Institutional arrangements leading to criminal charges for tax offenders
- ❖ Full overhaul of taxation system, under 2nd MoU expected until the end of 2012 (€2bn in tax revenues included in the current austerity package)

Size of tax evasion in Greece

- ❖ In 2011, estimated income tax revenues are ca 8bn. The wage & pension earners declared income of **ca €70bn**, while the self-employed professionals (**1/3 of the labor force**) declared only **€3.5bn!**
- ❖ AMT (2012) examine tax evasion in Greece. By pairing bank data on lending to different professional groups and their reported income, they estimate levels of tax evasion. According to their results, in fiscal year 2009, the self-employed **did not report taxable income of ca €28 bn**, hence **foregone tax revenues from the self-employed were ca €11.2 bn**.

IV. PRIVATIZATIONS NEED A JUMP-START, CAN IMPROVE CREDIBILITY

- ❖ Assets to be privatized are in real estate (55% of value), infrastructure (35%) and other (10%), which include lottery, banks, energy and old industrial firms
- ❖ Privatizations expected to generate €19bn by 2015 and €50bn by 2022 (including €16bn from selling the HFSF bank shares after their recapitalization)
- ❖ So far revenues of only €1.8bn
- ❖ New management team
- ❖ Major risks for the privatizations process a) GREXIT scenario and related uncertainty, b) political cost considerations, c) legal disputes over the real estate portfolio

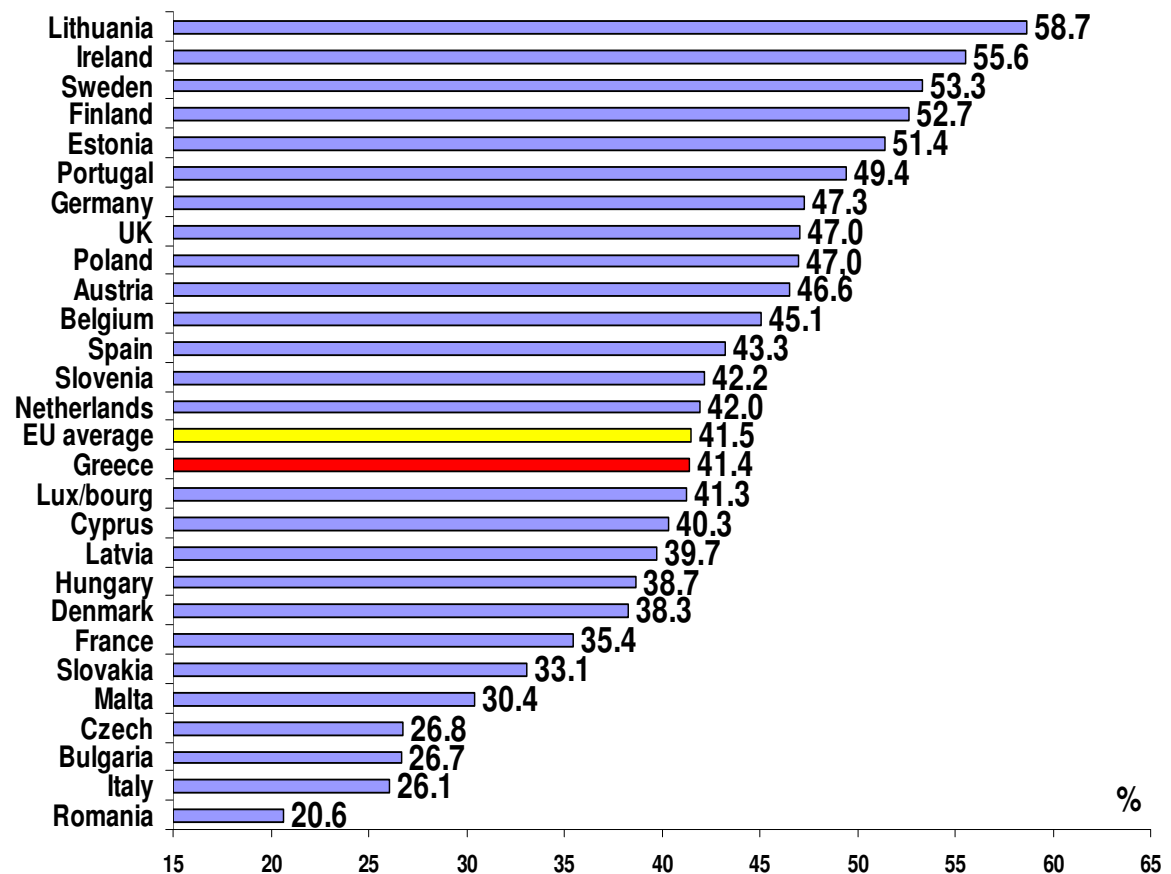
Cosco Pacific, an example of a past successful privatization

- ❖ Cosco Pacific, a unit of China Ocean Shipping, paid around € 4.0 bn in October 2009 for an initial 30-year (with a 10-year extension option) concession to develop and run container operations in Piraeus
- ❖ Greek state receives a minimum annual fee during the 30 years
- ❖ Cosco concession is the main driver for the upgrade of the Piraeus port:
 - Cosco bought a pier and upgraded a second one in June 2012 , Pier 11, increasing annual capacity by 1 million TEUs to 2.6 million TEUs
 - Cosco to build a third pier before 2015, which will add 1.1 million TEUs
 - Piraeus Port is a star performer in Cosco's terminal portfolio, a 69.5% YoY volume increase in June 2012, with Singapore ranking second with a 28.8% YoY increase

IV. ABSORPTION OF STRUCTURAL FUNDS

- ❖ ~ **€14bn** of public (EU + national) funds or **1.9%** of GDP/annum available
- ❖ **3.5 years** left to utilize them
- ❖ Close to the **EU average** in **absorption rates**.
- ❖ Yet, MoU 2012 absorption targets at risk due to liquidity & bureaucratic problems
- ❖ In 2014-2020 programming period, Greece expected to receive around **€12bn**, much less compared with the **€20.4bn** available under the NSRF
- ❖ This estimate can increase only if the recent economic crisis on Greek regional GDP will be taken into account in calculating relative living standards across EU-27

EU Member States absorption rates
(% of funds allocated per Member State already disbursed by the Commission)
(end of July 2012)



Source: EU Commission

SUMMARY

- ❖ **The crisis was triggered by fiscal concerns in Greece, a subset of the EMU divergences and moved beyond the Greek border as**
 - **moral hazard concerns dominated** the behavior of EU hardliners, while some countries in crisis did not realize the **regime shift** that was taking place
 - ECB did not act as Lender of Last Resort, although **it did avoid a sudden stop**
- ❖ **Greece has responded to the crisis by**
 - Fundamental reforms in social security and in the labor market, yet a less aggressive attitude in remaining reforms
 - An unprecedented-in-magnitude fiscal contraction, which is scheduled to continue despite the recession and the political turmoil, thus shrinking the state sector from 1/2 to 1/3 of the economy
- ❖ **Stopping the vicious cycle of austerity & recession is a major challenge**
 - Requires credibility, liquidity, improved sentiment
 - Europeans have to act smartly and front-load the economy with cash, not expenditure cuts (yet seems most likely)
 - ❖ Greece has to **revamp its tax collection mechanism and jump start privatizations, free up its product & service markets and re-organize its State sector**
 - ❖ Improved cost competitiveness, a new export-led economic paradigm, a re-capitalized financial sector, structural reforms and a large current output gap imply that once recovery starts, **growth can take off**

**Thank you
for your attention**

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I wish to thank my colleagues at Eurobank for their comments

APPENDIX: EVOLUTION OF EMU CRISIS, THE MARKET VIEW

10-yr spreads over Bunds

