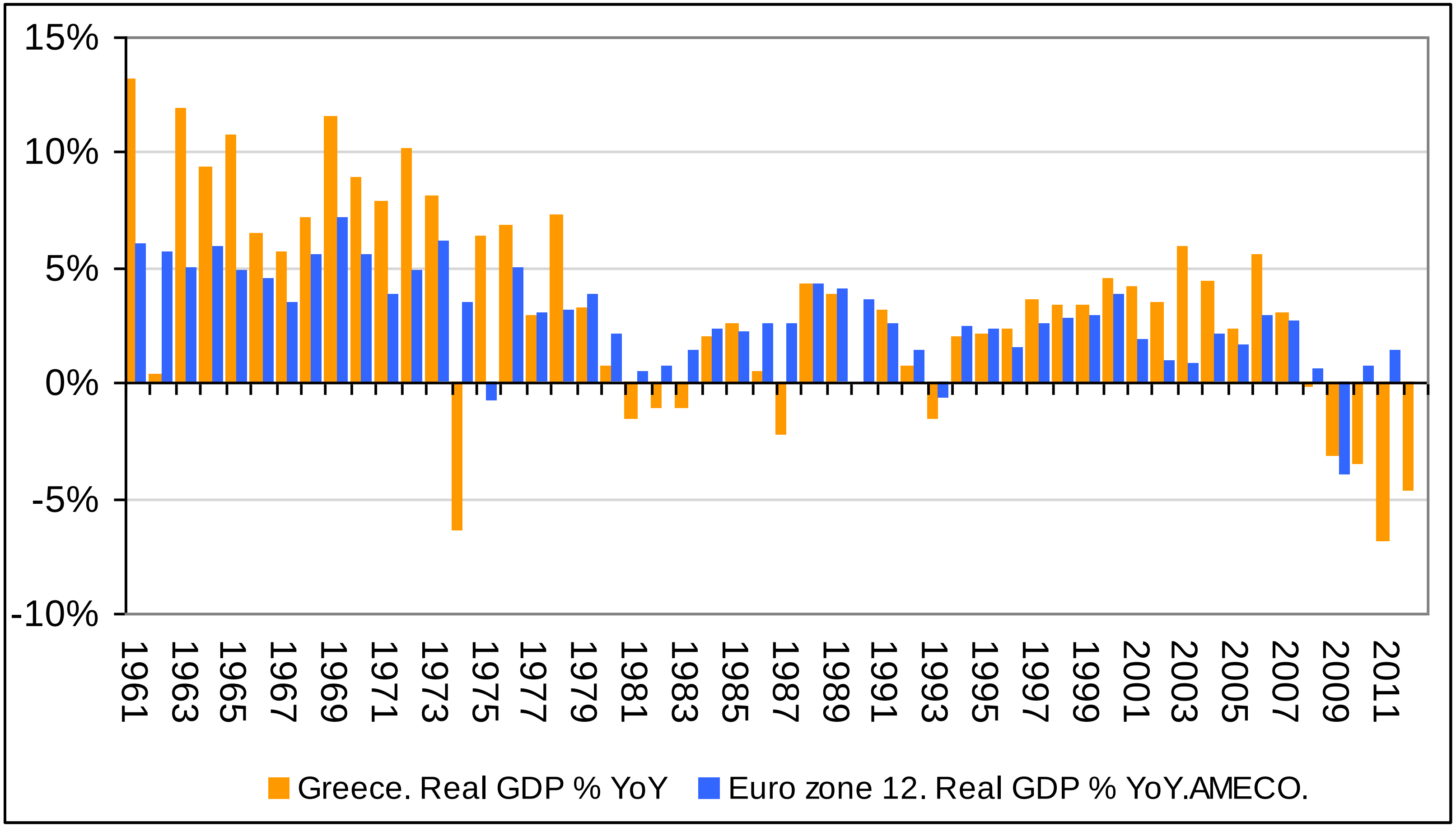
THE BROOKINGS INSTITUTION EUROPE GROWTH PROJECT

How we proceeded: Section I

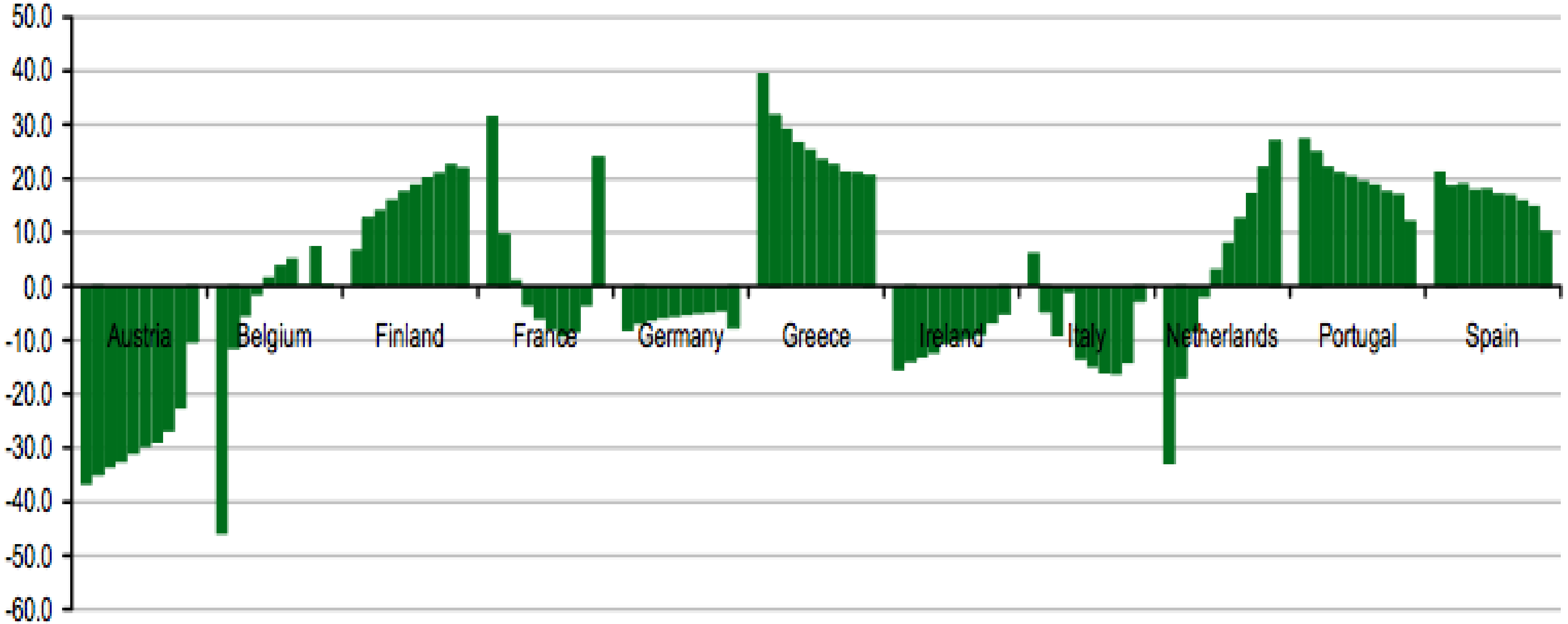
- **We analyzed the,** what we call**, *The 'Greek Paradox'*** of fast growth and low competitiveness during 1995-2008).
- **We investigated the role of domestic politics** during 1990-93 period.
- During the same period, **we looked at the IMF/EU reports to the Greek government**

Strong growth: Greece clearly outperformed since 1995-96 the benchmark eurozone economy, especially in 2000-2005.



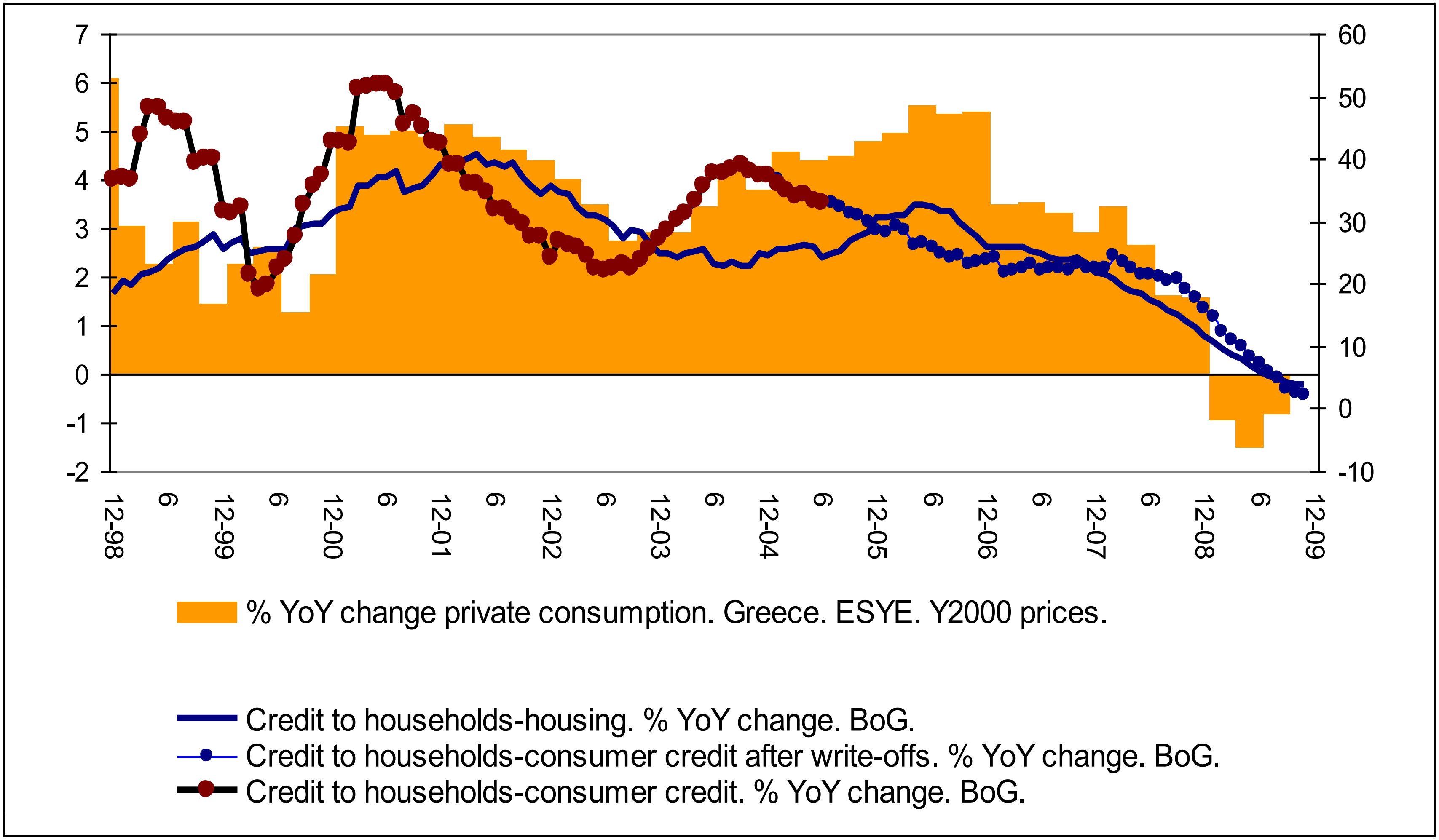
Real disposable income

Real disposable household income growth in Euro area economies, by income decile, 2000 to 2010, in cumulative % change



Source: UBS

The expansion of household credit (see lines) was a driver of private consumption (annual % increase, see bars - GDP component).



The other face of Janus: Low competitiveness 1995-2008

- Persisting inflation differential with the euro zone 1.5-2.0%)
- Persistent current account deficit (12-14% of GDP)
- High Budget deficits = -CA & inflation
- Red tape and growth stifling regulation keeping employment less than 50% of total population
- FDI = practically zero
- Public sector debt steadily excessive above 100%
- Consistently low competitiveness ranking, relatively to per capita GDP !

EVERY BUBBLE HAS ITS BURST!

We ended up with an Income – competitiveness disparity

just keep in mind:

•Not a perfect - & undecided-monetary union

•Euro is a hard currency for Greece

•Surplus countries deny to reflate in EZ

•Overreliance on foreign funding makes Greece extremely vulnerable to changes in lending conditions

Greek politics & IMF/EU on Greece's economy

(Greek) Politicians love bubbles 'til they burst (which they always do…).

- Our research has shown that politicians did know both the risks of Greece's accession to EZ and the structural reforms needed.
- On the other hand, IMF/EU kept stressing the problems in all this period but offered rather mild expressions and praise during 1995-2008

(**<u>Creditor's 1st - before crisis - failure…</u>**)

Section II
‘The Depression of the century’

The crisis period

2009: Papandreou junior wins elections with the …..

<u>“Greece has plenty of money to spend”!</u>

We enter the

THE TROIKA PERIOD: 2010 May stand-by agreement

IMF….EU… ECB…
Creditor's 2nd policy/political critical Failure:
Let the Greek government do "Business as usual"

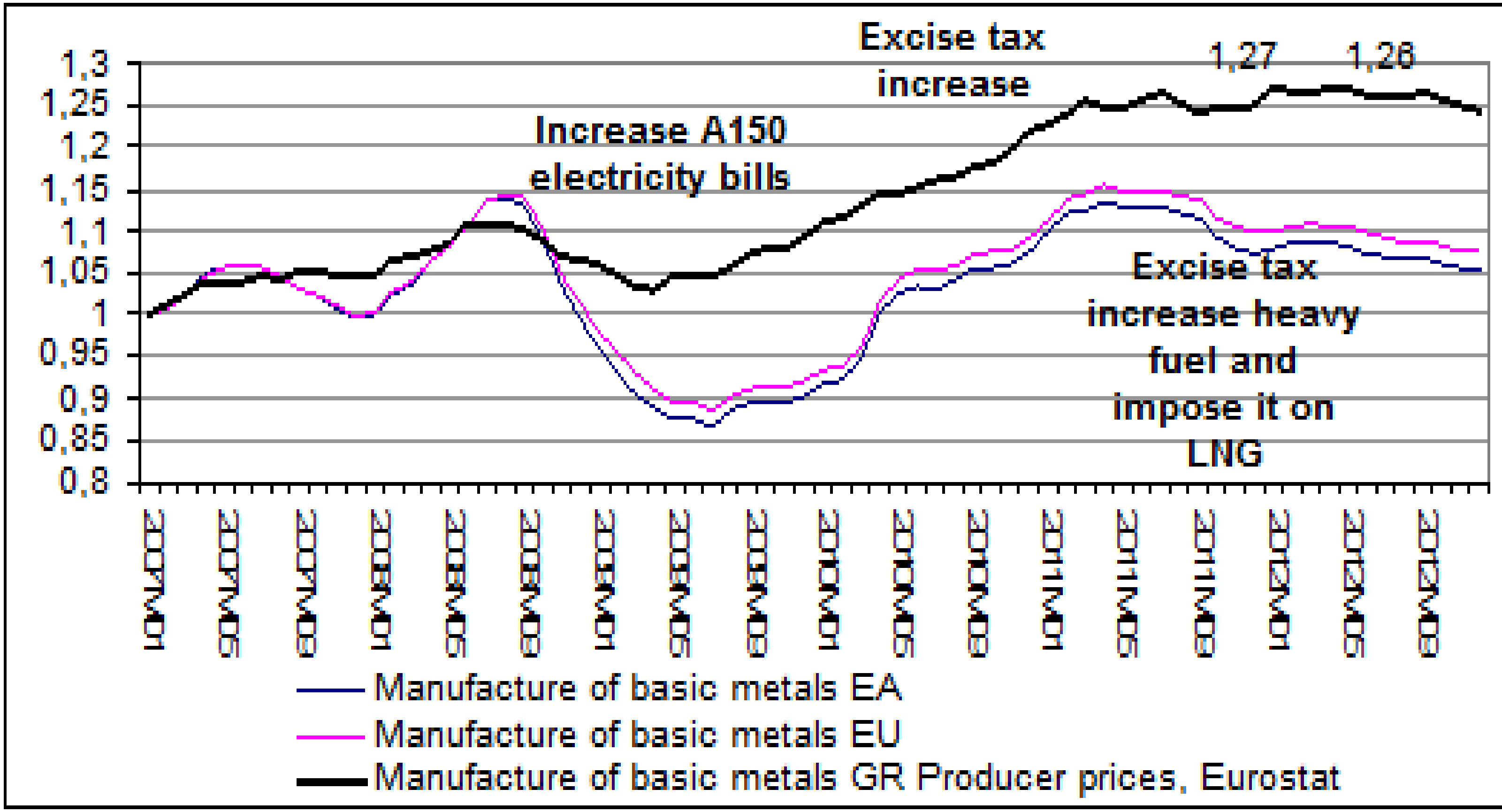
- The Troika did not pressed the government to materialize the details of the program!
- EU-IMF in fact learned from developments on the ground
- There were unfeasible requirements (i.e. 50 bil euros from privatizations 'till 2016).
- Lending policy (euribor + 400/300 points) at first place undermined sustainability
- **The productive** economy is almost expulsed from the euro zone and experiences a true collapse!
- **Taxes, taxes, taxes for fiscal adjustment!**

Need a proof?

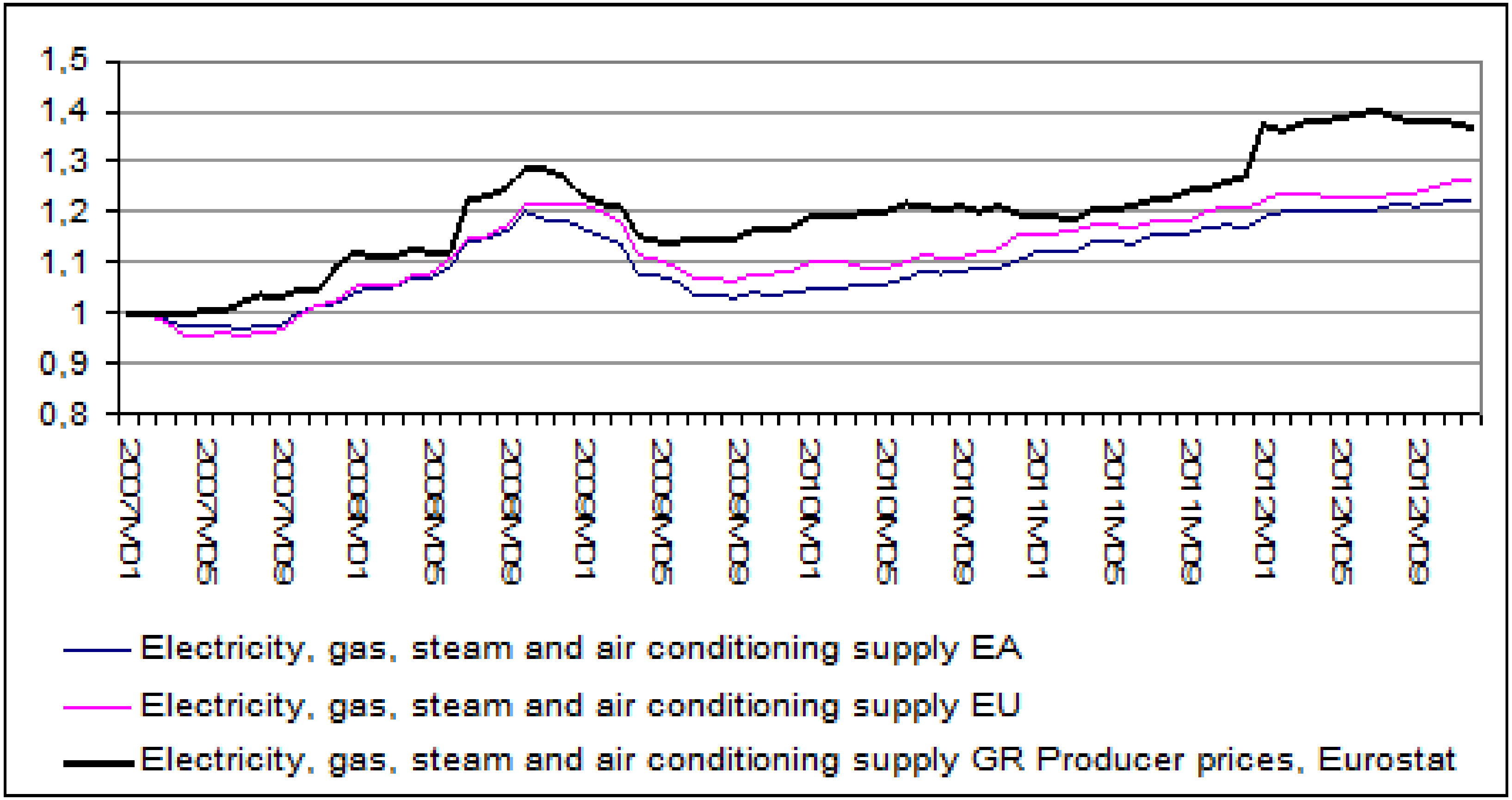
Indicative list of new taxes

- Multiple abolition of tax exemptions
- Increased of annual estate tax, up to 2% of administratively set value, and then additional estate tax through electricity bills
- Multiple VAT increases
- New personal income taxation law with higher rates, lower tax free income
- 3 tax increases on tobacco, alcoholic beverages and VAT increase on non-alcoholic beverages
- Further increase of tax on mobile communications – highest in EU
- 3 gas/petrol tax increases
- Multiple increases of taxes on electricity, especially for businesses – now probably highest energy prices in EU for industry!
- Introduction and increase of luxury tax
- Recurrent extraordinary tax on profitable companies and increased tax on dividends
- Introduction and increase of recurrent extraordinary tax on high personal incomes
- Tax on banks and increase of tax advancement
- Tax on tv advertisements
- Tax on violations of building permits
- Green tax
- Income tax on leased cars and private sector company cars (but not government official cars!!!)
- Introduction and then increase of tax on assumed income
- Increase in train, bus tickets
- Tax to avoid anti-smoking ban
- Fee to access hospitals
- Highest recurrent real estate taxes in the OECD, and probably the world!
- Taxes on yachts (now all foreigners took their yachts to Turkey and Montenegro!!!)

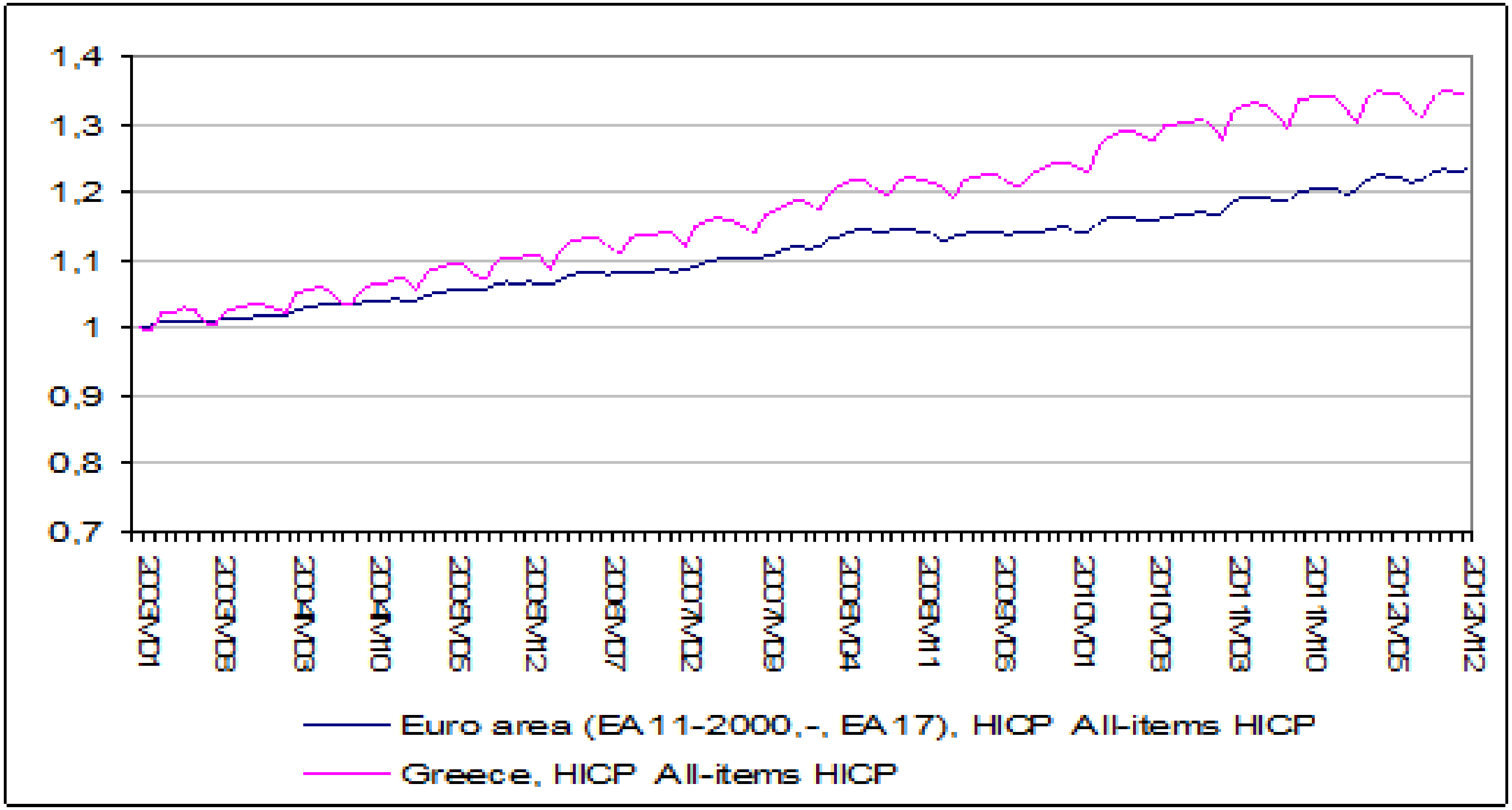
As a result, sectors that contribute significantly to exports (like metals) have been hit by large **<u>energy cost increases</u>** (gas, heavy fuel and electricity) which are entirely due to **excise tax increases + <u>government sponsored pricing strategies.</u>**



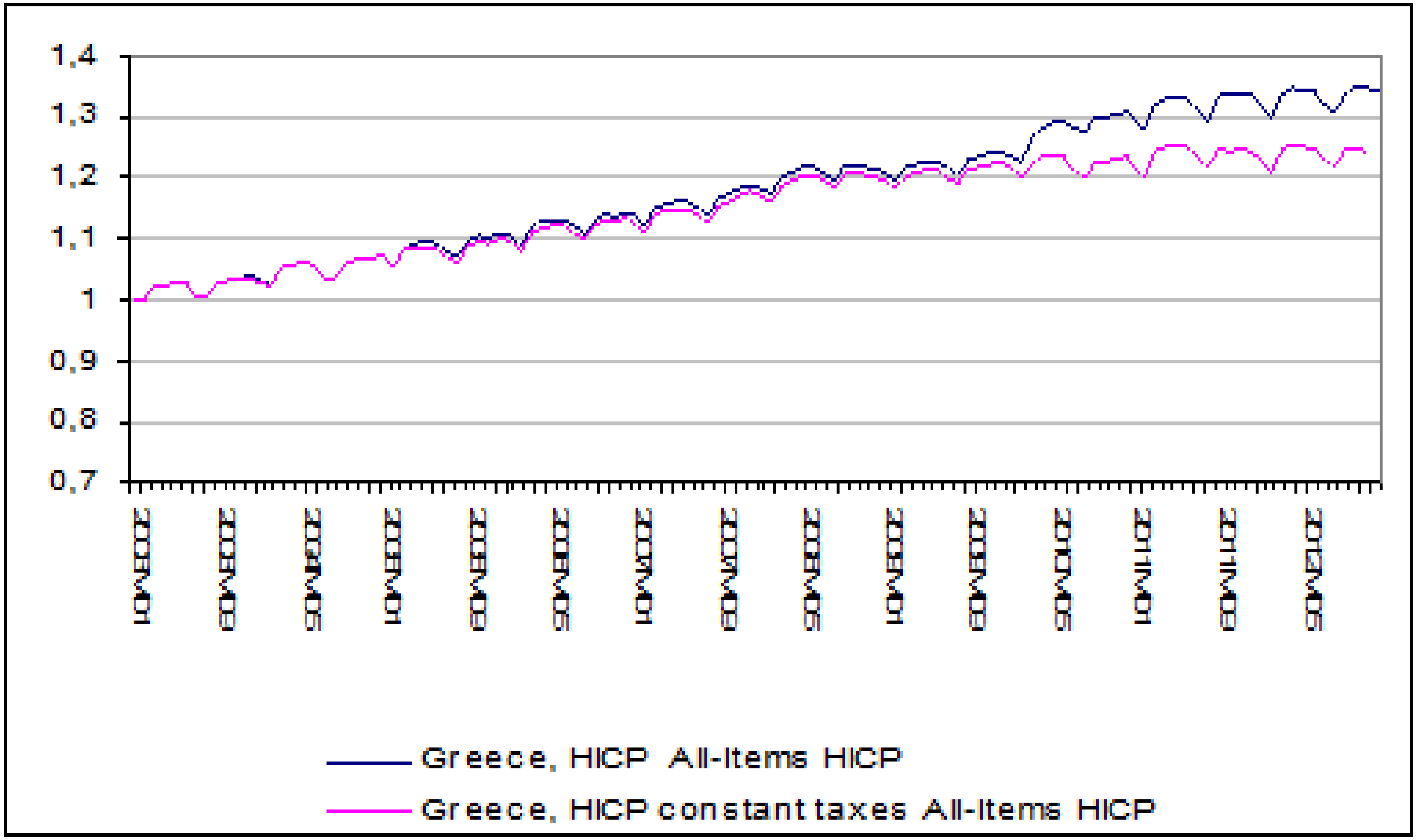
One can also see how the producer price of electricity and gas has risen compared to the rest of the EU.

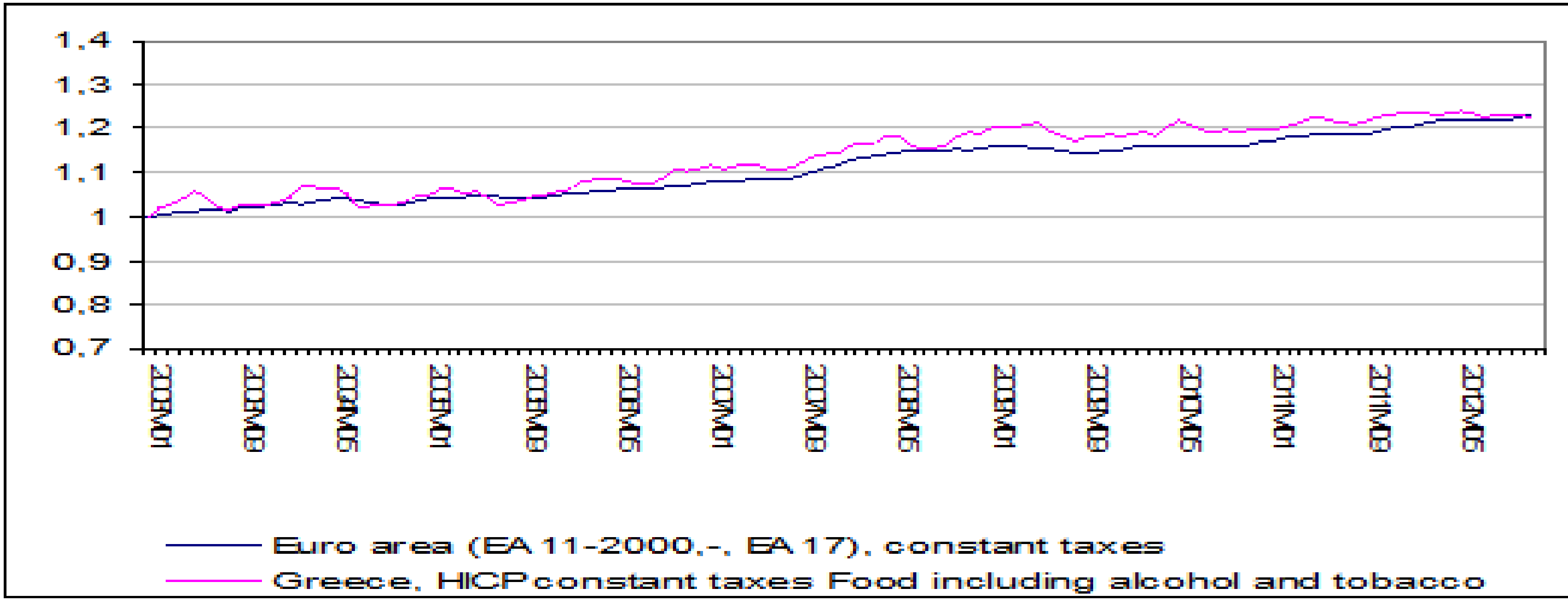


Greek consumer prices have also been directly and disproportionally affected by the increase in indirect taxes



The difference between HICP constant taxes & the 'tax storm', since 2010, Greece

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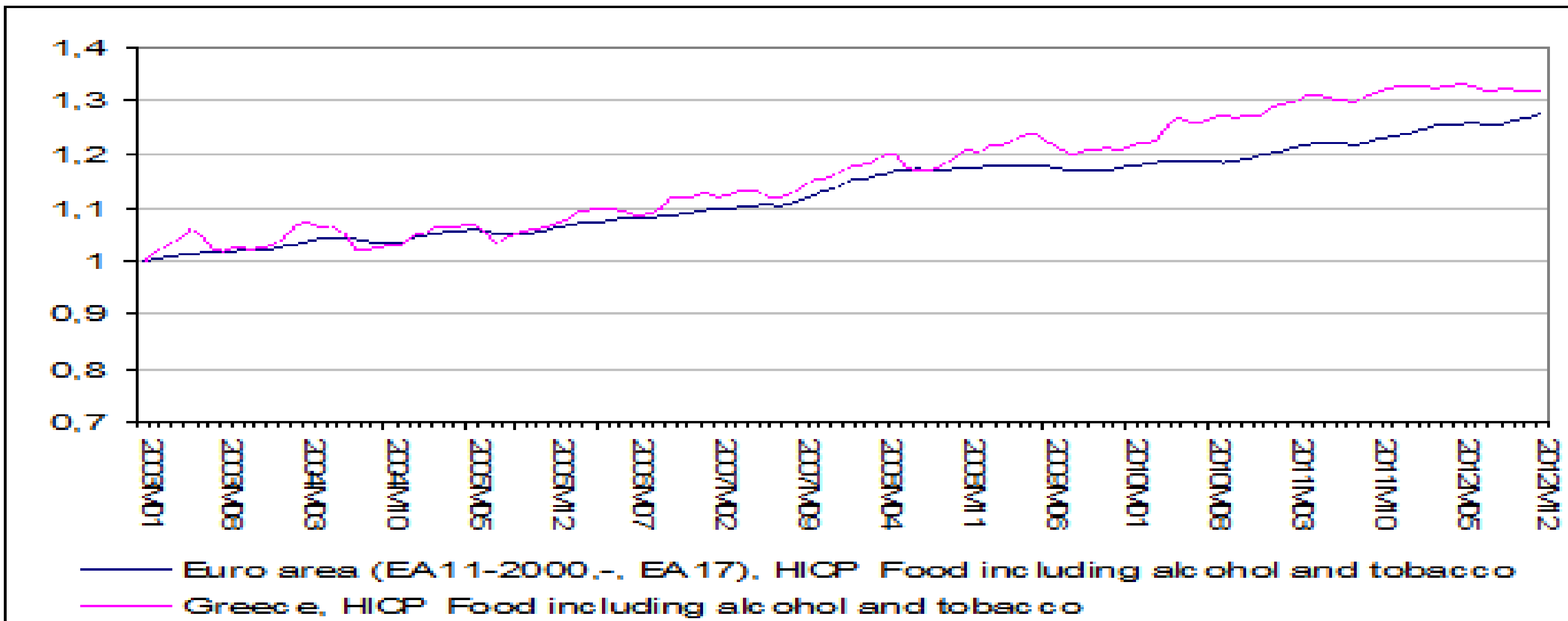
Euro area (EA 11-2000,-, EA 17), constant taxes
Greece, HICP constant taxes Food including alcohol and tobacco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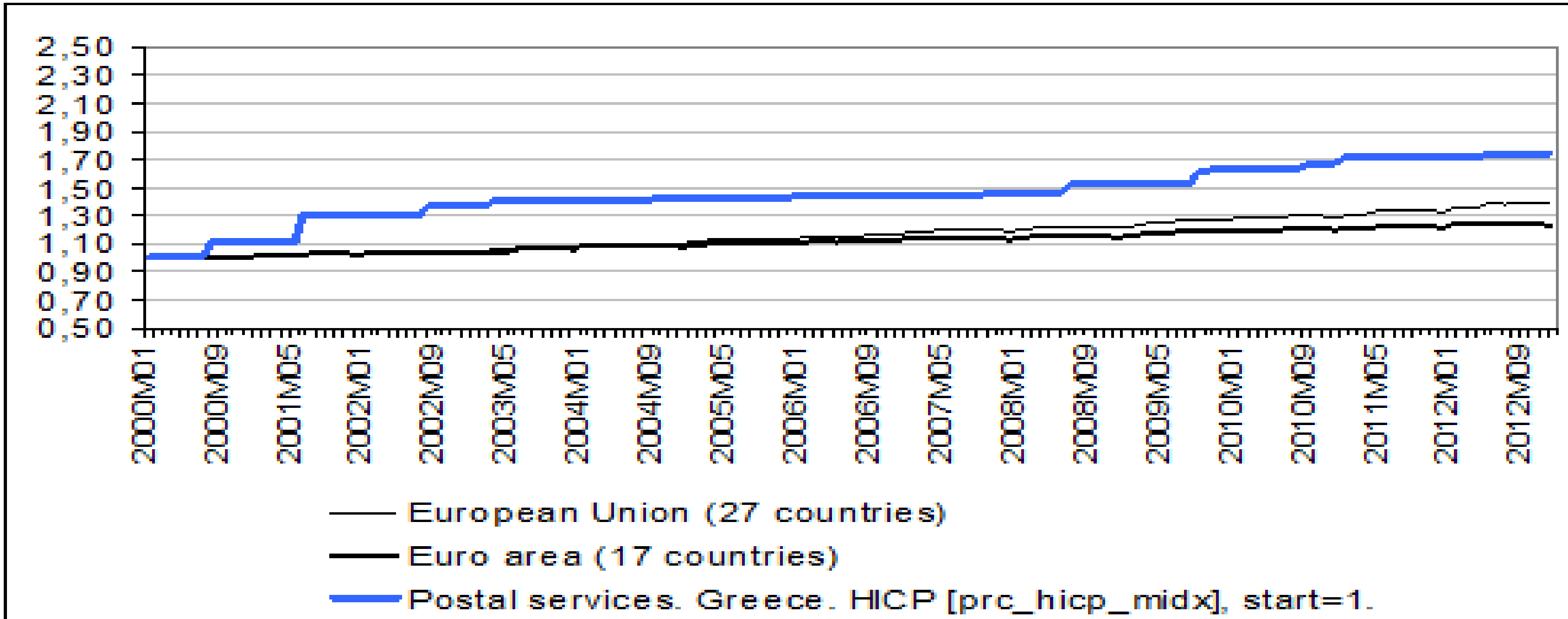
Euro area (EA11-2000,-, EA17), HICP Food including alcohol and tobacco
Greece, HICP Food including alcohol and tobacco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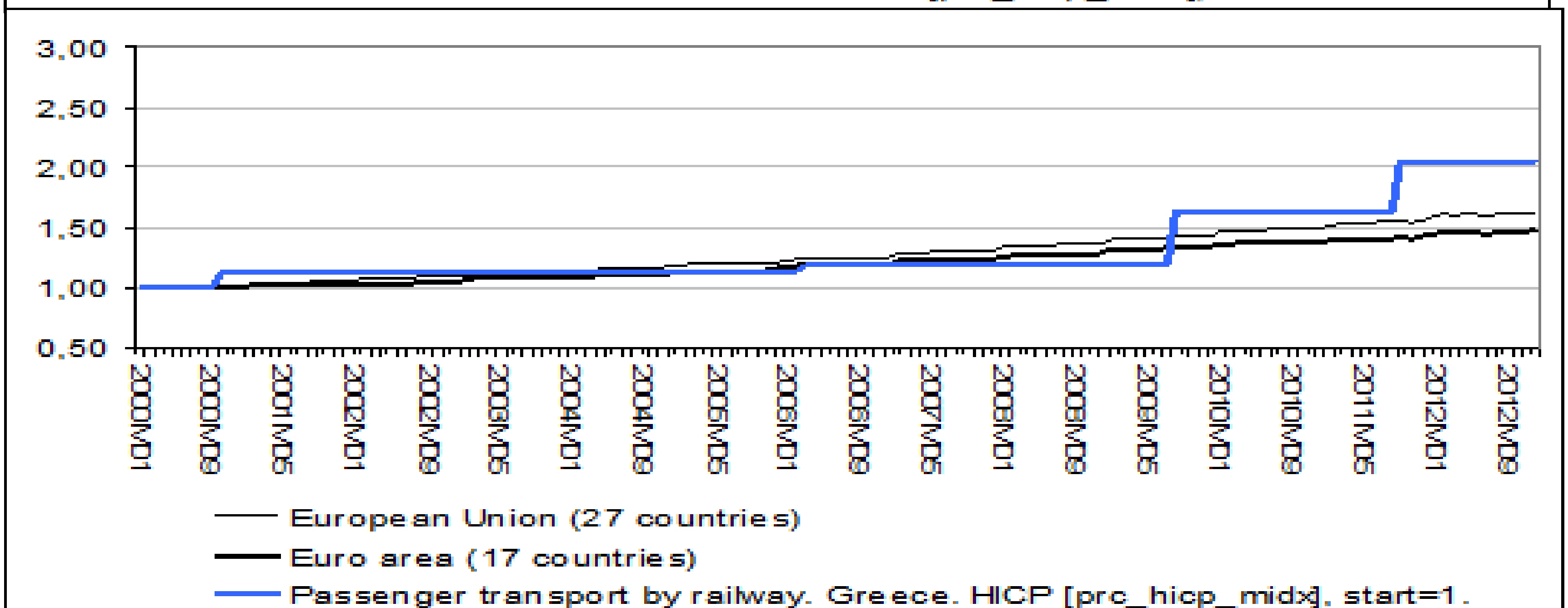
European Union (27 countries)
Euro area (17 countries)
Postal services. Greece. HICP [prc_hicp_midx], start=1.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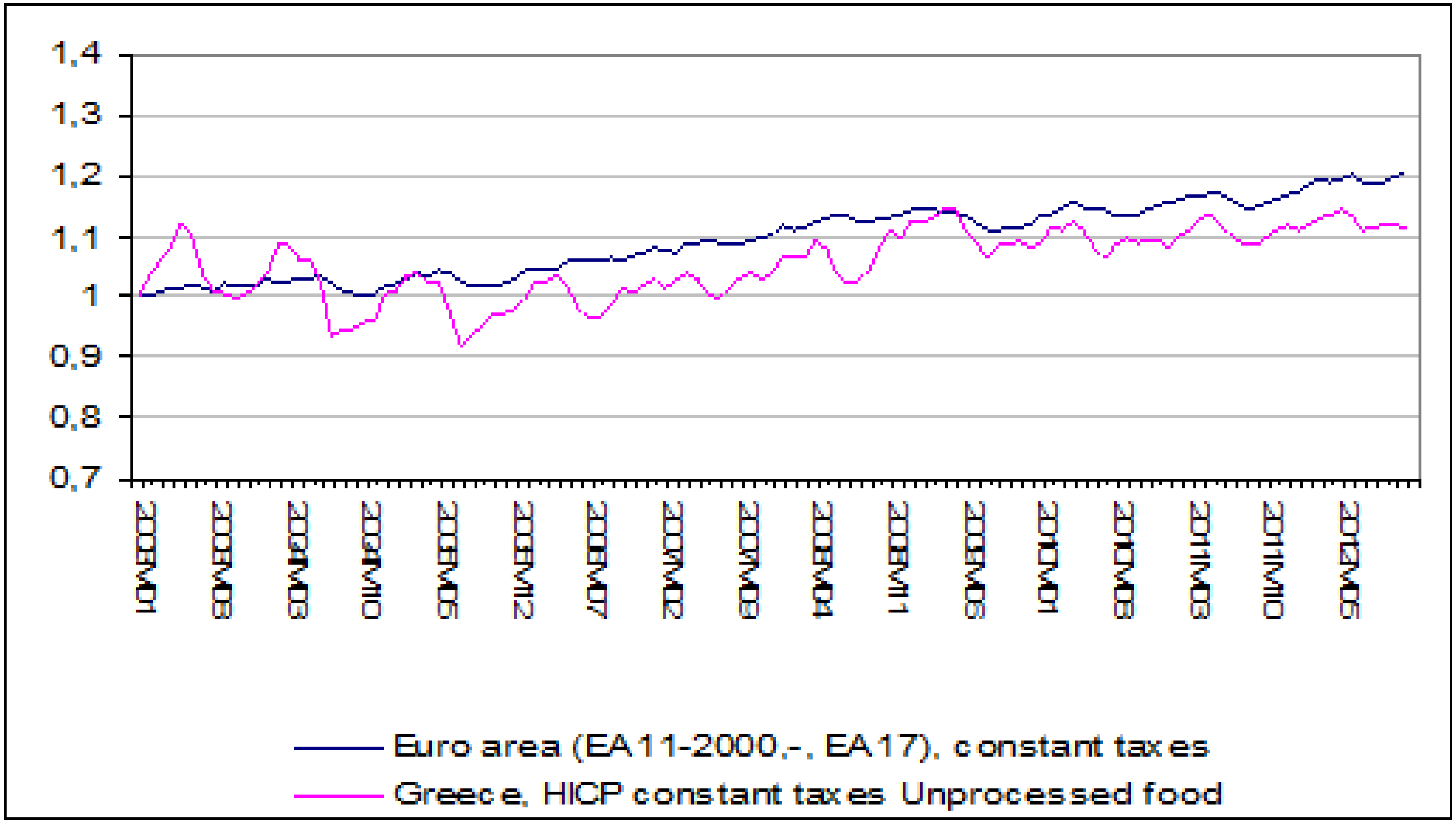
European Union (27 countries)
Euro area (17 countries)
Passenger transport by railway. Greece. HICP [prc_hicp_midx], start=1.

But with constant taxes…

internal devaluation might have been successful…



<u>So, the 3nd (lethal) failure …</u>

was to pursue Internal devaluation and at the same time tax heavily the productive sector of the economy.

<u>The $1mil. Question</u>:

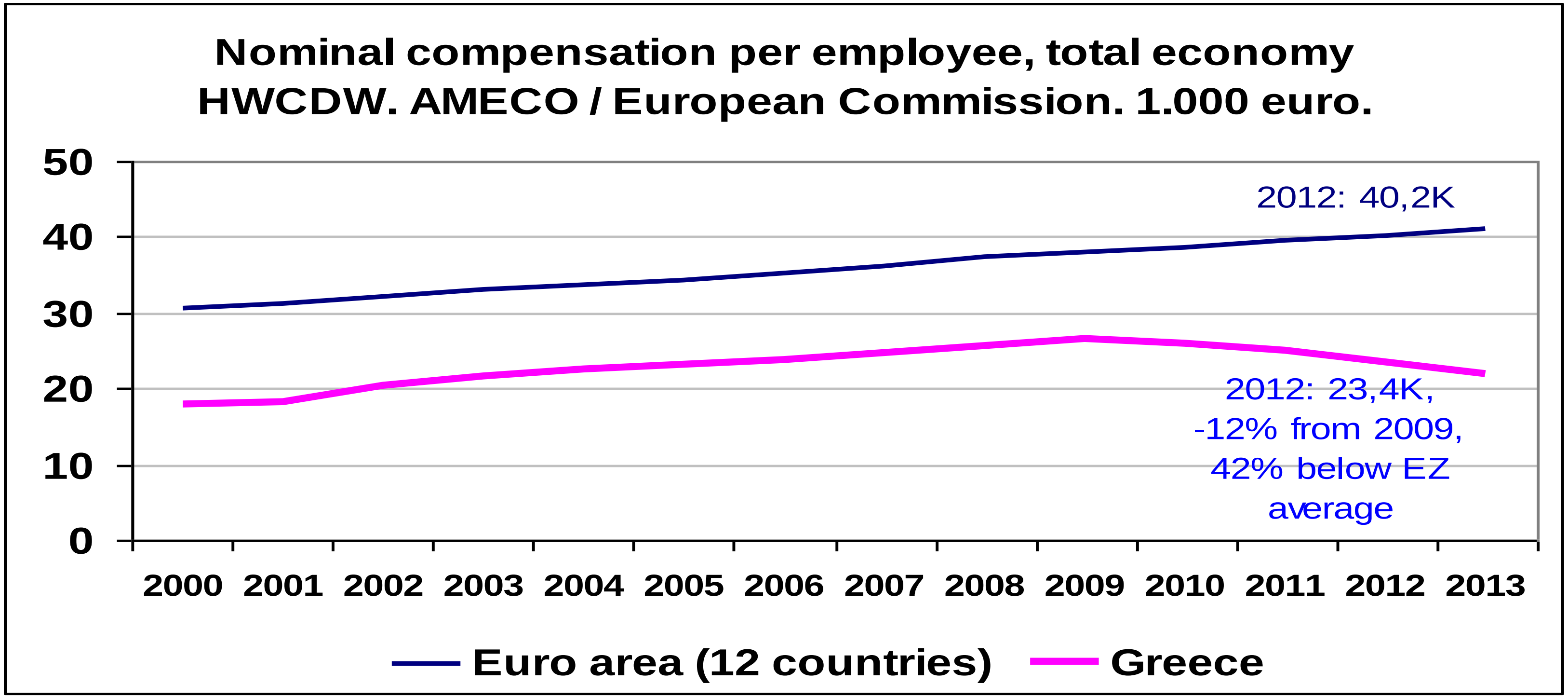
How a country with a ‘depression of the century’ can, at the same time- pay back a storm of maturing bonds?

It is not the ‘multiplier, stupid!

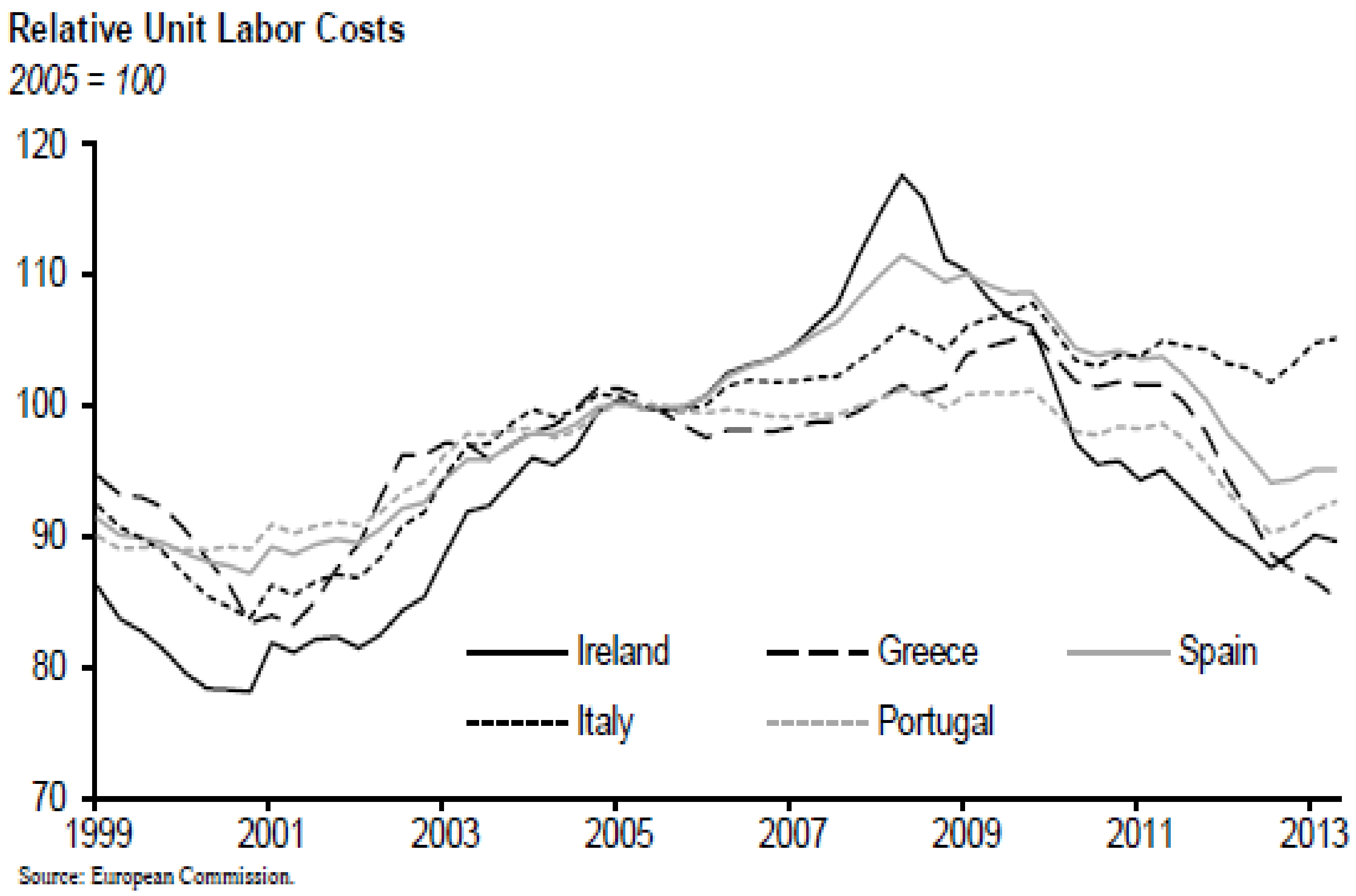
Let me conclude up to now:

- It is as simple as that: Prices have to go down for the internal devaluation recipe to work! But by taxing heavily the tax paying productive sector (instead of cutting the rent-seeking state) at the same time the recipe cannot work.
- Another adverse side-effect is the Debt/GDP goes sky high (good luck with your money, creditors) with Internal Devaluation of assets

The 4th Failure: Attacking first and foremost (private sector) wages (that is…attacking GDP).



Myth- busting. In LEVELS (not % change wrt 2000) private sector wages in Greece were LOW in 2009. Even more so if you took out state sponsored sectors (energy, utilities etc).

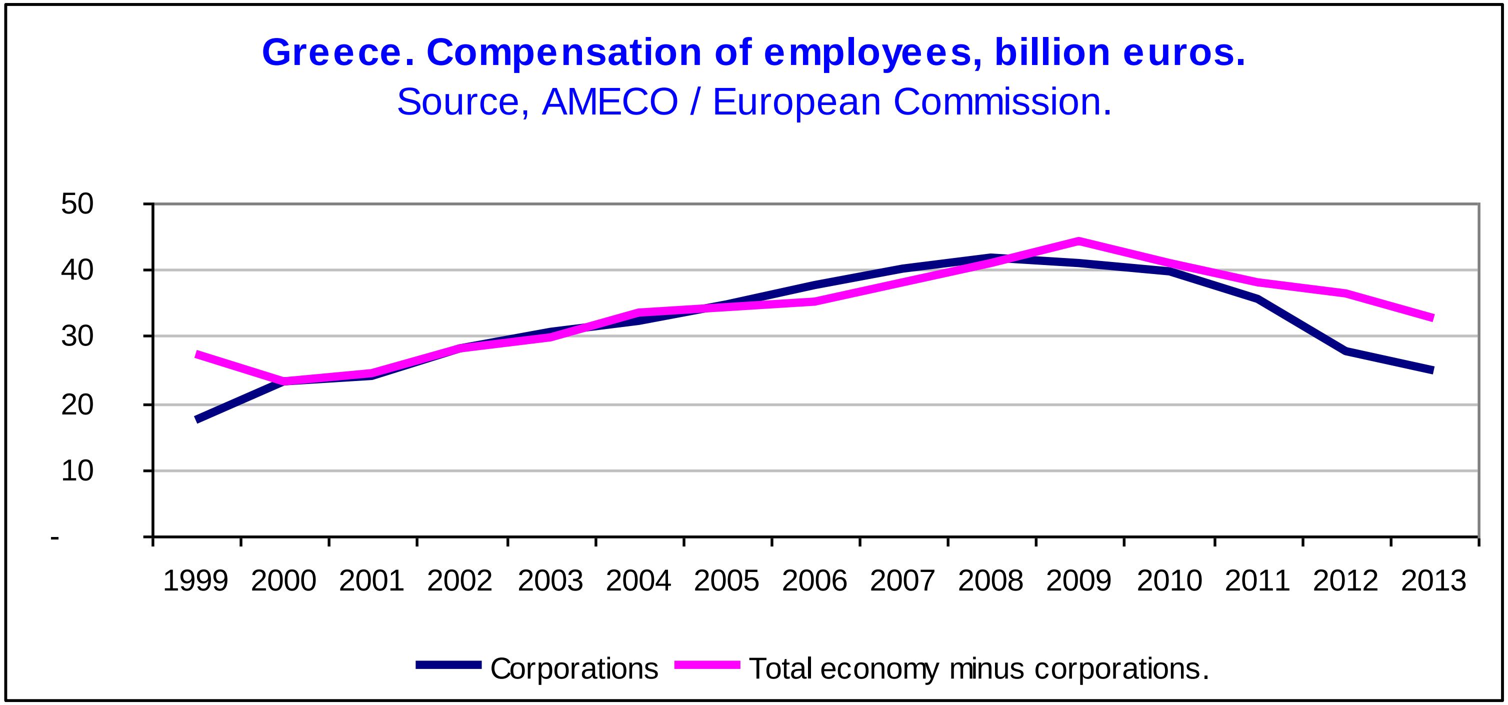


The grapes of wrath

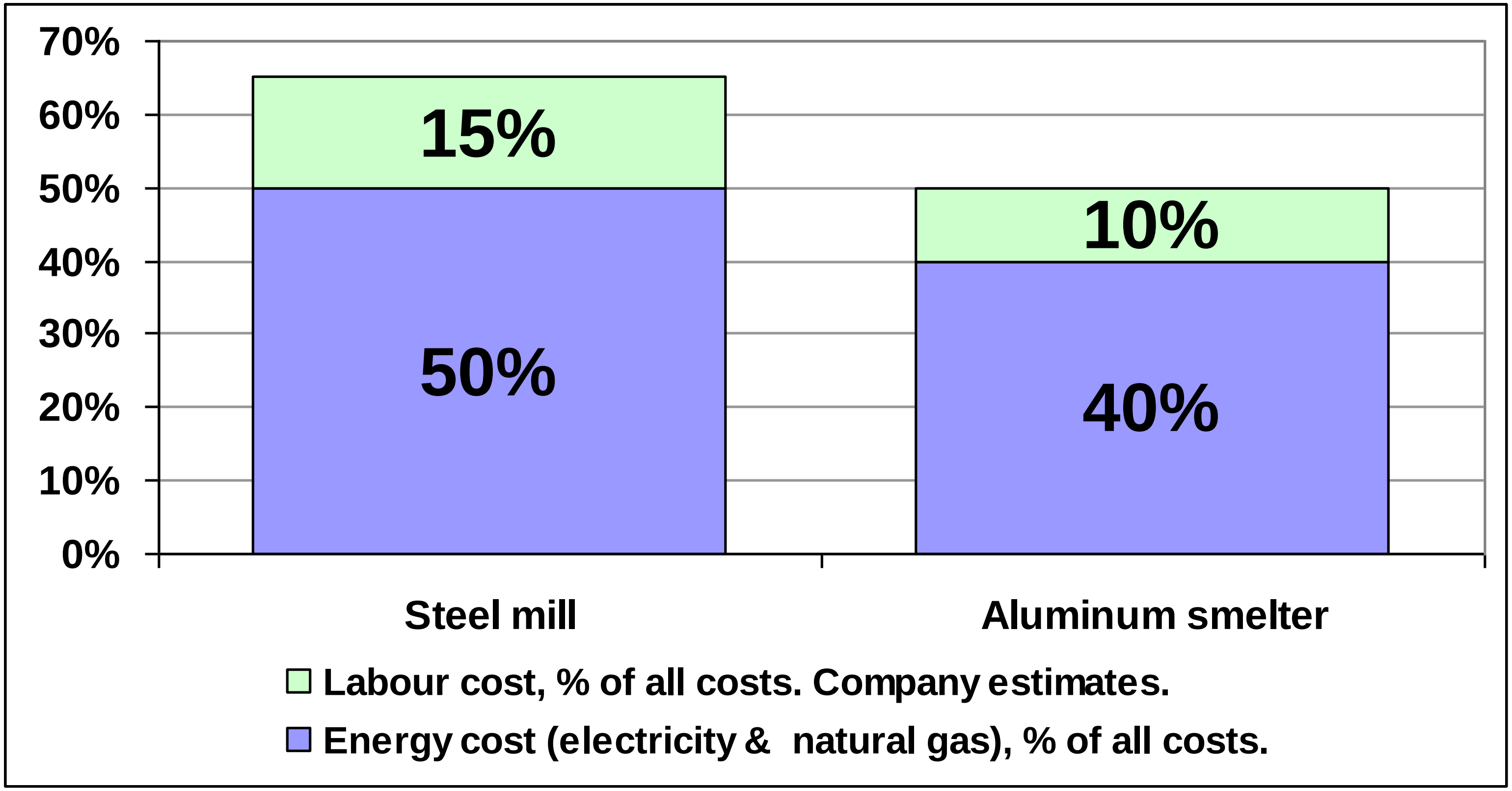
(selective private sector internal devaluation):

Private sector (tax paying) compensation fell more than in the public (tax receiving) sector. Now the balance worse than it was in 2009.

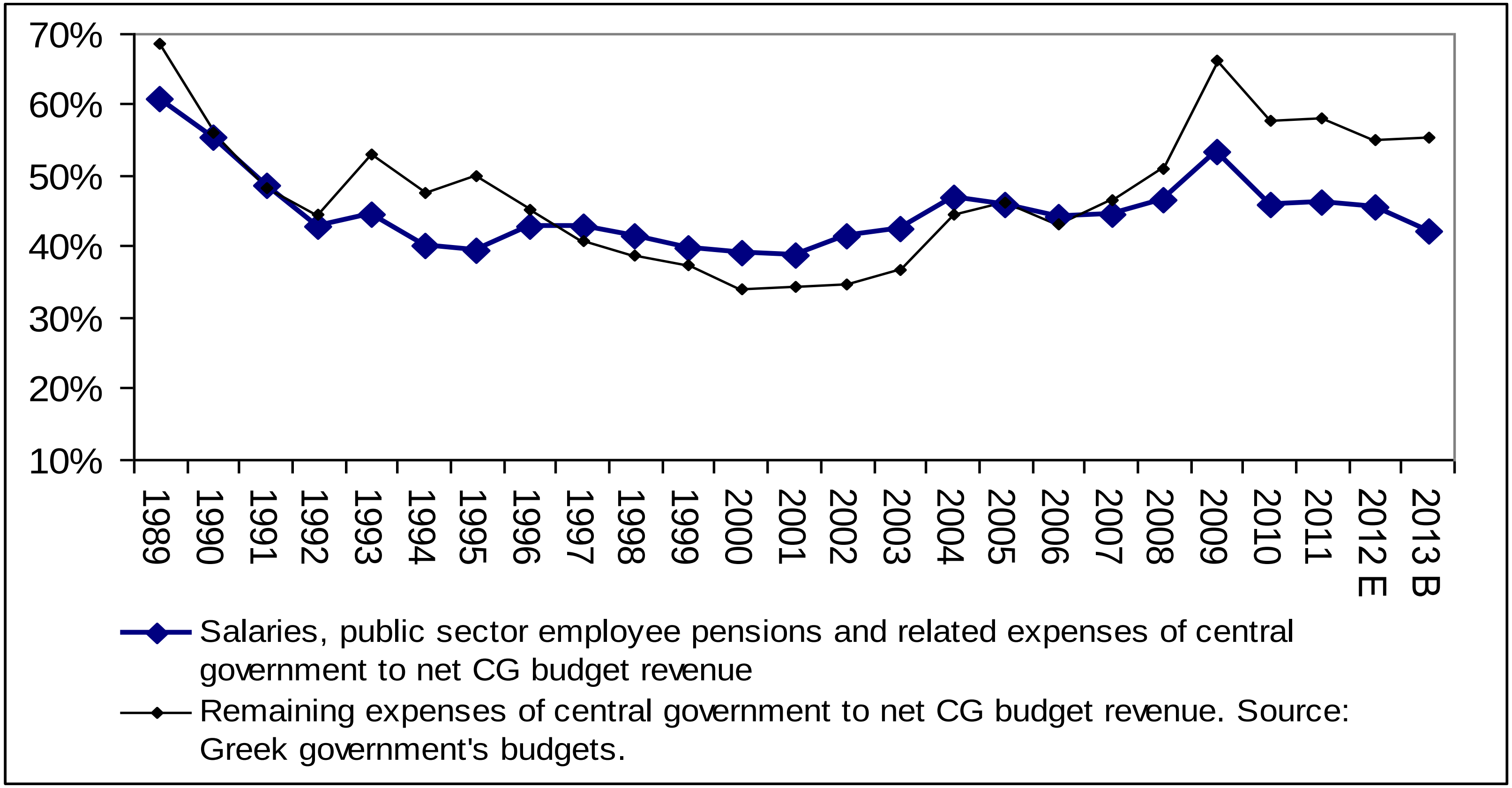
The true -4th- failure of the MOU!



But, was labor cost ever such a big issue…?
The unit labor cost is not the most important problem for many companies.



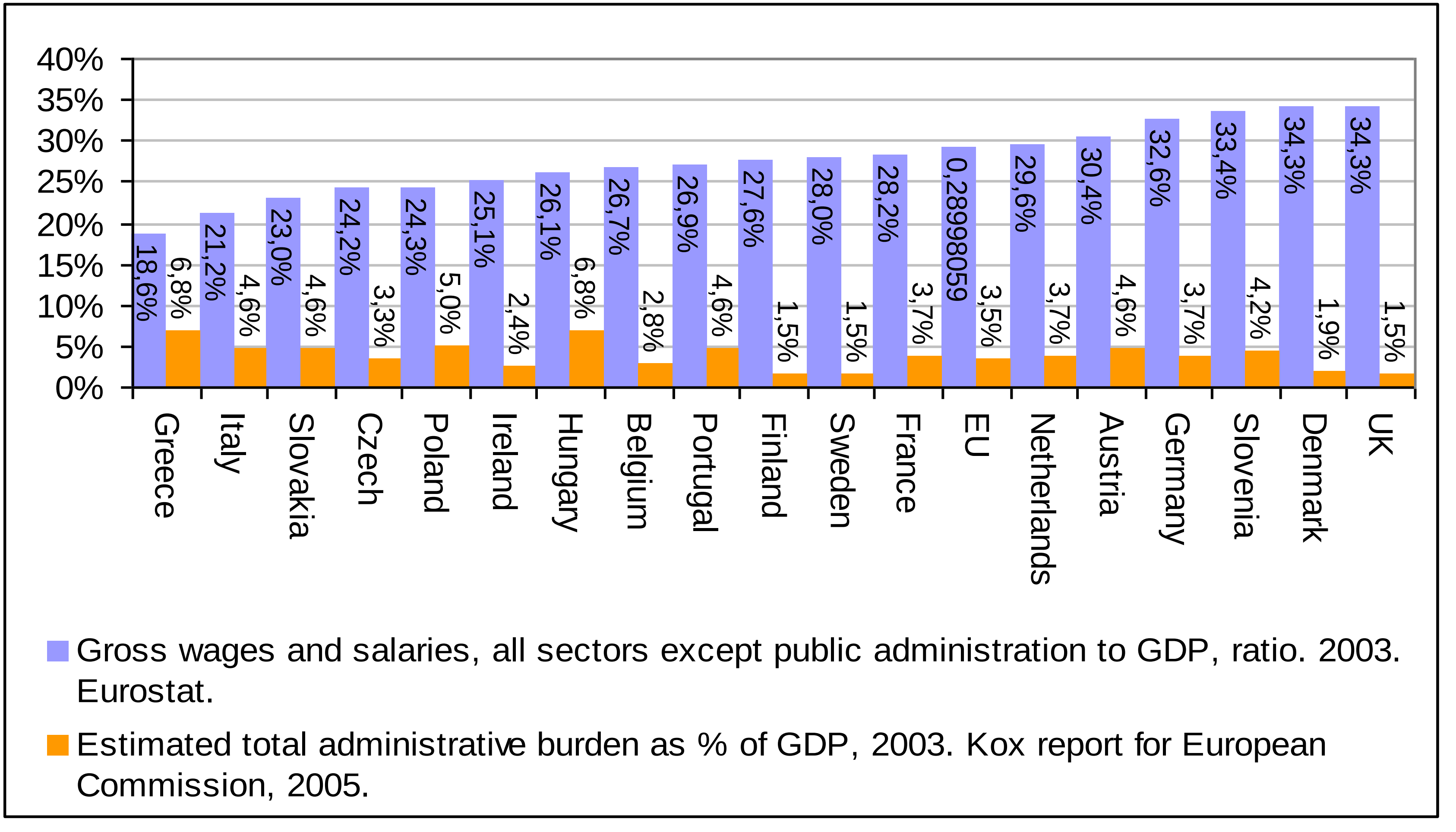
…instead of cutting remaining expenses and implement structural reforms within the State, we sharply (and horizontally) cut wages!



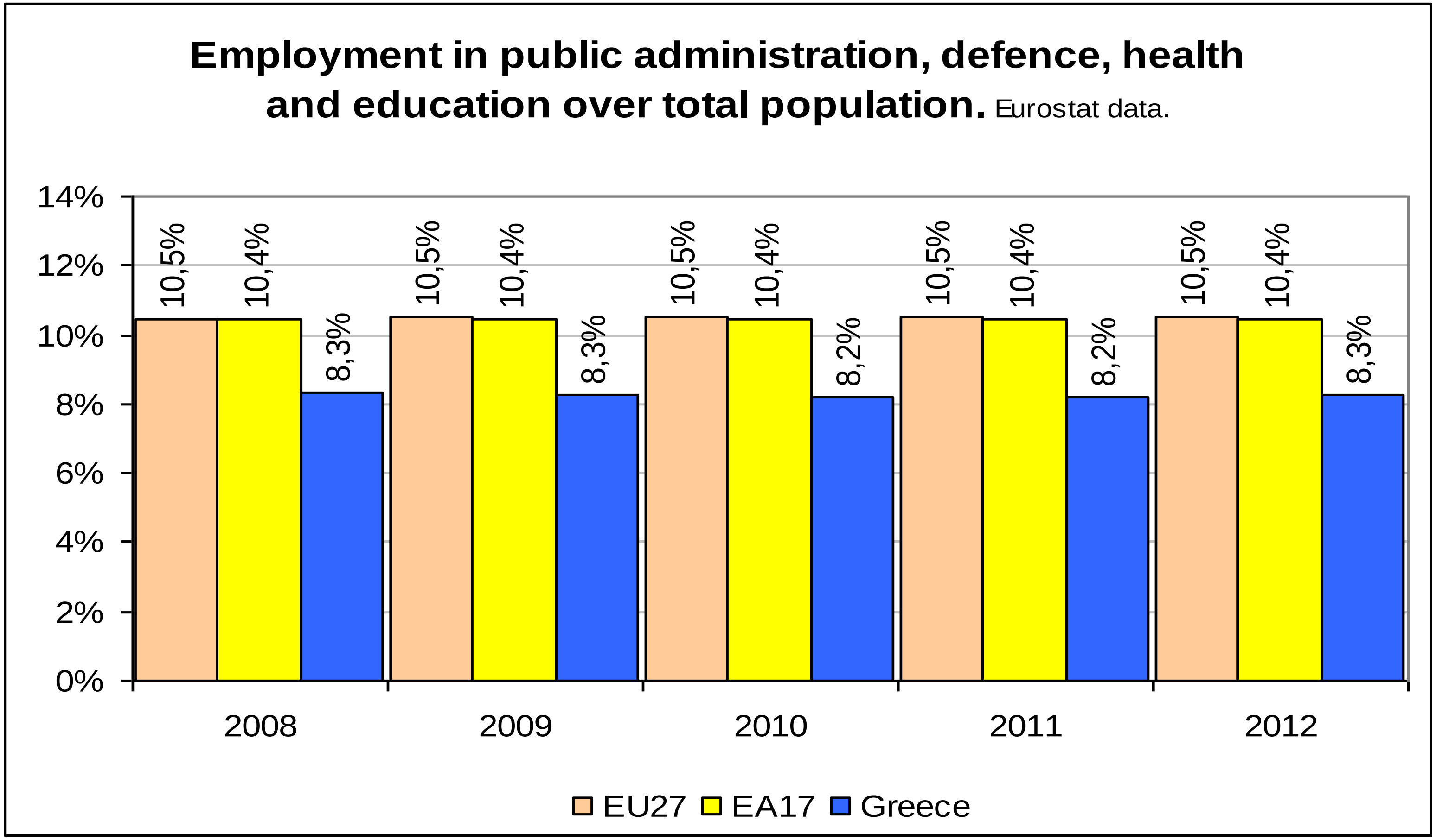
How did they miss this?:

labour cost = 18%/gdp. Administrative cost=6.8%

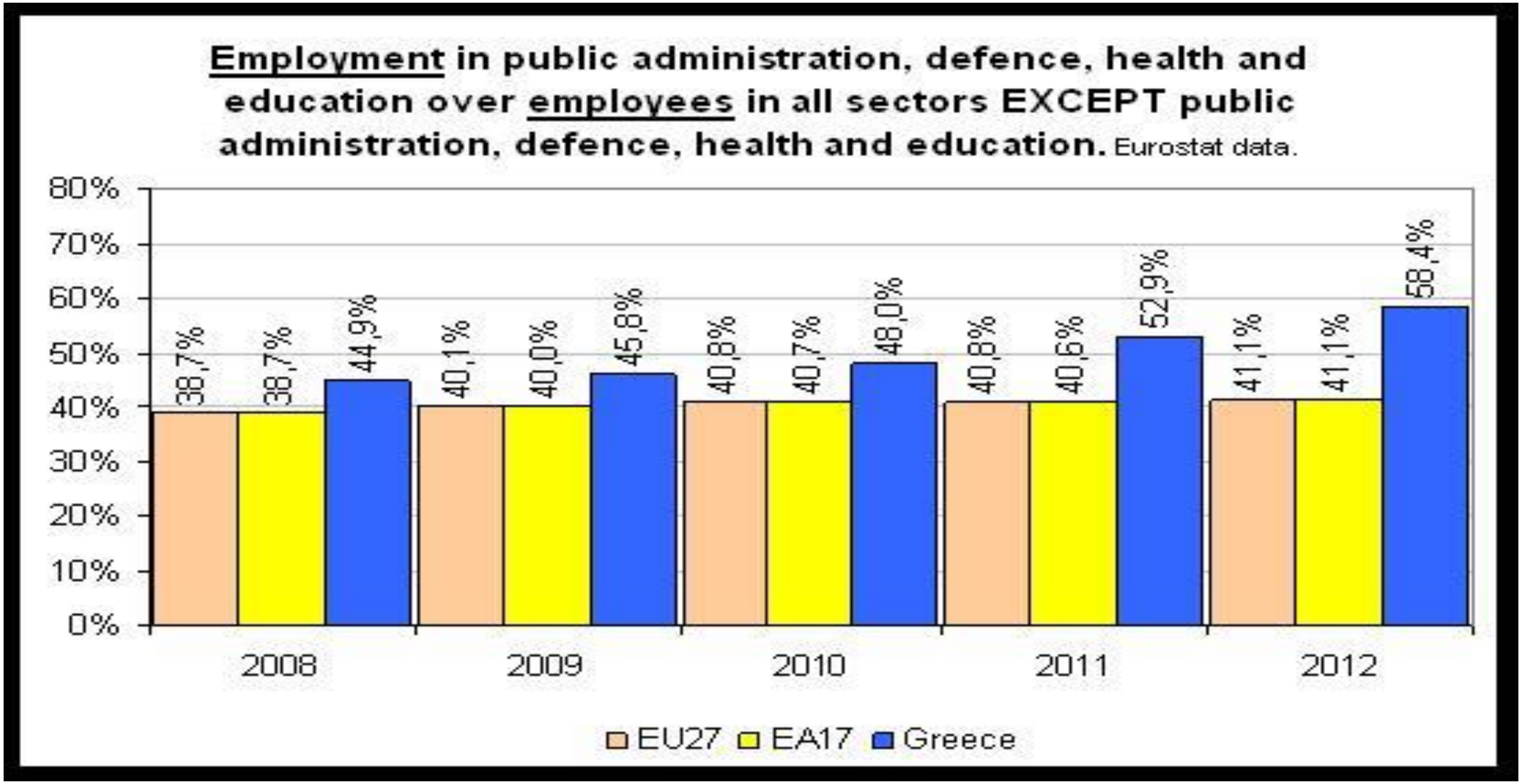
Greece had in 2009 the most to gain from structural reforms, and wages were smallest as % of GDP (ok, many self employed but…) among all EU countries!



Myth-busting the public sector was “large” when compared to private sector employment, not the population!



Again, public sector employment looks excessive when compared to the tax paying private sector employees! The key is to increase the latter!



The bonus strategic mistakes of the MOU

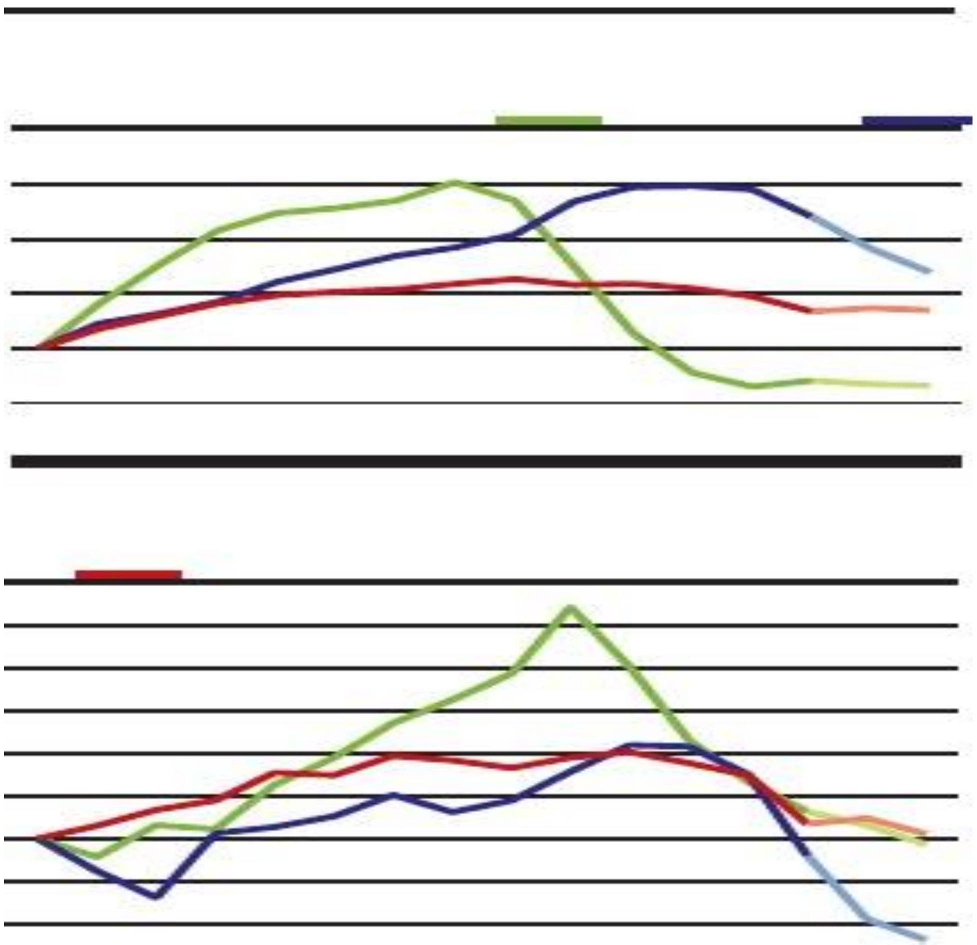
- “Obsession with internal devaluation of private sector wages, not with growth enhancing structural reforms”
- “Obsession with the “large” number of public sector employees, not the low number of private sector employees and neglect of qualitative, as opposed to quantitative, aspects of public administration.

The 5th Failure
Never put labour market deregulation ahead of product market liberalization

The troika did not understand the role and persistence of rents in protecting sectors (haven't read Pelagidis-Mitsopoulos' Vikings in Greece☺ !!!)

- Source: OECD for indisputable evidence…
- Need evidence? Producer prices moved much more sluggishly than costs. The result is a larger-than-planned reduction in real wages. See below

REER based on ULC (down panel) and GDP deflator performance, relative the rest of the EU15, 1999-2014. (blue Greece, green Ireland, red Portugal). Source Bruegel



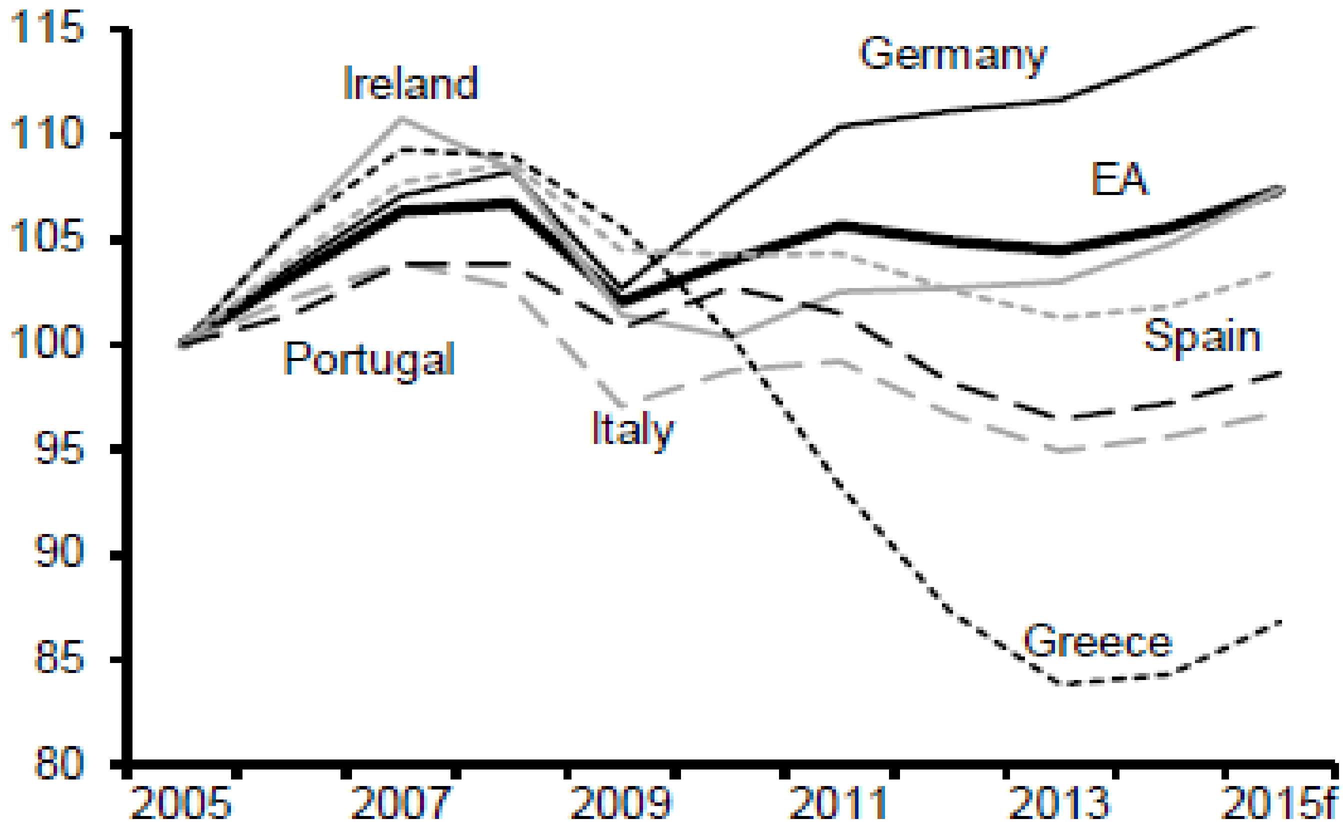
Not a happy end?

A “1929” for the productive sector

The <u>mother of failures</u>: Putting all the cost on the productive sector of the economy

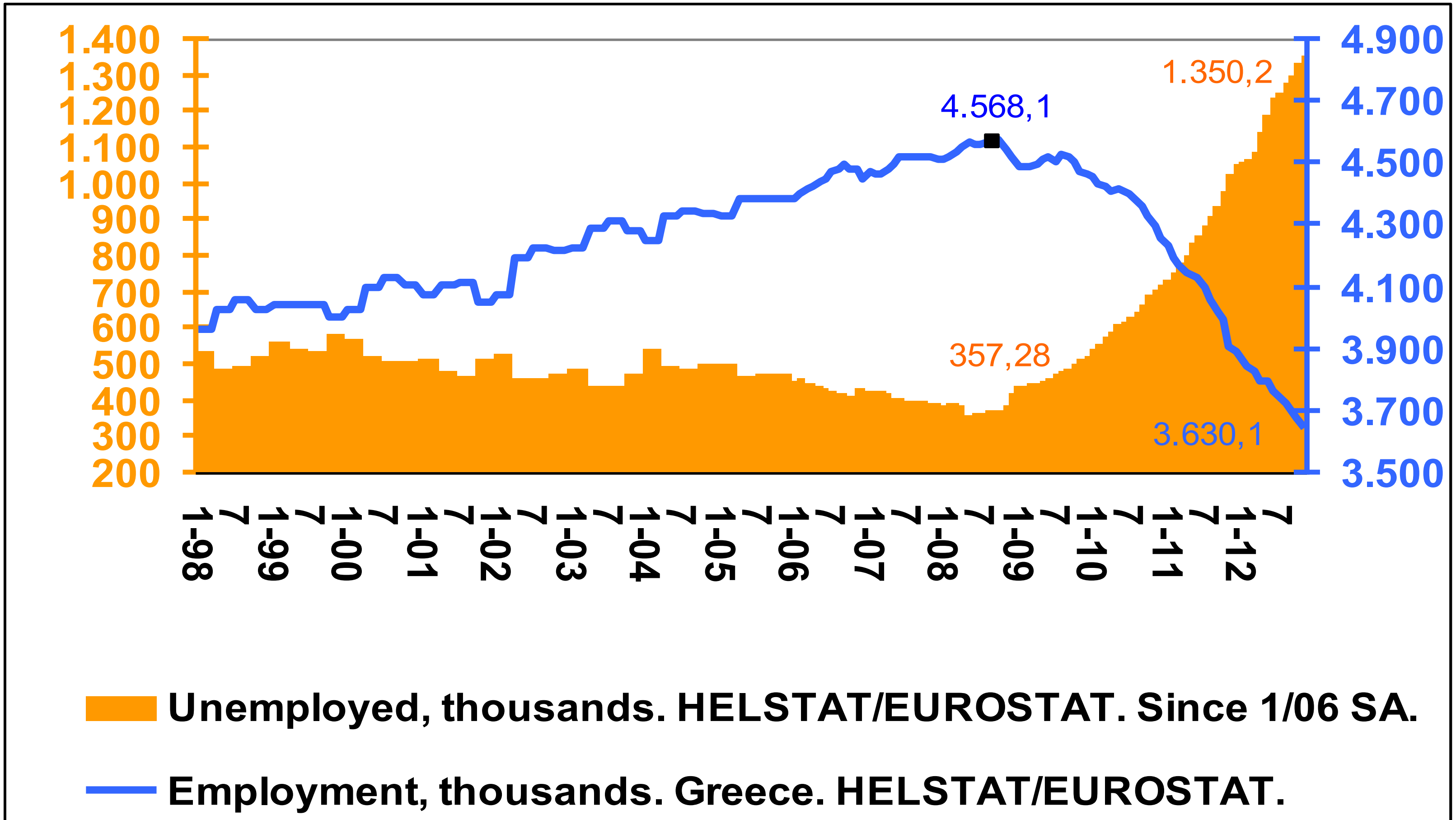
And the Oscar goes to…

Real GDP Levels
2005 = 100



Source: European Commission; f = forecast.

…and Over 1 mil. Jobs lost….almost 28% U is projected by the end of ’14. 61% Youth Un.



Conclusions:

<u>Combined failures</u>

a) Internal devaluation of productive sector, but not equally of public sector
b) tax heavily, but don't cut aggressively excess rent seeking expenditure
c) Deregulate labour markets in the middle of an emerging depression, even though they are not no1 problem because of self-employment, but don't reform aggressively at the same time (product markets in particular).
d) Scare away investors with Grexit talk and having bondholders <u>(that is mainly banks</u>) take the hit for the failure to promote growth enhancing reforms

a) But after 5 years of recession and so much collateral damage…

<u>**Austerity** doesn't seem to be a **growth model**…</u>

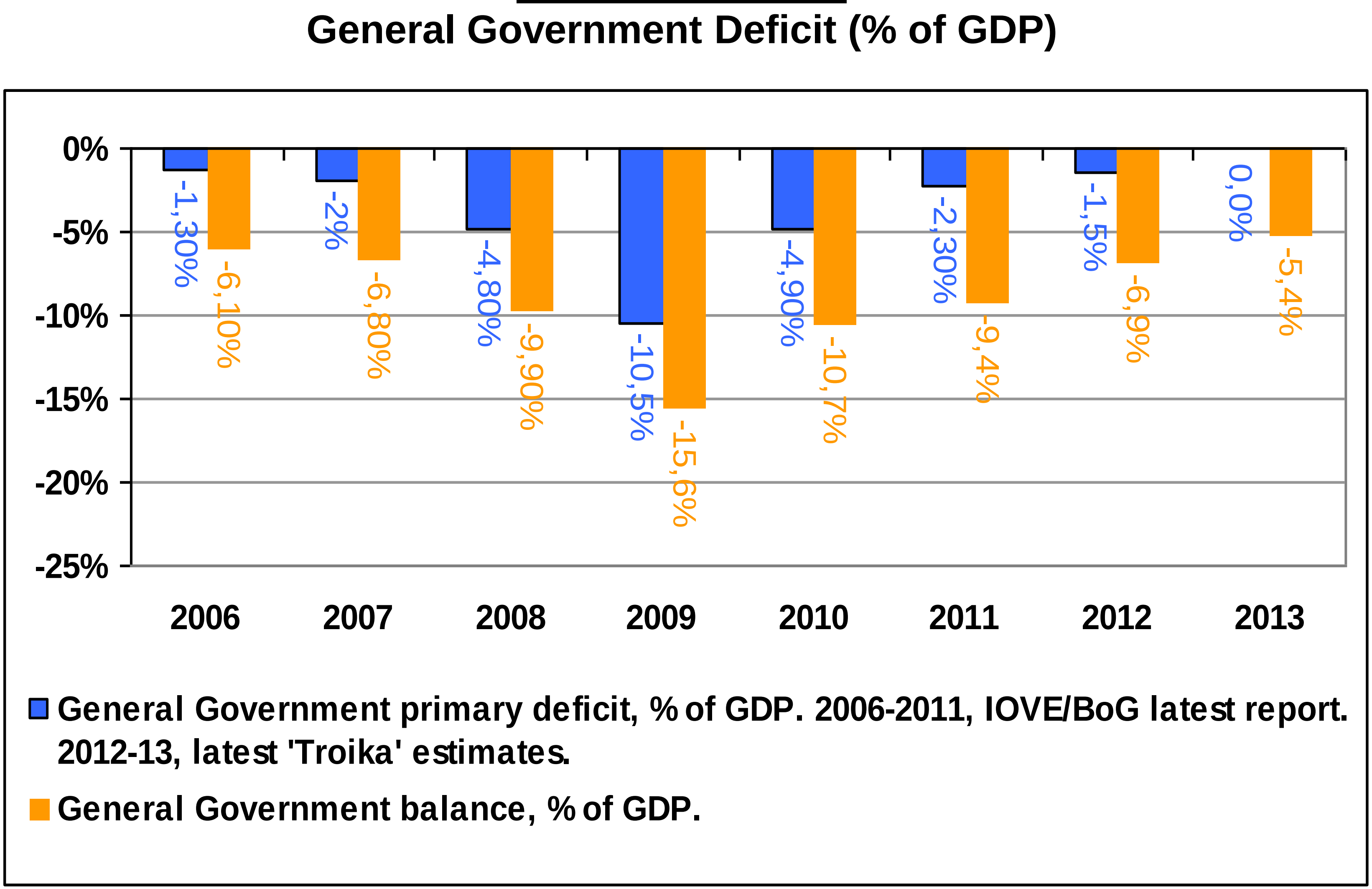
(at least so far…)

Is this the end?

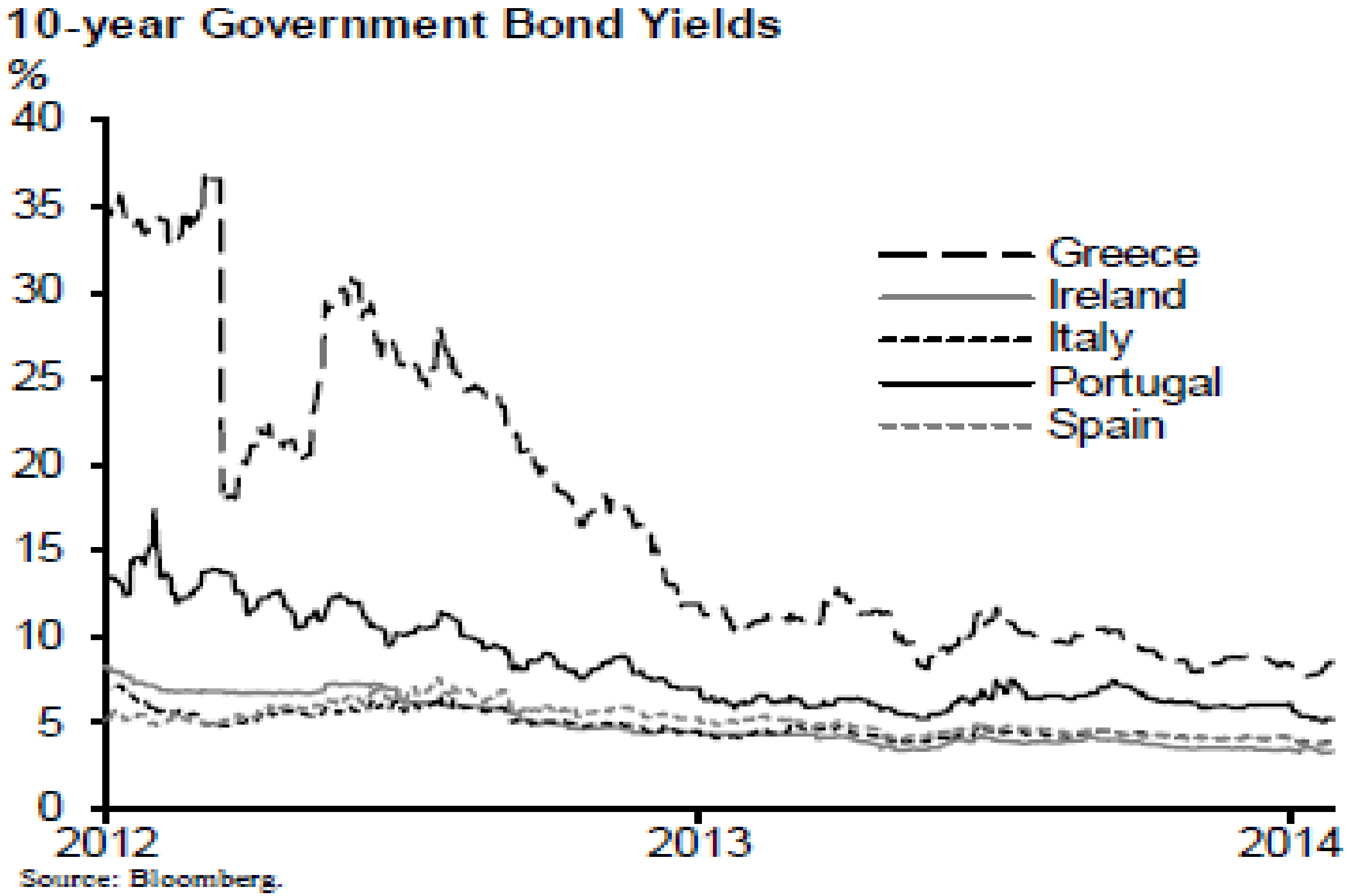
Greece of 2013/14: no more a scapegoat?

WE FEEL THE OFFICE SCAPEGOAT IS A KEY COMPONENT OF TEAM-BUILDING. AND YOU'RE A GREAT FIT FOR THE JOB.

Are there any (bounded) good news? A Grekovery is coming? Or a jobless “secular stagnation”?



10-year Gov. Bond yields are down



“Fiscal structural” reforms ALREADY implemented.

- Wide ranging social security reform.
- Large cuts in public sector salaries & salaries of public utility companies 2012-2013.
- Healthcare reform (on-line prescriptions, pricing of medicine, etc).
- Reforms in budgeting and fiscal reporting.
- Very large, across the board, tax increases (but with a significant inflationary impact!).
- Accelerating drive against tax evasion.

A. Implemented "growth enhancing" structural reforms (some examples)

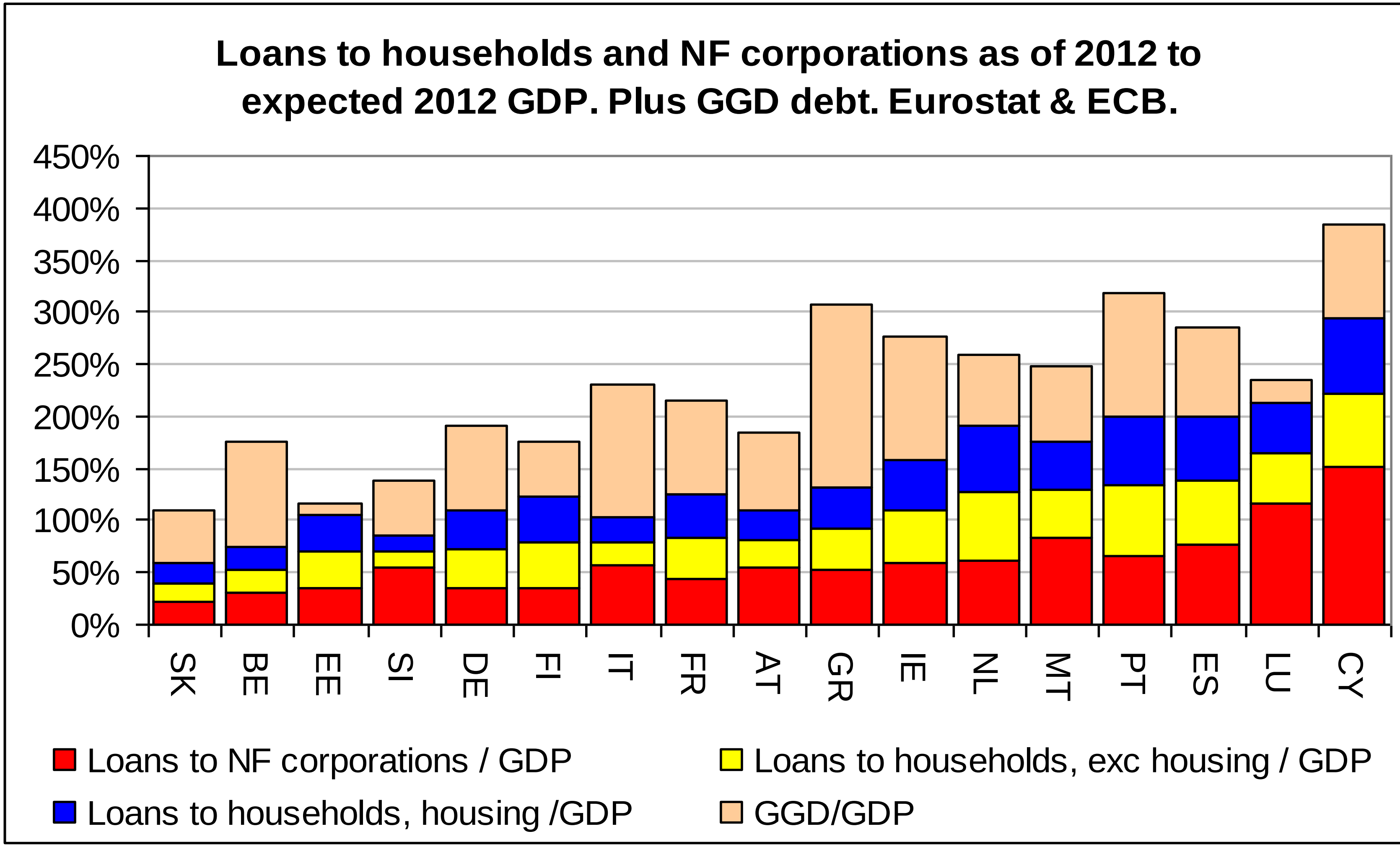
- Licensing process and spatial planning reform (about 40% complete).
- Road haulage deregulation (about 50% complete).
- Cruise ship home porting regardless of flag.
- Already some deregulation in professional fees and obligatory purchase of services (notaries public, lawyers for small real estate transactions, company start ups, fees of engineers), trademark submission without lawyer attendance, sale of baby milk outside pharmacies etc).
- Establishment of one-stop shops for company creation, and gradual improvement in their operation (yet complicated process design does not work well).
- Export facilitation (abolishing obligation to register in "exporters registry", a strategy to boost exports, link Piraeus port terminal operated by COSCO with rail network etc).

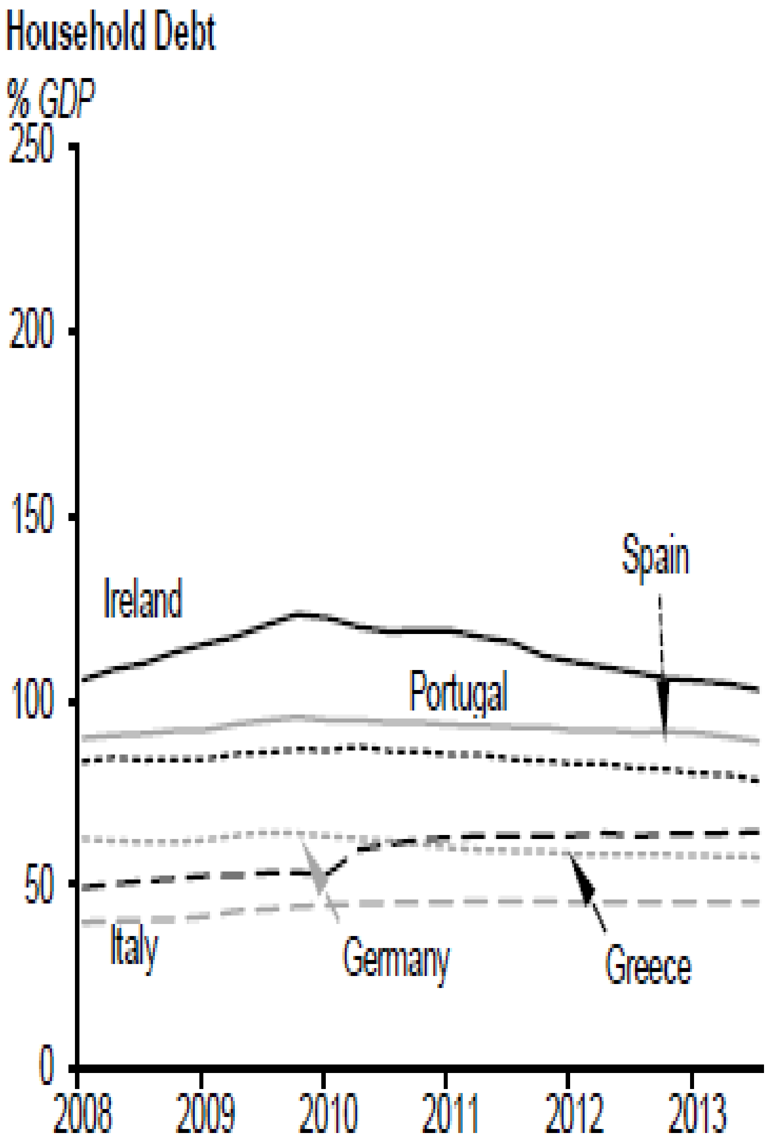
Where have these things gone?

- They were implemented TOO LATE
- Now the depression means that you don’t get the upside of these unprecedented reforms!

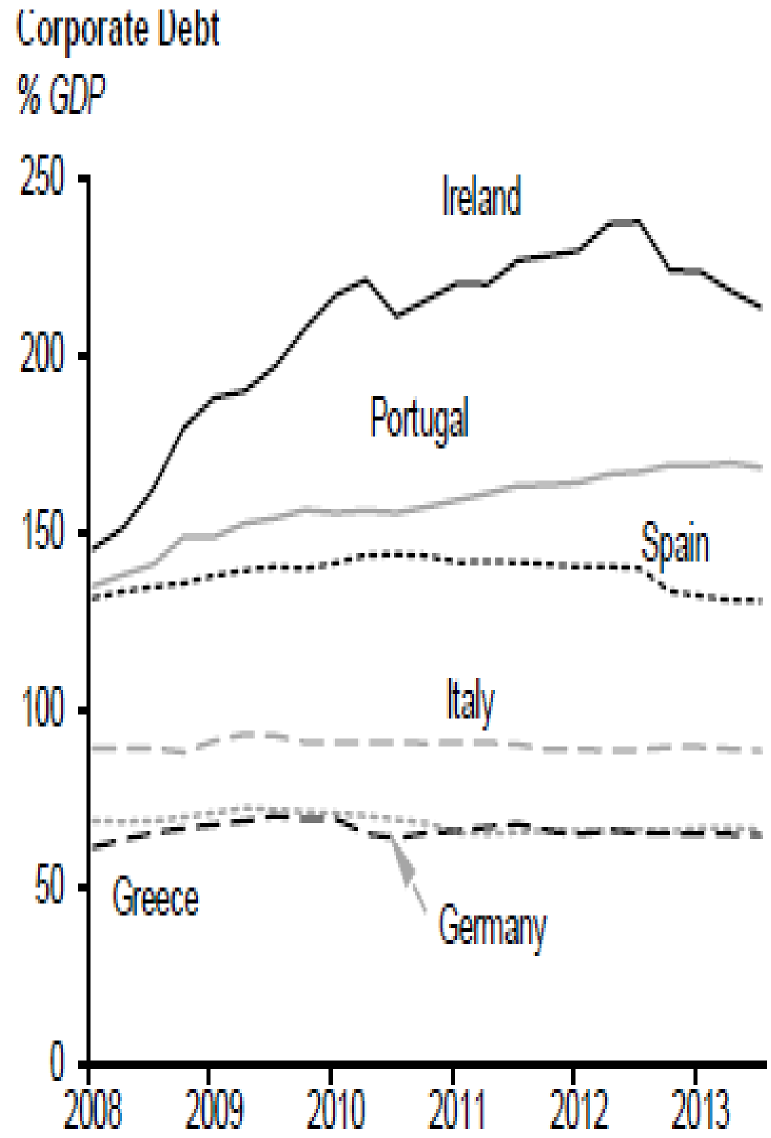
- <u>It is the depression stupid!!!</u>

Some bounded good news: Even after a 23% fall in nominal GDP, the private sector is still not overburdened by debt!





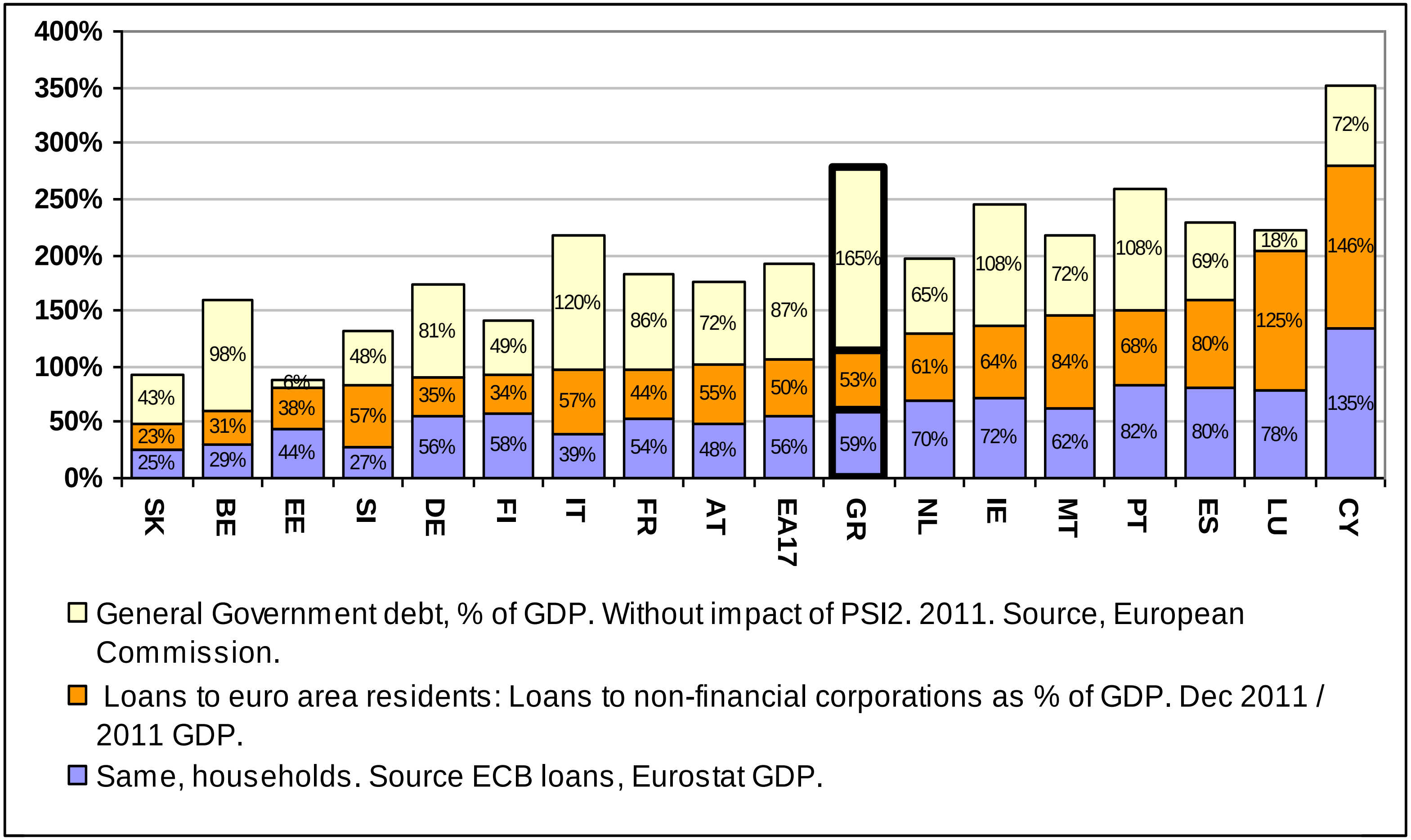
Source: European Commission, European Central Bank.



Source: European Commission, European Central Bank.

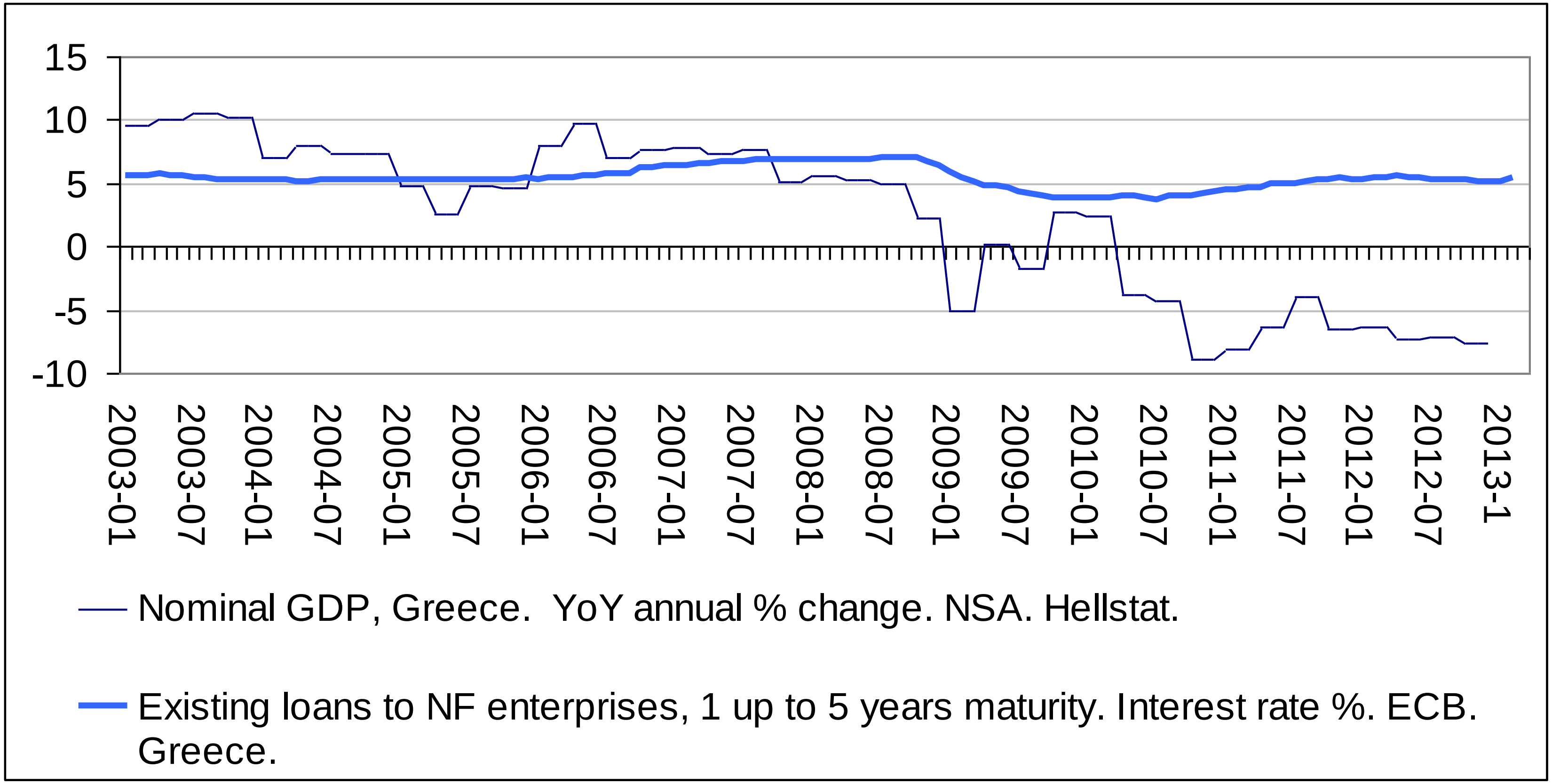
But risks are also there!

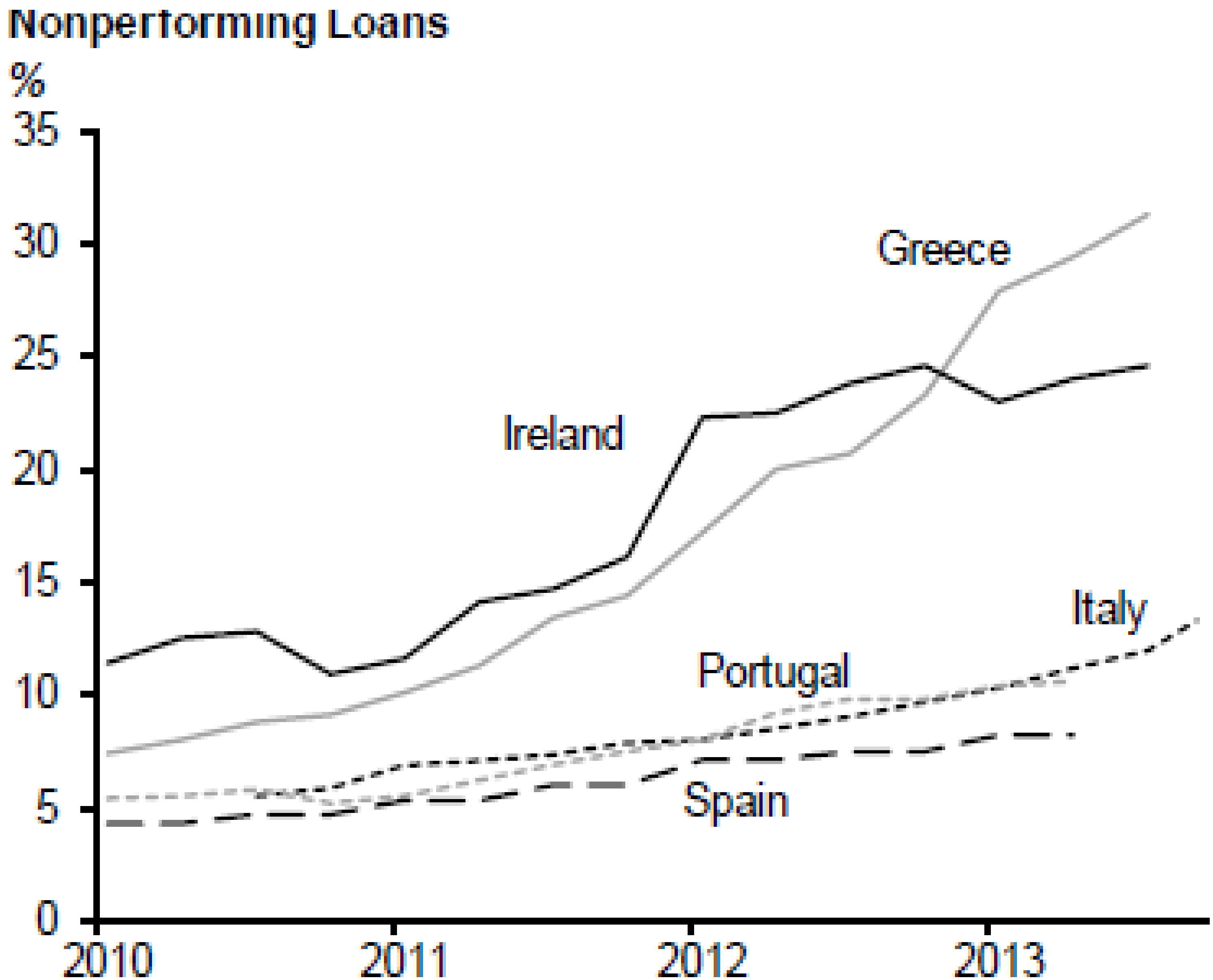
since public sector - General Government debt as % to GDP is 176% in 2013, but debt sustainable? To discuss...)



Nominal GDP and cost of financing to non-financial companies in Greece.

(Debt +) NPL = are still managing down expectations

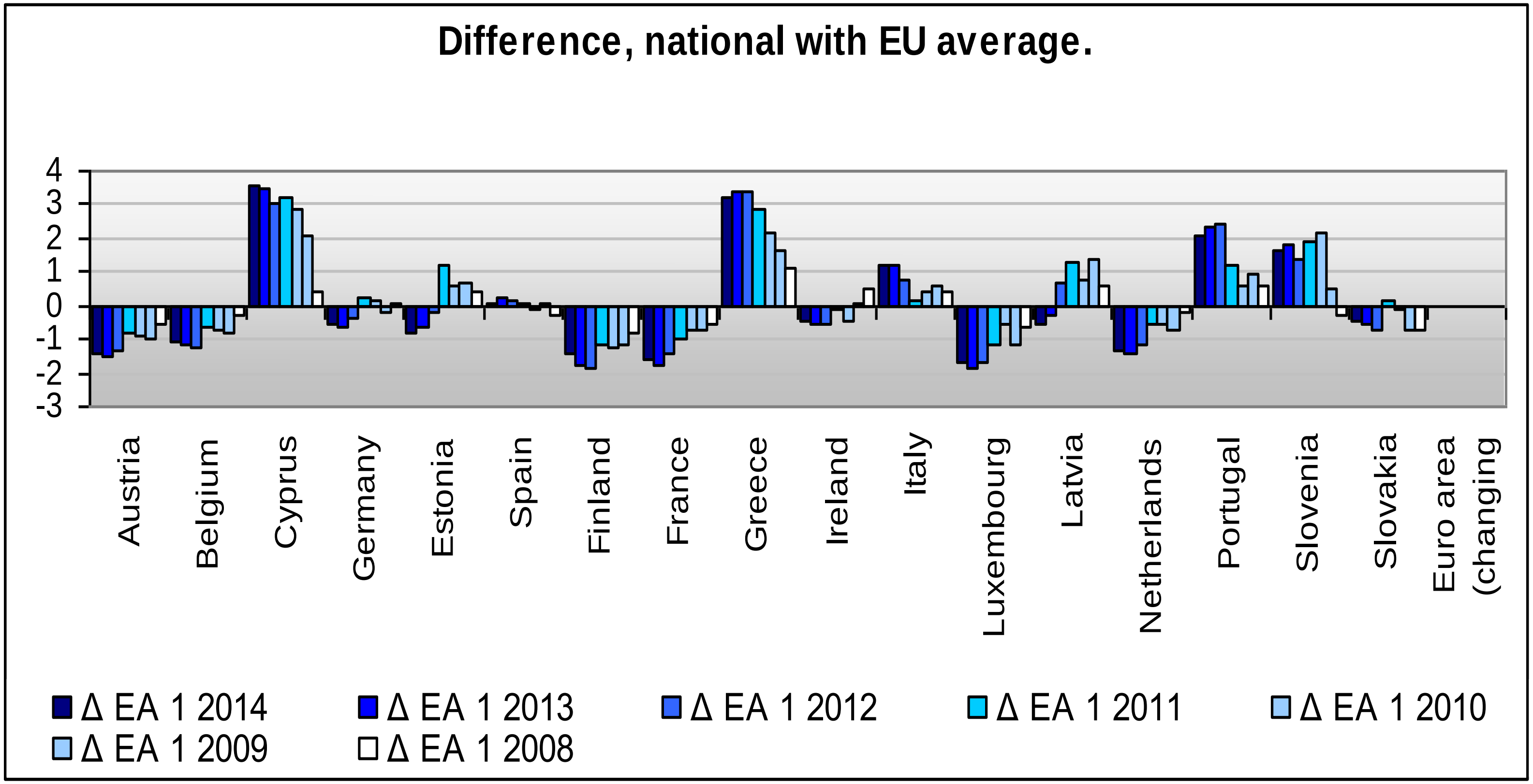




Source: IMF FSI, Banca d'Italia.

Greek enterprises: Facing **sky high Interest rates**

(A reply to Daniel Gros wondering why Greece is so special and, unlike Portugal, does not export so much…)

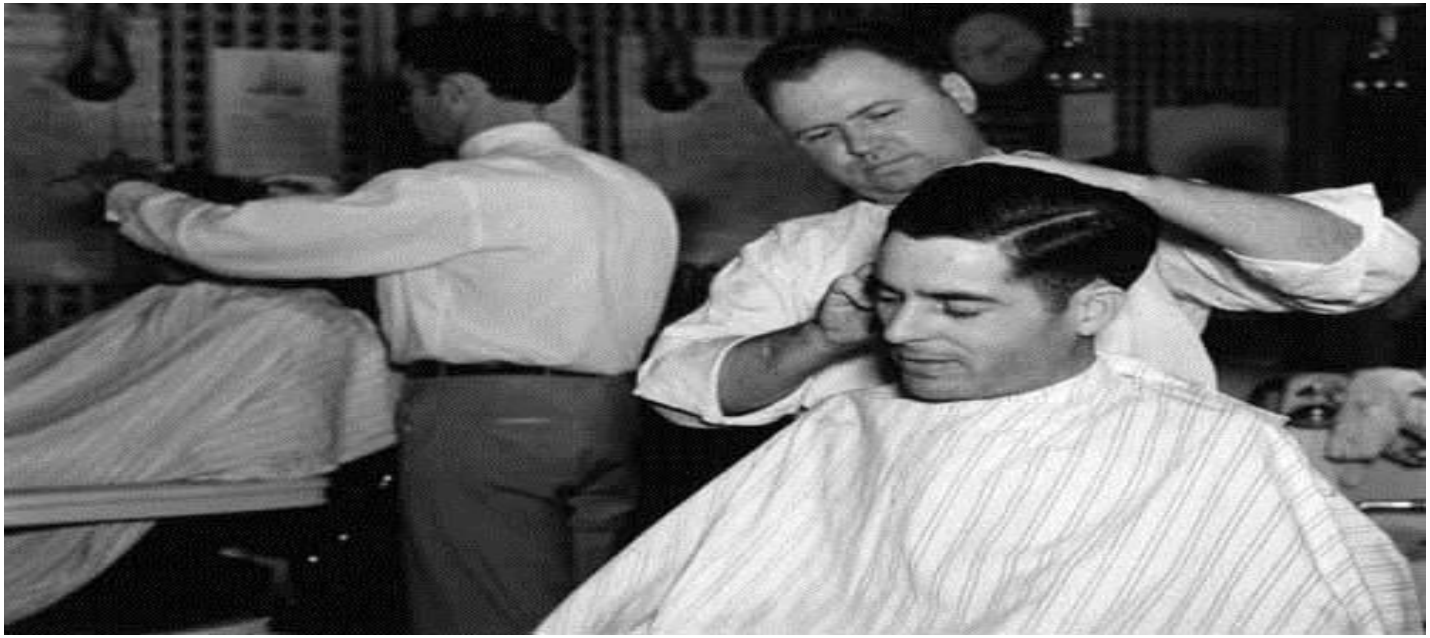


The main policy deficit now

- A comprehensive strategy to restore reasonable conditions of financing in the private sector.
- Replenishing core capital of banks is not enough, a strategy to stabilize trust and make money of a much larger magnitude (ie 40 bil at least) flow voluntarily in the country is needed.
- **Still dealing with a depression as if it still were a sovereign debt crisis! It is not! <u>The issue is not debt sustainability so much now</u>. <u>The key is to finance again the productive economy, putting it back on track.</u>**

The coming Failure(?)
Grexit talk part II

IMF whispering that Banks need 25 bil. more!
Note: Blackrock says Banks need 6 bil.!



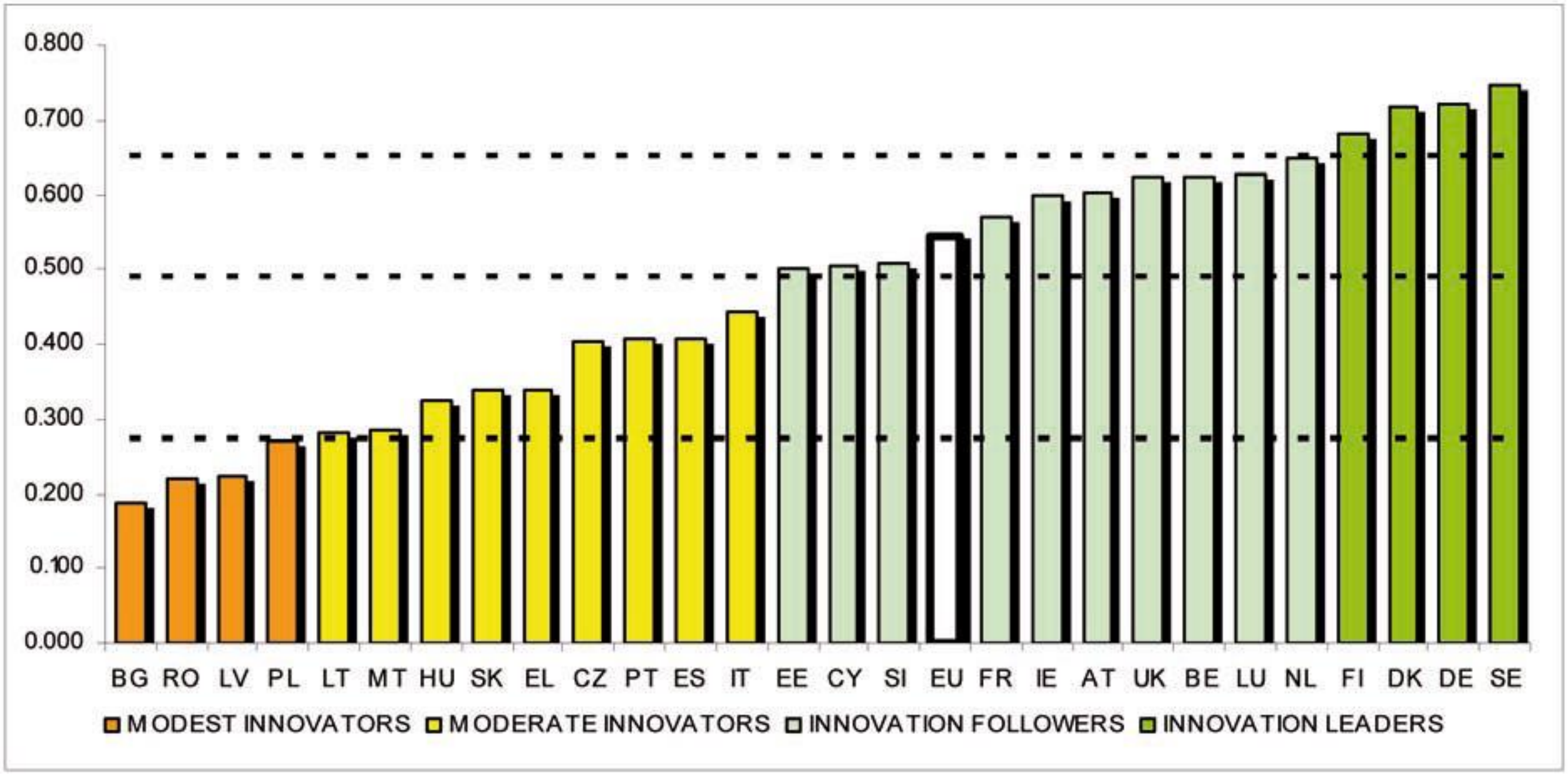
As GREXIT talk No.1 did, fear of a deposit haircut (Grexit talk part II):

- Scare away deposits
- Scare away investors
- Create a huge cost of money for the private sector
- Create financial suffocation in the private sector

Section III

- GO BEYOND THE COMPARATIVE ADVANTAGE STEREOTYPES (TOURISM, SHIPPING, SOME AGRICULTURAL PRODUCTS, ETC.)
  - Exports of fuel: 6.2 bil. (nobody talks about)
- **Exports of goods: 13.2 bil. (nobody mentions, except Ricardo Hausmann & friends)**
- Receipts from tourism/travel: 12.0 bil. (everybody talks about)
- Receipts from transport services: 14.1 bil. (everybody talks about)

Summary Innovation Performance EU member states (2013)



Important points

- *The role of competitive forces to drive innovation*
- *Differences in technology based innovation according to their nature*
- *The difficulty of bringing all the necessary ingredients together and the role of institutions.*
- *Taxing selectively success and punishing failure both do cost*
- *Primary science, research infrastructure, the role of the state and transfer of knowledge.*
- *The challenges to finance innovation*
- *Employment creation, firm size and firm age*
- *Need to maintain a healthy production base that collaborates with the innovators*

1. We investigate why business spend (dependent variable) in R&D in various countries.
2. Which policy variables play the critical role (candidate regressors)
3. Independent variables highly correlated, but <u>everything</u> has to fit well together!

		WEF GCR, used sub-indexes
Dependent variable		12.03 Company spending on R&D, 1-7 (best)
Independent vb	1	1.01 <u>Property rights</u>, 1-7 (best)
	2	1.02 <u>Intellectual property protection</u>, 1-7 (best)
	3	1.09 <u>Burden of government regulation</u>, 1-7 (best)
	4	2.01 <u>Quality of overall infrastructure</u>, 1-7 (best)
	5	5.03 Quality of the educational system, 1-7 (best)
	6	6.01 Intensity of local competition, 1-7 (best)
	7	6.13 <u>Burden of customs procedures</u>, 1-7 (best)
	8	7.02 Flexibility of wage determination, 1-7 (best)
	9	8.05 <u>Venture capital availability</u>, 1-7 (best)
	10	10.01 Domestic market size index, 1–7 (best)
	11	11.05 <u>Value chain breadth</u>, 1-7 (best)
	12	12.02 Quality of scientific research institutions, 1-7 (best)
		World Bank Governance indicators
	13	Control of Corruption: Estimate
	14	**Government Effectiveness**: Estimate
	15	Regulatory Quality: Estimate
	16	**Rule of Law**: Estimate
	17	Voice and Accountability: Estimate

Following the data analysis, one can formulate the following main proposals for Greece: (details in the book…)

- In Greece there is an existing research capacity along with a noteworthy physical infrastructure.
- The breadth of the value chain is important.
- Financing for innovative projects is a problem, and the problem needs to be fixed comprehensively, which implies that the institutions that are needed to support such financing need to be put in place or need to be enhanced accordingly.
- Respect for property and intellectual property need to be policy priorities.
- Governance in general needs to improve.

Thank you

and be optimist! ↓↓

Table 2. The GG Debt burden for Greece	
Total amount of GG debt (bn €)	**305,0**
Average Maturity 2013-2047 (years)	17,2
GG Debt maturing in 2014 (bn €)	24,1
GG Debt maturing in 2015 (bn €)	16,1
GG Debt maturing in 2016-2024 (bn €)	61,9
Average yearly GG Debt maturing in 2016-2024 (bn €)	6,9
GG Debt maturing after 2025 (bn €)	202,9
Average yearly GG Debt maturing in 2025-2047 (bn €)	8,78
GG Debt maturing after 2030 (bn €)	165,4
Average annual amortization payments (bn €)	8,7
Average annual interest payments (bn €)	9,0
Average yearly payments for servising the debt (bn €)	17,7
Average nominal GDP 2013-2047 (bn €)	317,0
Average annual servising cost/GDP (%)	**5,6%**

Table 3. Greek GG Debt servicing cost and its financing in 2014 and 2015

	2014	2015
GG Debt maturing (bn €)	24,9	16,1
Interest payments (bn €)	8,7	9,8
Total Servicing cost (bn €)	33,6	25,9
Eurozone and IMF financing (bn €)	19,3	11,0
To be financed by Greece (bn €)	14,3	14,9
Remaining Greece's GG Debt servicing Cost, % of GDP	***7,8%***	***7,8%***
Means of financing		
GG Primary Surplus 2013	**0,5**	
GG Primary Surplus	***2,8***	***5,7***
Privatization revenues	***4,0***	***2,5***
ECB related Incom (SMP and ANFA)	***2,5***	***2,0***
Net Private capital inflows in Banks	***3,5***	***1,5***
Treasury bills	***1,0***	***0,0***
New GGBs issuance		***3,2***
Total financing	***14,3***	***14,9***
Funding Gap (Alpha Bank estimates)	***0,0***	***0,0***
IMF Estimates (IMF Est., July 2013)	***4,4***	***6,5***

Sorce: IMF (June 2013) and Minsistry of Finance

Table 4. Greece's Gross Financing Needs in the period 2014-2025

	Maturing Debt (Bn €)	Interest pay-ments (Bn €)	Total Servicing cost (TSC) (Bn €)	GG Primary Surplus with profits from SMP GGBs		Privati-zation Revenues	Gross Financing Needs		IMF and EC financing	Re-maining financing Need	
				Billion €	% of GDP	Billion €	Billion €	% of GDP	Billion €	Billion €	% of GDP
2014	24,9	8,7	33,6	5,5	3,0%	4,0	24,1	13,2%	19,3	4,8	2,6%
2015	16,1	9,8	25,9	7,7	4,1%	3,0	15,2	8,0%	11,1	4,1	2,2%
2016	7,1	10,5	17,6	10,7	5,4%	3,0	3,9	2,0%	6,6	-2,7	-1,4%
2017	7,5	11,0	18,5	10,0	4,8%	3,0	5,5	2,6%	0	5,5	2,6%
2018	3,9	10,5	14,4	9,0	4,1%	3,0	2,4	1,1%	0	2,4	1,1%
2019	7,9	10,5	18,4	9,6	4,2%	2,5	6,3	2,7%	0	6,3	2,7%
2020	4,1	10,5	14,6	9,0	3,7%	2,0	3,6	1,5%	0	3,6	1,5%
2021	4,2	10,5	14,7	8,5	3,4%	2,0	4,2	1,7%	0	4,2	1,7%
2022	5,9	10,5	16,4	9,5	3,7%	2,0	4,9	1,9%	0	4,9	1,9%
2023	8,2	10,5	18,7	9,5	3,5%	2,0	7,2	2,7%	0	7,2	2,7%
2024	8,6	10,5	19,1	9,7	3,5%	2,0	7,4	2,7%	0	7,4	2,7%
2025	7,3	10,5	17,8	9,5	3,3%	2,0	6,3	2,2%	0	6,3	2,2%

Note: (a) The GG Pripary surplus Includs the return of profits of NCBs from GGBs purchased under the SMP program of ECB. b) Financing Needs for Greece in 2014-2015 are before the already commited financial aid from the IMF and the EZ

Source: IMF (October 2012 and June 2013) and EAD Alpha Bank calculations

•APPENDIX: The project is to become the California of Europe
•What if we aggressively implement reforms ….

•Completion of licensing process and spatial planning reform (about 40% now complete).
•Completion of road haulage deregulation (currently about 50% complete).
•Complete deregulation in professional fees and obligatory purchase of services (notaries public, lawyers for small real estate transactions, company start ups, fees of engineers), trademark submission without lawyer attendance, sale of baby milk outside pharmacies etc).
•Establishment of one-stop shops for company creation, and gradual improvement in their operation (as the ill devised current complicated process design does not work well).
•Export facilitation mainly through reduction in redundant red tape.
•Complete licensing, business park legislation, etc.
•Rationalize the complex system of third-party payments.
•Rationalizing regulation and taxes in the energy sector.
•Rolling out the privatization program in a more aggressive way, emphasizing assets crucial for competitiveness like ports, and not gambling. The example of Piraeus port should be used as a benchmark.
•Structural reforms that will improve the business environment and that are yet to be identified.
•A meaningful tax reform.