Greece in a Continuing Crisis and the Challenge of Reforms

by

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FEBS Conference, University of Piraeus, Greece, Monday, December 21, 2015

6th National Conference
of the Financial Engineering and Banking Society
20-21
December 2015
F.E.B.S.
FINANCIAL ENGINEERING AND BANKING SOCIETY
University of Piraeus, Piraeus / Greece

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ΣΧΟΛΗ ΧΡΗΜΑΤΟΟΙΚΟΝΟΜΙΚΗΣ & ΣΤΑΤΙΣΤΙΚΗΣ

ΤΜΗΜΑ ΧΡΗΜΑΤΟΟΙΚΟΝΟΜΙΚΗΣ ΚΑΙ ΤΡΑΠΕΖΙΚΗΣ ΔΙΟΙΚΗΤΙΚΗΣ

Greece in a Continuing Crisis and the Challenge of Reforms

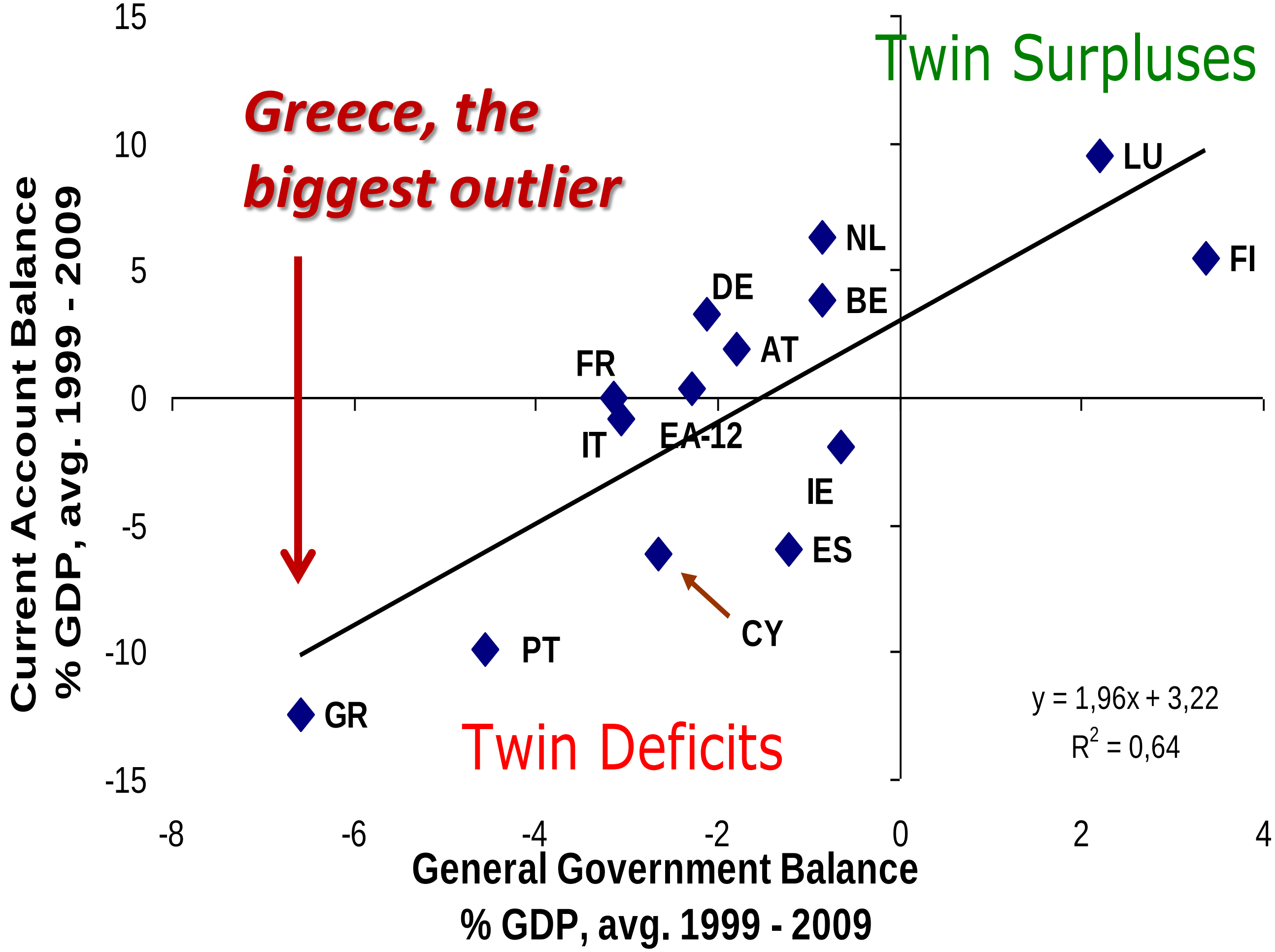
I. Decades-long imbalances (Shortage of Supply / Excess Demand), a deep and prolonged recession, the beginning of a recovery, and a subsequent new downturn

II. Will the Supply Side Recover? Reforms remain the way forward

I. The Past: Serious imbalances …

- Two major imbalances , fiscal & external
- Greece was an outlier in the Euro Area
- Fiscal imbalance will not be fully cured unless pension system is stabilized
- Current account reflected a deeper supply-demand imbalance, a serious competi-tiveness problem

Eurozone Years up to the Greek Crisis



Source: European Commission

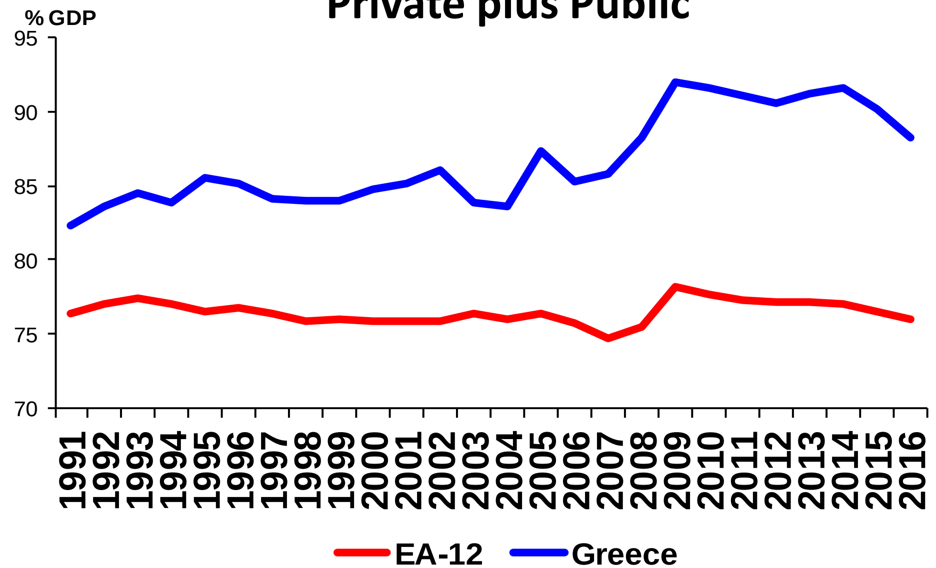
I. Imbalances: Another Comparison

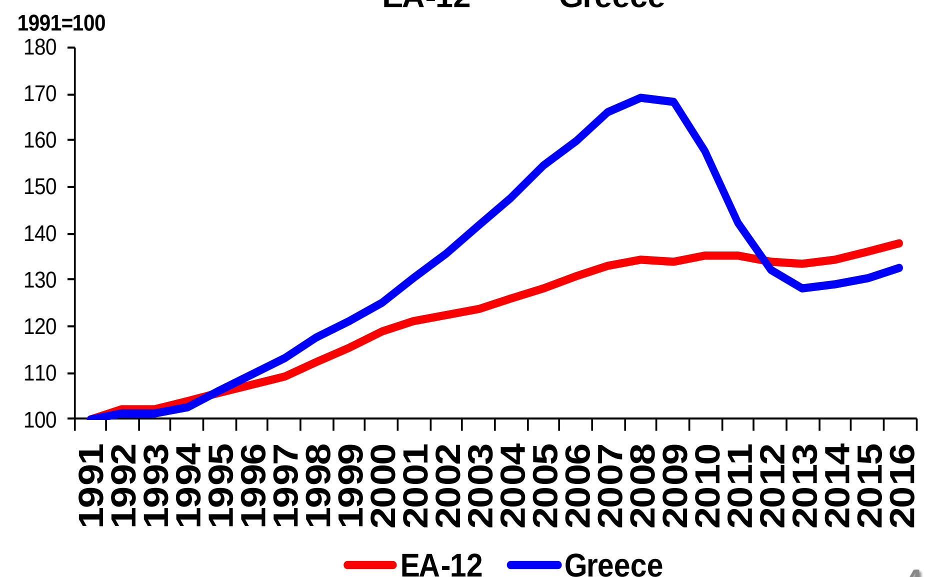
- Our society over-consumes and under-produces
- The gap in consumption with EA-12 is over 15 percentage points of GDP
- Before the crisis, exports were a very small share of GDP
- Investment has become a very small share of GDP since the beginning of the international crisis

(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

Real Consumption

Private plus Public

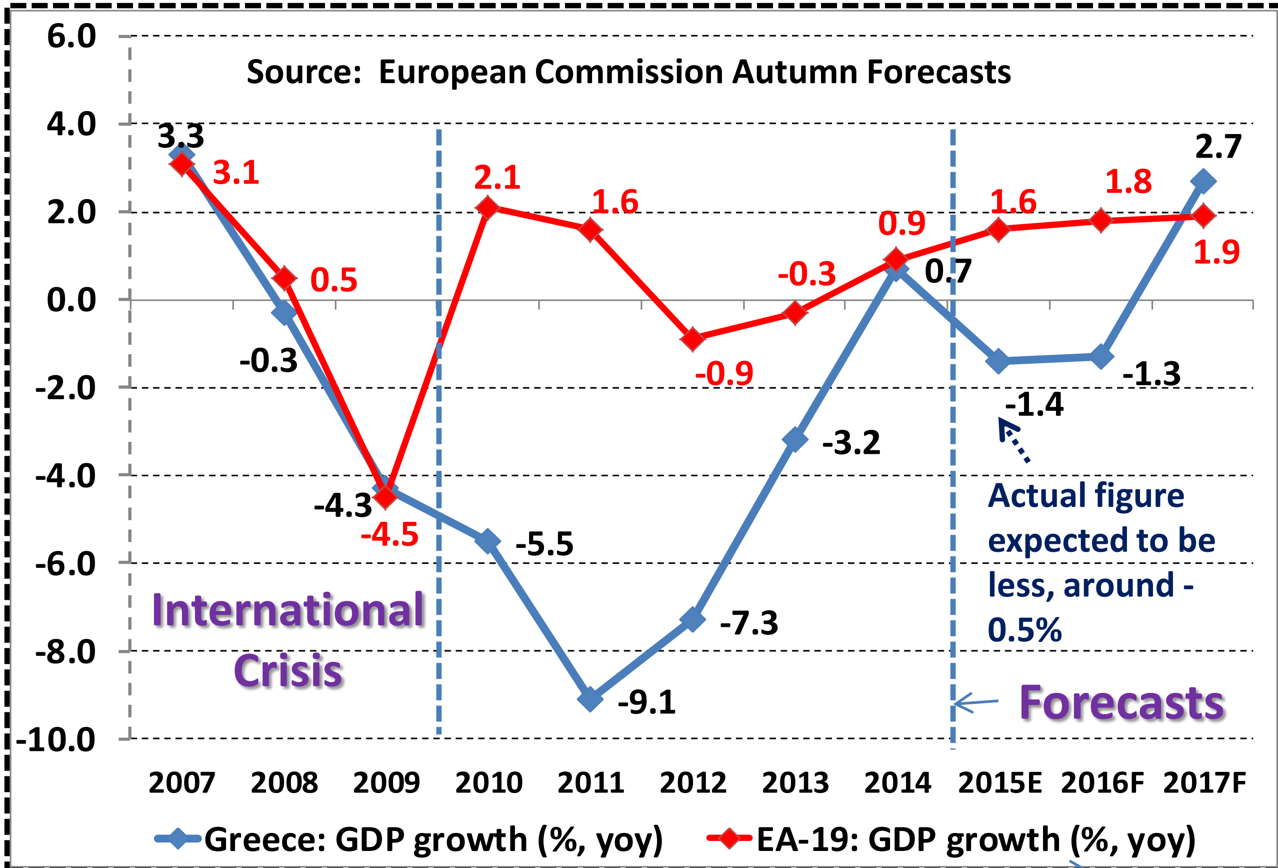




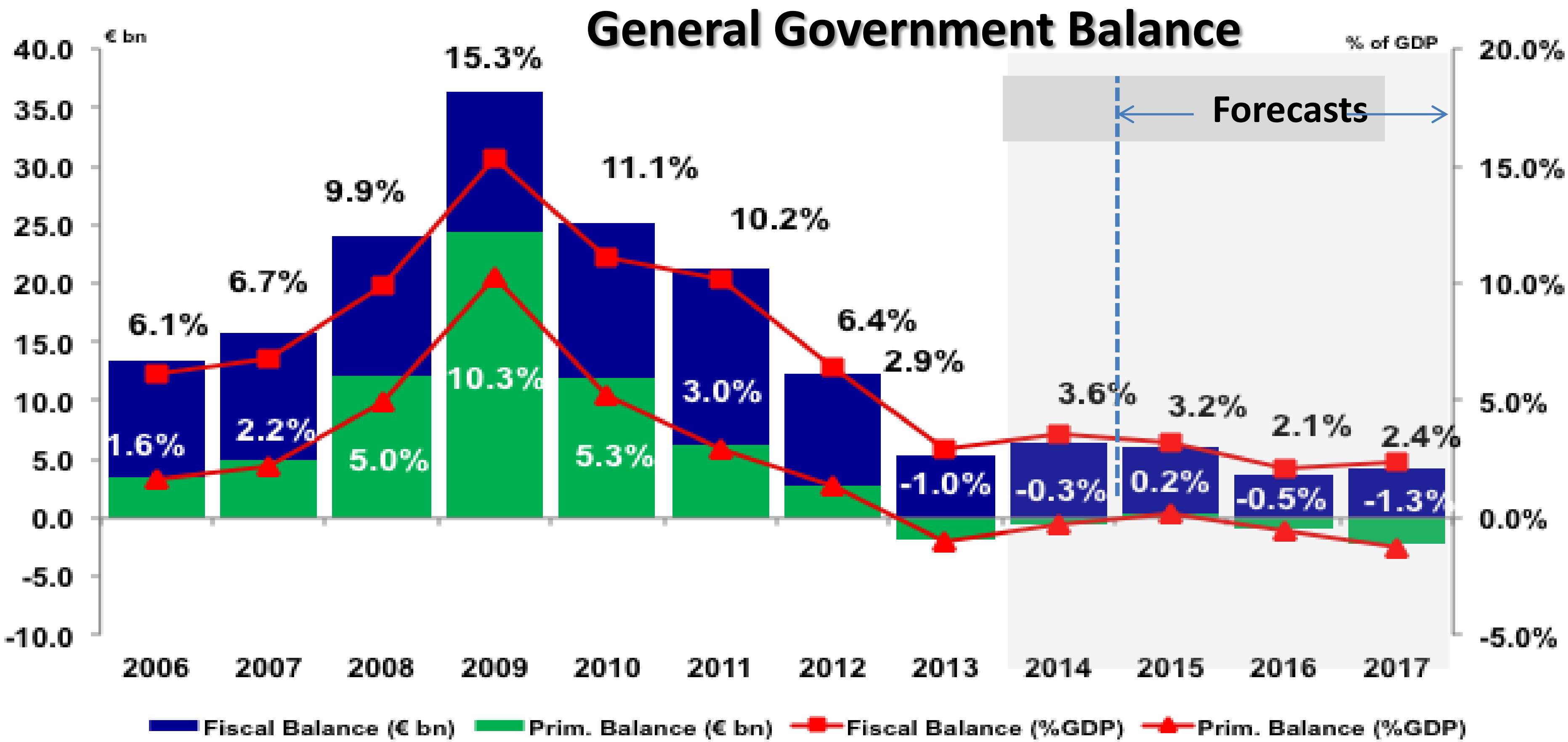
I. Imbalance corrections lead to recession, and subsequent mistakes make it W-shaped

Additional reasons besides the ORIGINAL GREEK SIN (the imbalances) for the unusually large recession:

- ❑ Sluggish and partial implementation of reforms and their wrong sequencing
- ❑ Collapse of confidence
- ❑ Liquidity crunch
- ❑ Fiscal Multiplier larger than assumed



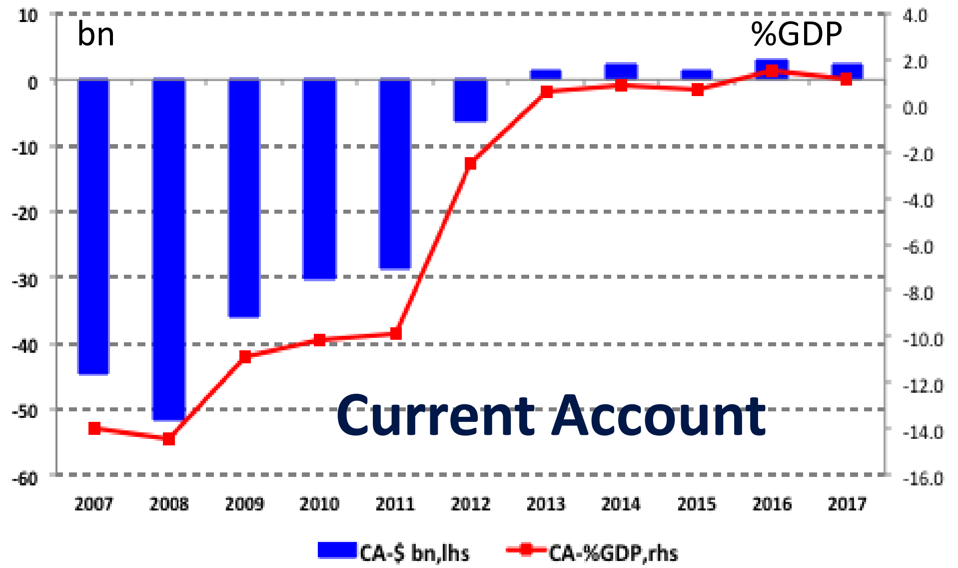
I. A Necessary Huge Fiscal Consolidation

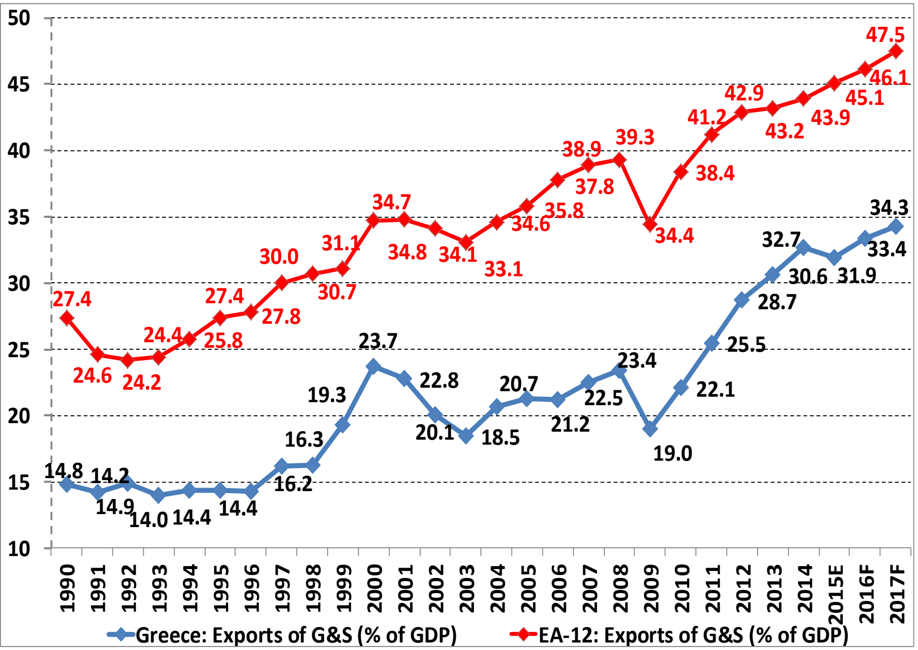


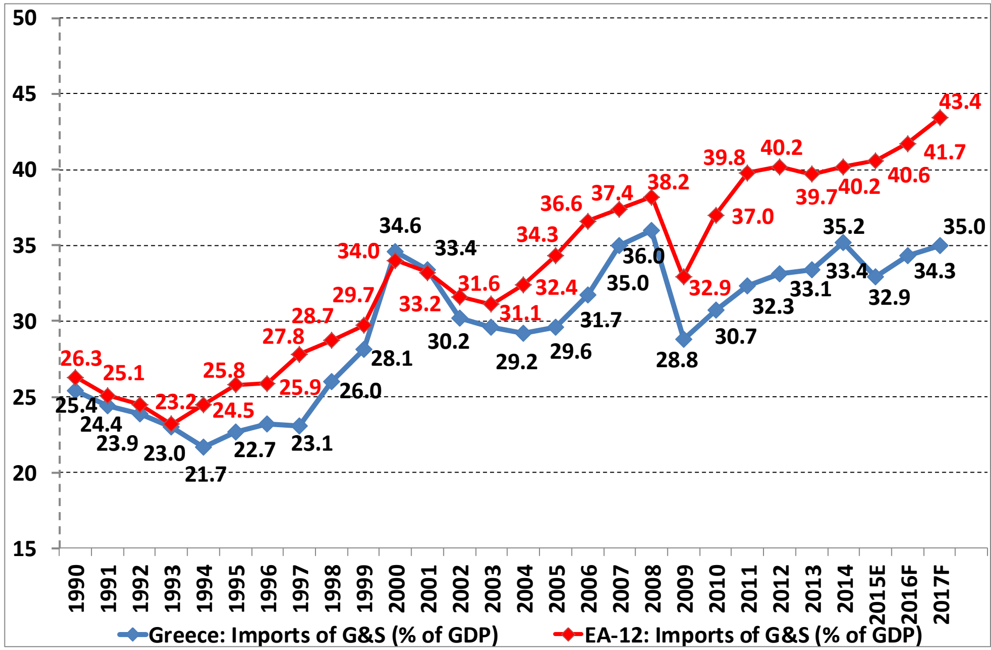
- **Enormous fiscal consolidation** since 2009,
  - When Gen. government expenses were €128.2bn and General Government revenues €91.9 bn.
  - In the budget of 2015, the corresponding expenses and revenues were both projected at ≈€80bn.

I. External imbalances improved

- Current account corrects as imports collapse
- Exports increase as a %GDP but their level is sluggish and reaches the 2008 level only in 2014

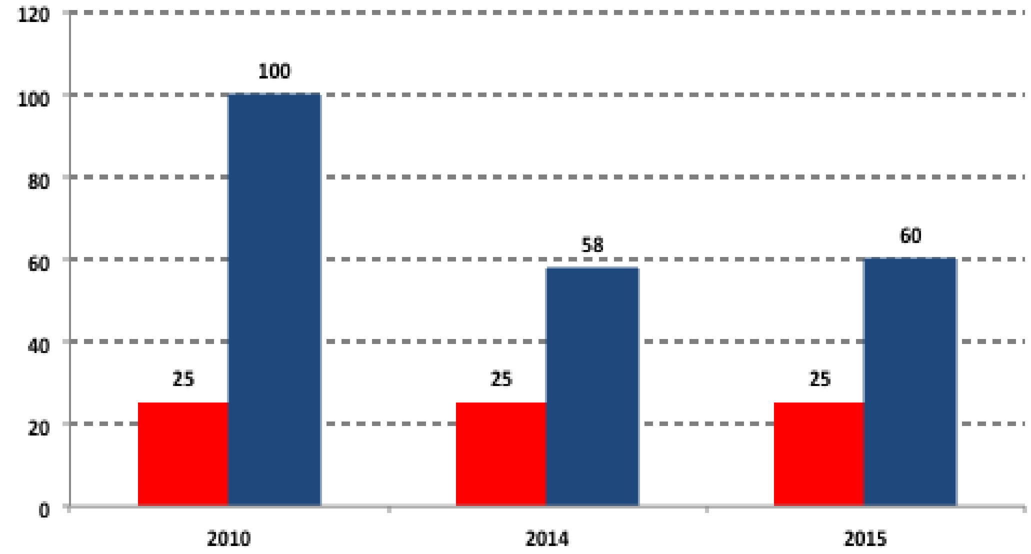


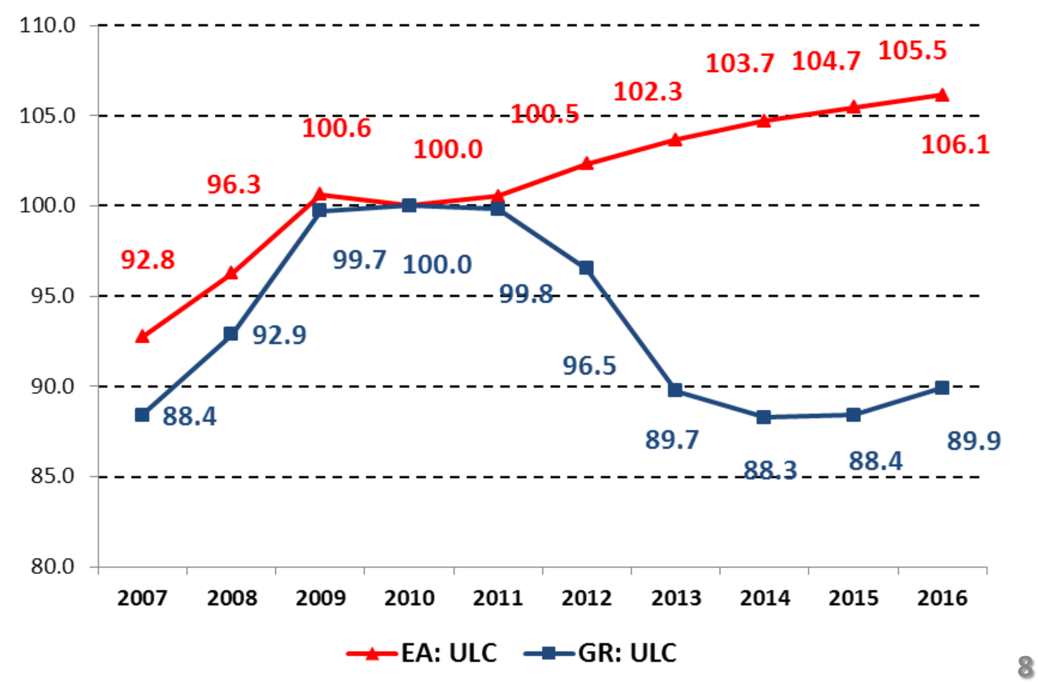




I. Need to improve quality competitiveness

- **Foundations of an extrovert and competitive economy via reforms:**
  - ✓Competitiveness rankings↑
  - ✓Cost competiveness improved
  - ✓FDI in 2013 and 2014 exceeded 2007 level
  - ✓Privatizations picked up momentum
  - ✓Investment in machinery & equipment up in 2014,
  - ✓Yet total Δ(investment) negative in 2014 with a bigger dip in 2015, which is expected to continue into 2016





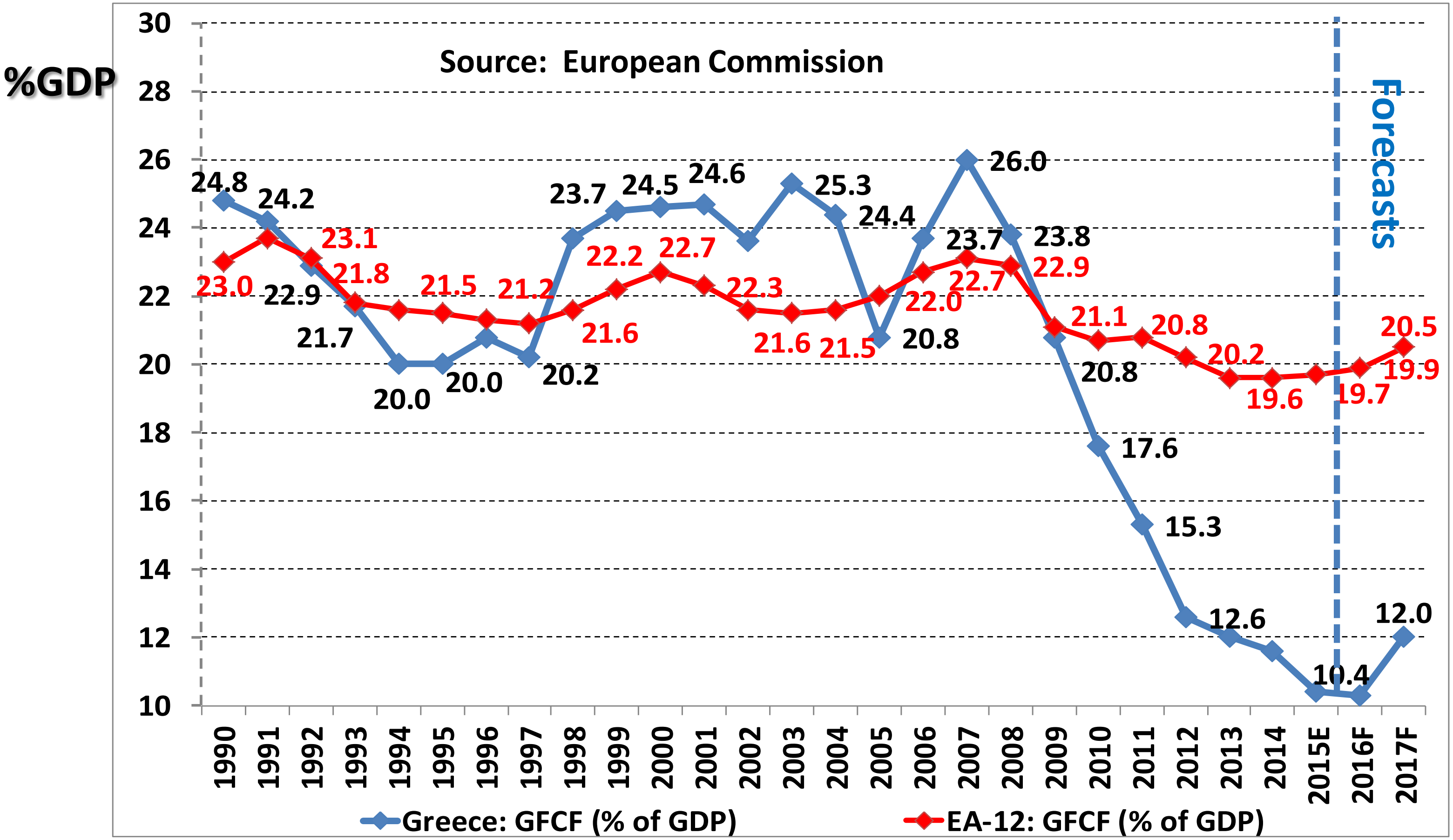
I. Growth requires Investments & Exports

- ✓**THE GROWTH MODEL**: In the future, consumption should
  - i. Grow positively, but
  - ii. at rates lower than growth in investment & exports
- ✓Exports have picked up but not by as much as in other periphery countries
- ✓**Investment is still a major problem**
- ✓Actual GDP growth figure in 2015 is expected higher than the EU forecasts, at -0.5%

	Shares in 2014 Nom. GDP	2014 growth Real	2015 growth Real	2016 growth Real
Private Consumption	70.4%	+0.5%	-1.3%	-1.7%
Government Consumption	19.9%	-2.6%	-0.2%	-1.0%
Total Consumption	90.3%	-0.2%	-1.1%	-1.5%
GFCF	11.6%	-2.8%	-10.2%	-2.0%
Domestic Demand	101.9%	+1.0%	-2.7%	-1.6%
Imports	32.7%	+7.5%	+0.1%	+1.2%
Exports	35.2%	+7.7%	-4.0%	0.0%
GDP (nominal, € bn)	177.6			
Real GDP		+0.7%	-1.4%	-1.3%
GDP deflator		-2.2%	-1.1%	+0.6%
Unemployment (avg)		26.5%	25.7%	25.8%

Source: European Commission Autumn 2015

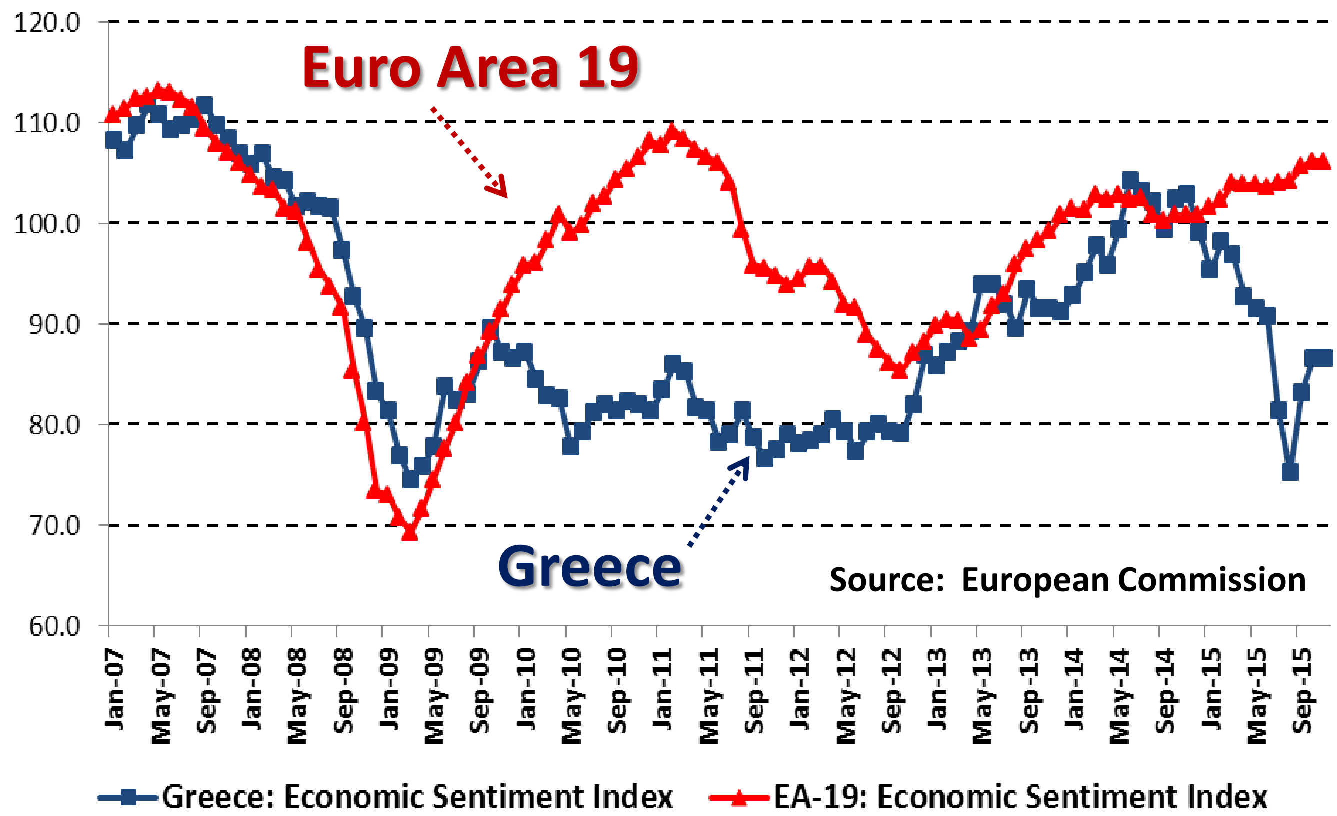
I. Investment is a binding constraint on growth



- It will be difficult for Investment to reach the pre-crisis shares of GDP, as real estate investment will take time to recover
- What is needed for growth today is Investment in machinery & equipment

I. At a minimum, new investments require State credibility and improvement in sentiment

- The sentiment index in Greece moved together with sentiment in EA until late 2009, both declining
- Decoupling during the Greek crisis
- From late 2012 on, Greek sentiment moves upward and again together with EA sentiment



- Greek sentiment peaked in the period June 2014 - November 2014, but subsequently began a fast downward slide as the political landscape deteriorated and generated new uncertainty, thus decoupling a second time from the rest of EA

II.

I. Decades-long imbalances (Shortage of Supply / Excess Demand), a deep and prolonged recession, the beginning of a recovery, and a subsequent new downturn

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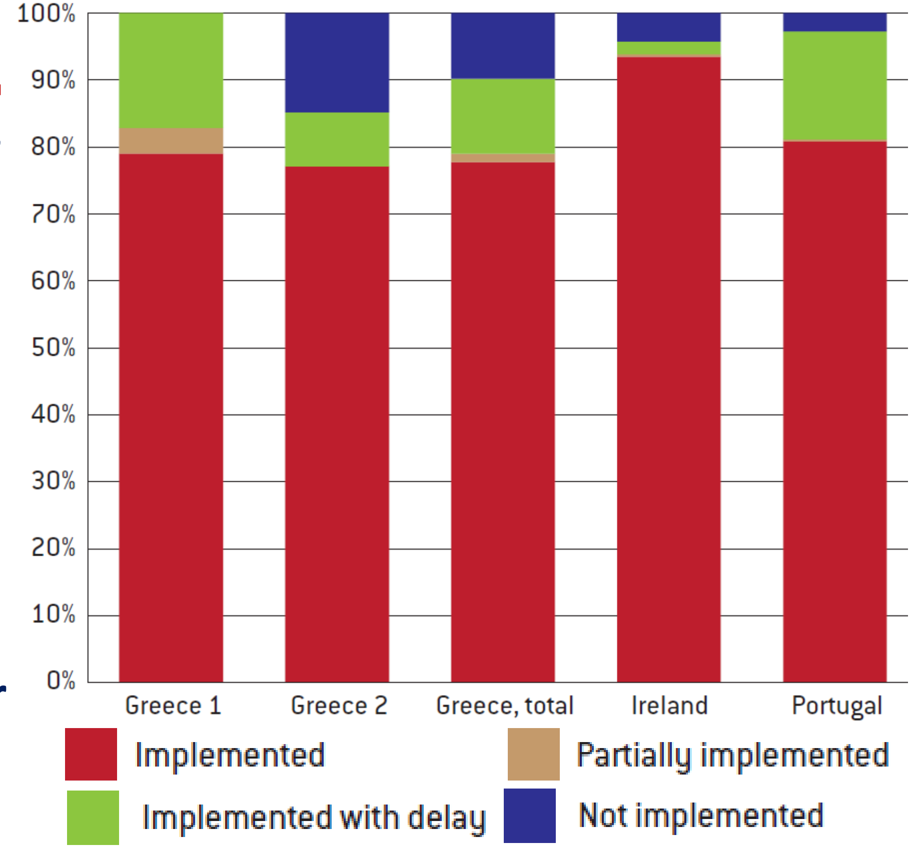
II. Structural Reforms should be Part of an Articulated Growth Strategy

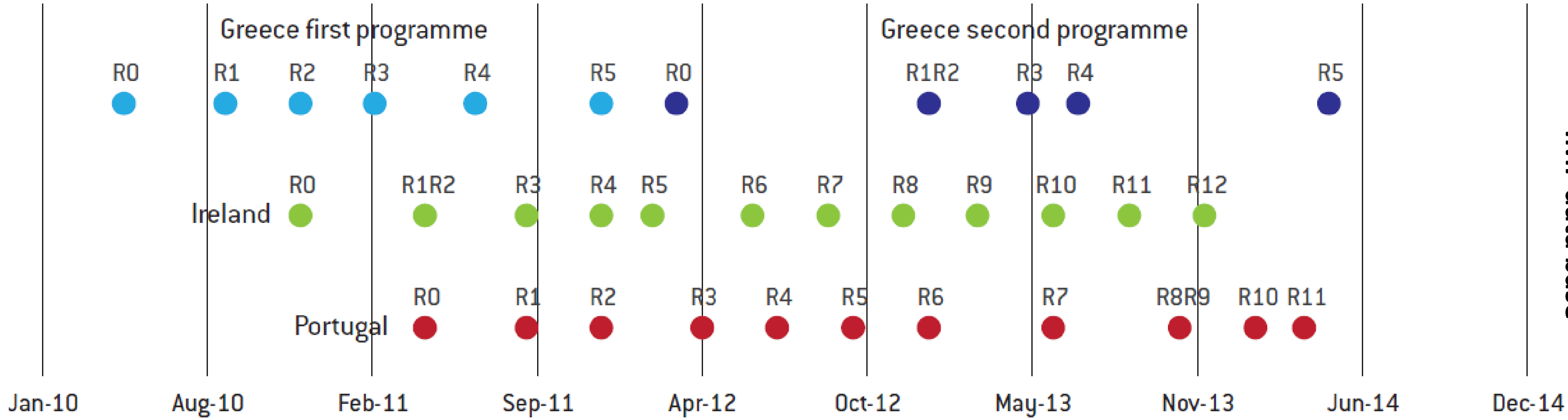
Historical evidence suggests

- **<u>Ownership</u> of structural reforms is a must, for otherwise they can easily be reversed by politicians captured by the interest groups or other voters**
- **Structural reforms often have short-run political costs, yet only long-term benefits, hence they ought to be <u>implemented quickly as a package deal</u>, subject to the constraints imposed by the ability of the State bureaucracy to deliver. Otherwise,**
  - **<u>Growth – enhancing</u> reforms should be targeted first**
  - **The <u>sequencing of reforms matters</u> as the Greek case showed in a negative way: Labor market reforms preceded product market reforms**
- **Given the unavailability of monetary policy and the constraints imposed on fiscal policy, Reforms represent the <u>only policy tool for Greece</u>**
- **Reforms are <u>easier to administer in an economic upturn</u>, yet in the Greek case, given the huge imbalances, there was no other way but proceed**
- **Reforms can have a maximum growth impact <u>when coordinated with other policies</u>: STABLE TAX REGIME, INDEPENDENT INSTITUTIONS, etc.**

II. MoU Implementation

- Ireland was very quick in implementation, had an efficient administration and its program was simple and focused mainly on the financial sector
- In Greece, 80% of MoU implemented on time, just as in Portugal
- Greece is unique with 3 consecutive & overlapping programs, with the leftover actions carried over to the next Program
- Unwillingness to take ownership & deliver led to mistrust and made the Greek programs increasingly more detailed

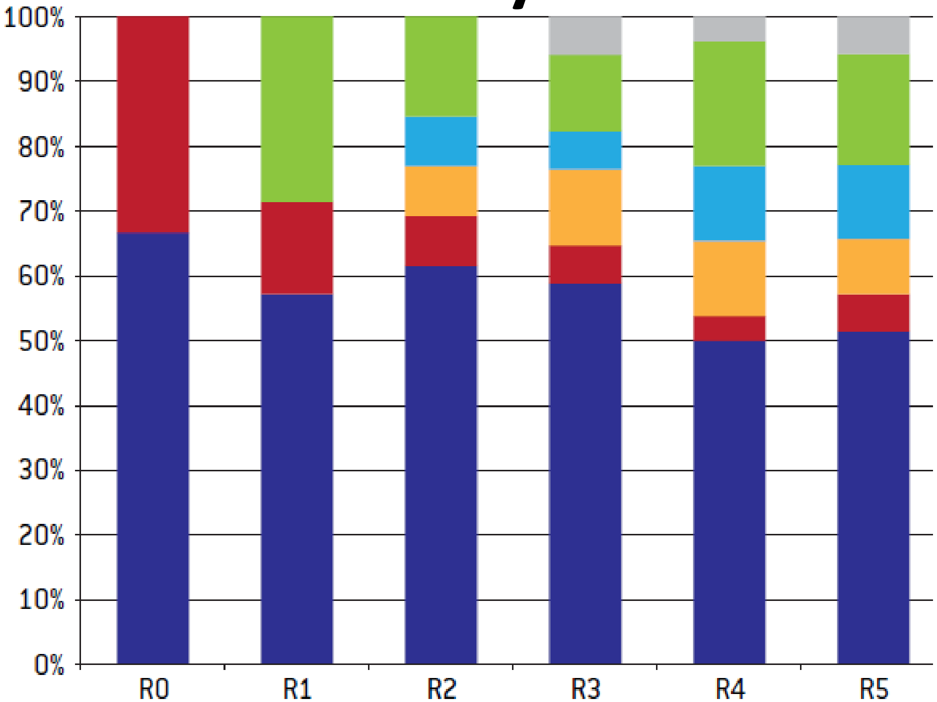




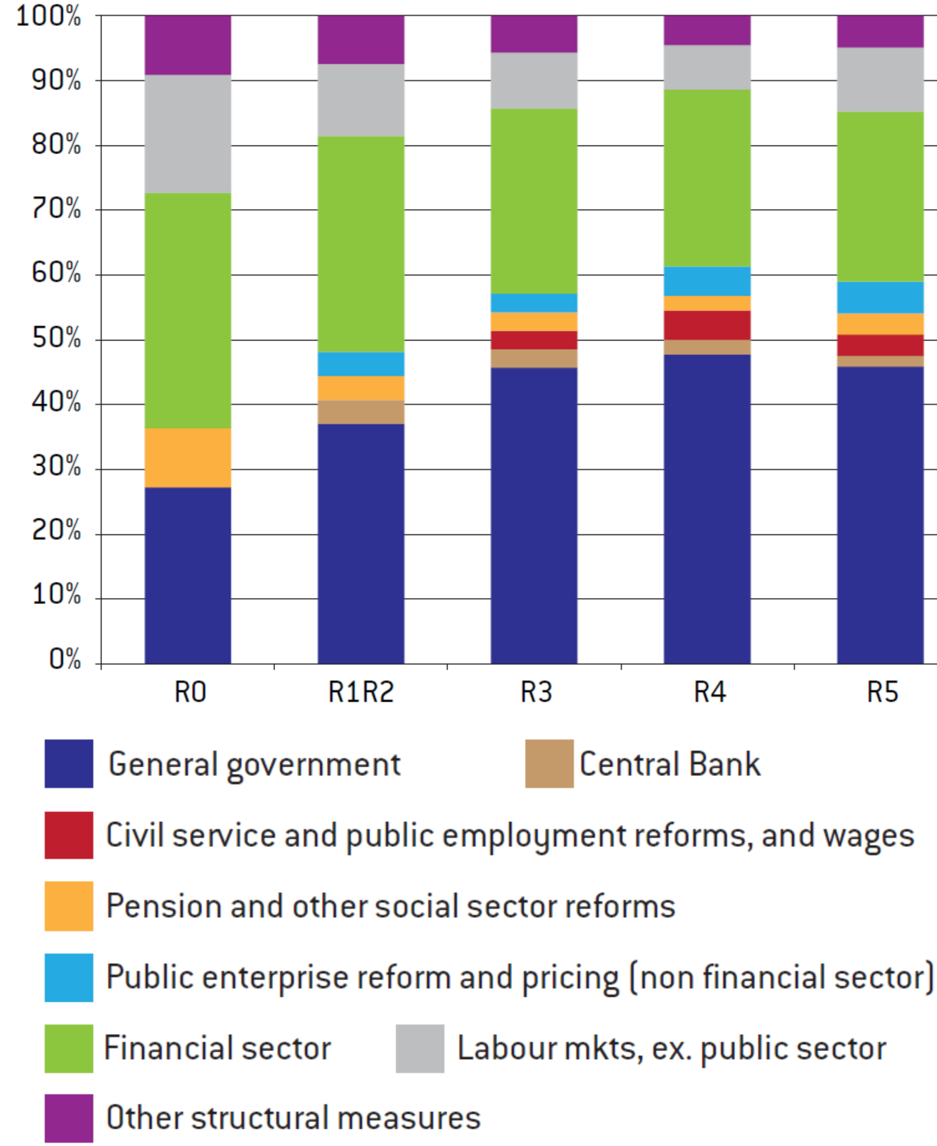
Source: Terzi (2015), IMF data base

II. First & Second Greek Programs

1st: May 2010



2nd: March 2012



2nd relative to 1st had important differences:

i. Less emphasis on CA & Fiscal adjustment as they were on track

ii. More emphasis on labor market, and subsequently on liberalizing product markets, opening professions, improving business environment

iii. More emphasis on privatizations

Source: Terzi (2015), IMF data base

II. Important Reforms

- The corrections of the twin imbalances are important reforms by themselves
- Large privatizations (ΟΛΠ-1, small PPC, Regional airports-1, Hellenicon, …)
- Restructuring of ministries, employee evaluation procedure, unified wage framework, wage grid
- Improved flexibility in labor markets (no carry-over of past privileges (μετενέργεια), part-time employment, consensus arbitration
- Improved sustainability of pension system (unification of funds, new IT systems, increase in pension age limit, abolishment of many premature pensions, abolishment of third party fees)
- Opening up of closed professions, energy auctions, separation of ADMIE, simplification of permits to do business
- Progress in land registry
- Organic Budget Law-I with registries, automatic expenditure cuts, … Parliament Budget Office, Fiscal Council, Tax policy unit
- Independence of Tax administration (ΓΓΔΕ)
- Observatory for monitoring local authorities and their expenses

II. The August 2015 3RD MoU with its 4 pillars

- **Implementation Period: 2015-2018,Conditionality will be updated on a quarterly basis**
- **About 220 actions, with 110 front-loaded until January 2016**

I. Restoring fiscal sustainability:

- More gradual fiscal path due to objective weakness: Primary surplus balance targets of -¼, 0.5, 1¾, and 3.5 % of GDP in 2015, 2016, 2017 and 2018 and beyond, respectively
- Tax policy reforms (Income tax revamp, eliminate exemptions, VAT, tax on farmers), minimize Arrears, central procurement, more savings from Pension expenses, reinstate reforms in Health Care, Roll-out GMI

II. Safeguarding financial stability:

- Recapitalization of banks before the end of 2015, tackle strategic defaulters, sell NPLs, new governance structure of HFSF & banks

III. Growth, competitiveness and investment:

- Reforms in labor markets & product markets (including energy) via business environment and competition policies
- Ambitious privatization programme

IV. A modern State and public administration

- Efficiency of judicial system, (Code of Civil Procedure, fight fraud & corruption)
- Institutional & operational independence of key institutions such as Revenue Administration & ELSTAT
- Pension reforms to remove exemptions, end early retirement
- Fiscally-neutral Wage Grid, Better recruitment process for Managers
- Rationalization of SOEs

Summary: Reforms still spell growth

- The Greek economy **stabilized in 2014**, with its major imbalances gone; Productivity-enhancing reforms were set at center stage, economic sentiment was running high, ECCL was agreed, the EU Commission was ready to close the 6th and last Review of the 2nd Program & the country was ready for a major take-off in 2015 with a re-entry by the State into the international borrowing markets in sight
- Yet, it took just 6 months of inaction, confusion about the European point of view, attempts to reverse reforms, and a lot of cheap domestic bravado talk to generate uncertainty, fear of future instability, massive deposit withdrawals, a jump in bank NPEs, capital controls, a complete destruction of bank capital, and a reversal of the previous growth momentum
- But bygones are bygones; Despite the foot-dragging of last year, the country still has a chance to stabilize and grow if reforms were to be explained to the population so that their <u>ownership prevails</u>
- Another major challenge is to reestablish credibility and attract FDI, which is desperately needed; Credibility is also necessary for the State to re-enter international markets in the future

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Thank you
for your attention!

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Appendix: Example of a supply side reform in 2012

LABOR MARKET REFORMS IN 2012

- **Adjustment / Reduction of wage floors:**
  - 22% reduction in the minimum wage
  - 32% reduction in the minimum wage for employees under the age of 25
  - Reduction of severance payments
  - Abolition of automatic (3-year) wage increases
  - Annulment of the marriage allowance
- **Structural measures to level the playing field in collective bargaining**
  - Shortening 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%.
  - Elimination of unilateral recourse to arbitration
- **Adjustment of non-wage labor costs:**
  - Close earmarked funds engaged in social expenditures (OEK, OEE)
  - Decrease by 1.1% in employer contributions to social security funds as of Nov 1, 2012
- **Alterations in other restrictions**
  - Reduction of minimum time between shifts / worker at 11h a day
  - Increase maximum workdays per week from 5 to 6 in retail establishments