

Greece 2010-2015

A story of misperceptions and fallacies

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Key questions of the presentation

- 1. Were Greek politicians aware of costs for Greece to join the single currency and the reforms that should be done?
- 2. What did the IMF say about the euro accession of Greece and its performance in the euro area? A failure both before and after the program?
- 3. To what extent the current mess is explained by a dysfunctional political market and the rise of political extremism? Debt, debt sustainability and Political market/risk connected?
- 4. Can exports boom the economy?
- 5. Product, labor and tax reform issues
- 6. Political risk and Europe

Our theory: Vikings in Greece

Kleptocratic Interest groups in a rent seeking economy, *The Cato Journal* N.3, 2009



1. Investigating the role of domestic politics (90's)

Extracts from our field work

On fiscal adjustment
On EMU membership
On taxation and institutions
On Vested interests and institutions
On future Unemployment

Conclusion:

Our research has shown that politicians did know both the risks of Greece's accession to EZ and the structural reforms needed at the time..

2. Evaluating the creditors

- IMF/EU kept stressing the problems in all this period but offered rather mild expressions and praise during 1995-2008!
- The 1st program 2010-12
 - Unfeasible objectives
 - No real pressure to government to materialize critical reforms (business environment, privatization, product markets and professional services, bad laws etc).
 - Huge tax increases
 - Lowering wages horizontally especially in the private sector, no non-wage costs cut
 - No cut in rent seeking expenditures (enough)
 - GDP recovery forecast and access to the markets for 2012 completely non realistic.-

BUT ABOVE ALL, GREXIT KILLED CREDIBILITY, KILLED THE ECONOMY.

GREXIT TALK

- Hans-Peter Keitel: "In the event of non-compliance with credit agreements, there is no longer a place for Greece in the euro zone".
- Peter Ramsauer : "Greece will no have no alternative to leaving the euro zone if it gets no further fiscal aid".
- Jean-Claude Juncker: "Greece will not leave the euro zone unless the country totally refuses to fulfill any of its reform targets". July 2012
- Markus Soeder: "Because Greece can't or doesn't want to make it, it only makes sense to smooth its way out of the euro-- otherwise it is just like a money sink". June 2012
- Angela Merkel: "We want Greece to stay in the euro, but we insist that Greece sticks to commitments that it has agreed to".
- Ken Clarke: "Everybody says they'll leave the euro, actually that's quite likely but it doesn't necessary follow. ... I honestly hope that the Greeks will vote responsibly and I hope that we can avoid turmoil."
- Laurent Fabius: "If Greeks want to stay in the euro zone, they can't vote for parties that eventually make them exit the EZ
- Herman Van Rompuy added: "We want Greece to remain in the euro area while respecting its commitments". Nov. 2011
- Nicholas Sarkozy: "It's clear that question has to be on the European future of Greece: does Greece want to stay in the euro? We hope it does, but it's up to Greek people to pronounce on that".
- Angela Merkel: "We would rather achieve a stabilization of the euro with Greece than without Greece, but this goal of stabilizing the Euro is more important".
- Philipp Roesler: "The Greeks have a choice: reforms within the euro zone or no reforms and leave. There is no third way".
- **Wolfgang Schaeuble**: "We want Greece to stay in it, that everybody stays in it. We also want to help them to stay in it. But if a country can't carry the burden or doesn't want to carry the burden, and the Greek people have to carry a heavy load, then we have to respect the decision of this country". September 2011
- Philip Roesler: "Our common goal is the stability of the euro and we want Greece to stay in the euro".
- Daniel Rubini "Greece should leave the Euro". March 2011
- **Wolfgang Schaeuble**: blasts Hans-Werner Sinn's proposal of a Grexit " calculations of milk girls should be left to milk girls - for professors there are different standards". July 2012.
- **Wolfgang Schaeuble**: "Greece will not default" and "leaving the euro is not an option". October 2012.
- **Wolfgang Schaeuble**: "a Grexit will never occur" and "there is no more risk of contagion". November 2013
- Hans-Werner Sinn: " Greece can survive only with the drachma". June 2015.
- IFO 29.5.2015 IFO (**H W Sinn**) recommends a stop of the ECB support to Greek banks
- **Wolfgang Schaeuble**: Voluntary departure from the eurozone "could perhaps be a better way" for Greece. July 2015.

3. Let's talk about Grexit and risk

Disbursement of funds in bil. Euro, compared with peers, the 2 programs (IMF not included)

	Greece	Portugal	Ireland	Spain	Cyprus	Total Use	Total Ability
EFSF/ EFSM/ GLF	144.6 52.9	52	40.2			236.8 52.9	740
ESM				41.4	9	50.4	500

Now with the 3rd program = 237.3 bil. (no ELA)

Table 2: Gross Disbursements to Greece from the euro-area and the IMF (€ billion)

	Date	EFSF	IMF	Total	Cumulative total
First Economic Adjustment Programme					
1.	May 2010	14.5	5.5	20.0	20.0
2.	September 2010	6.5	2.5	9.0	29.0
3.	December 2010/January 2011	6.5	2.5	9.0	38.0
4.	March 2011	10.9	4.1	15.0	53.0
5.	July 2011	8.7	3.3	12.0	65.0
6.	December 2011	5.8	2.2	8.0	73.0
Total first programme		52.9	20.1	73.0	
Second Economic Adjustment Programme					
1.	March / June 2012	74.0	1.6	75.6	148.6
2.	December 2012 / May 2013	49.1	3.2	52.3	200.9
3.	May/June 2013	7.5	1.8	9.3	210.1
4.	July / December 2013	2.9	1.8	4.7	214.9
5.	April / August 2014	8.3	3.6	11.9	226.8
	February 2015 ¹	-10.9		-10.9	215.9
Total second programme		130.9	12.0	142.9	
Total of the two first programmes		183.8	32.1²	215.9	
Third Economic Adjustment Programme					
1.	August / December 2015 ⁵	21.4		21.4	237.3
Overall total at end of December 2015		205.2	32.1²	237.3	

1) EFSF bonds transferred to the HFSH in March 2012 and returned in February 2015.

2) Greece started reimbursing the IMF in 2013. At the end of 2015, the balance still owed to the IMF was equal to SDR 13.7 billion (approximately €17.4 billion).⁶

Financial support of Greece, 2018, estimation =
 302 bil. Minus 23.5 re-imbursements in 2nd-3rd program=278.4 or 120% of
 GDP!
 Portugal and Ireland 42%!

Table 3: Loans to Greece from the euro-area and the IMF (€ billion)

	Euro-area	IMF	Total	Cumulative total
First economic adjustment programme	52.9	20.1	73.0	70.3
Second economic adjustment programme	130.9	12.0	142.9	215.9
Third economic adjustment programme	86.0	-	86.0	301.9
Reimbursements during the second programme ¹⁶		- 13.1	- 13.1	288.8
Reimbursements during the third programme		- 10.4	- 10.4	278.4
Net total at the end of August 2018	269.8	8.6	278.4	

Where did all that money go...?

Table 6: Use of the EU and IMF loans	First programme	Second programme	Third programme
Reimbursement of bonds (private bondholders) ¹	41.1	2.9	3.5
Reimbursement of bonds (public bondholders) ¹		25.3	12.5
Cost of the restructuring operations ¹		37.5	
Recapitalisation of the Greek banks ¹		34.1	23.2
Financing of the budget deficits ¹	31.9	29.9	36.4
Total net² disbursements by the EU and the IMF	73.0	129.8	75.6

1) The sum of the financing needs during a programme that appears in the official documentation is systematically higher than the figure of the foreseen loans because of the presence of other complementary forms of financing (e.g. privatisation receipts, return of the profits on the bonds bought under the SMP operations, increases in the short-term financing "T-bills", etc.). The differences compared to the actual net disbursements are €30.0 billion for the first programme, €12.0 billion for the second and €5.7 billion for the third (see also Annex 1 at the end of the paper). These differences have been proportionally apportioned among the items in the table and deducted from the effective expenditure under each item. The data for the third programme is taken from the European Commission's analysis of July 2015 and from the "Financing needs" document under the third programme of August 2015.

2) Net of the reimbursements to the IMF (€13.1 billion and €10.4 billion).

Greece: Net cash flows

Rogoff & Bulow 2015

Table 1. Greece's economy, 2006-09.

Change in outstanding debt:	86
Less: Consolidated interest	(44)
Plus: Adjustments	10
Plus: EU subsidies	20
Total Inflows	72

Table 2. Greece's economy, 20010-13: Total inflows increase as the economy declines

Change in outstanding debt:	18
Less: Consolidated interest	(45)
Plus: Adjustments	106 (the debt write-down due to the PSI program)
Less: Increase in accounts payable	(6)
Plus: EU subsidies	18
Total Inflows	91

Cash flows turned negative in 2014!

Type of Debt	Issues Minus Redemption	Interest	Fees	Net Cash
T-bills	-.442	0.373	0	-0.815
Long Term	-9.736	2.839	0.004	-12.579
Short Term (Repo)	8.605	0.010	0	8.595
Bank of Greece + Other Residential				-0.556
EFSF/ESM/IMF				2.927
Other Non-Residential				-0.534
Settlement of Past Years' Obligations				-1.152
Participation in Share Capital Increases				-0.493
ANFA + SMP				0.580
From EU				4.845
Net Foreign Flows (sum of bold items)				-5.535

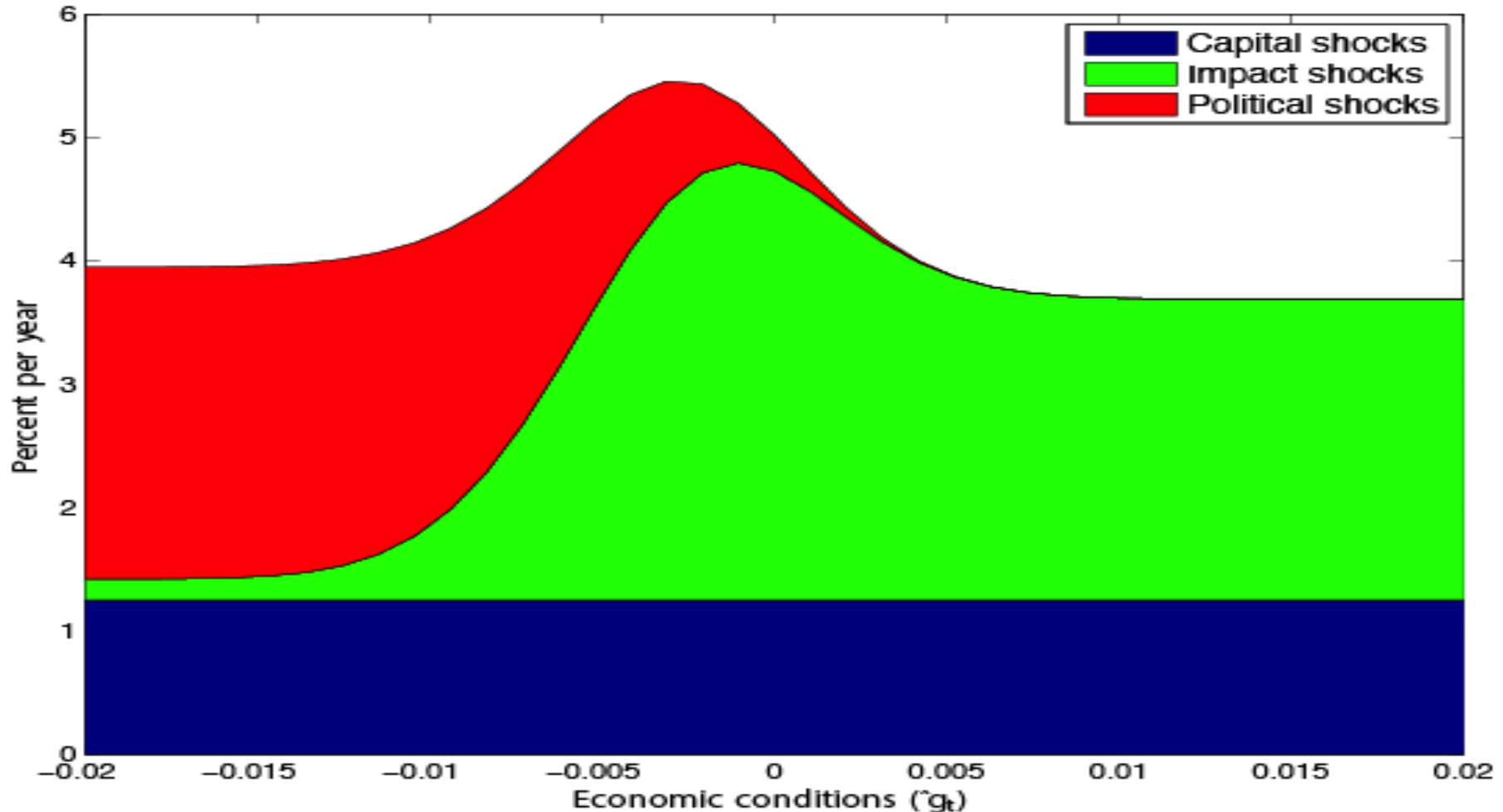
Wrap up

- **Almost 400 bil. (if you add ELA) has been given to Greece but rather poor results!**
- **No agreement, i.e. no reforms = no money (net outflow), so ‘stagnorecession’ returns...**
- **Any recovery shoots come with the program, despite program flaws (?)**
- **Grexit talk comes with “no agreement periods”! (2016, a déjà vu year?)**

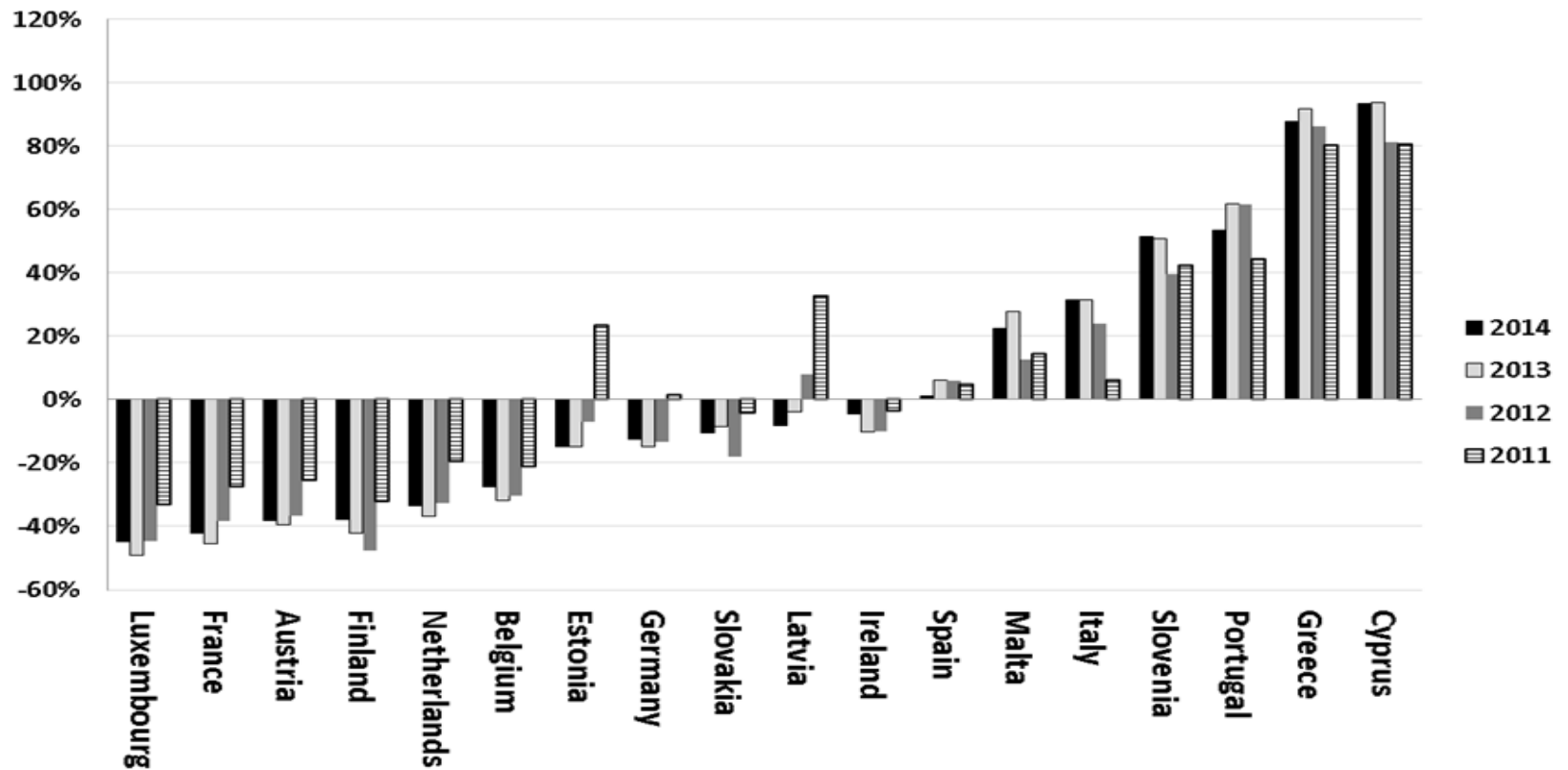
The price of No deal/Grexit/political uncertainty on financial markets

‘It’s the politics stupid!’

Pastor & Veronezi, 2013, 2014, Kelly 2014, etc



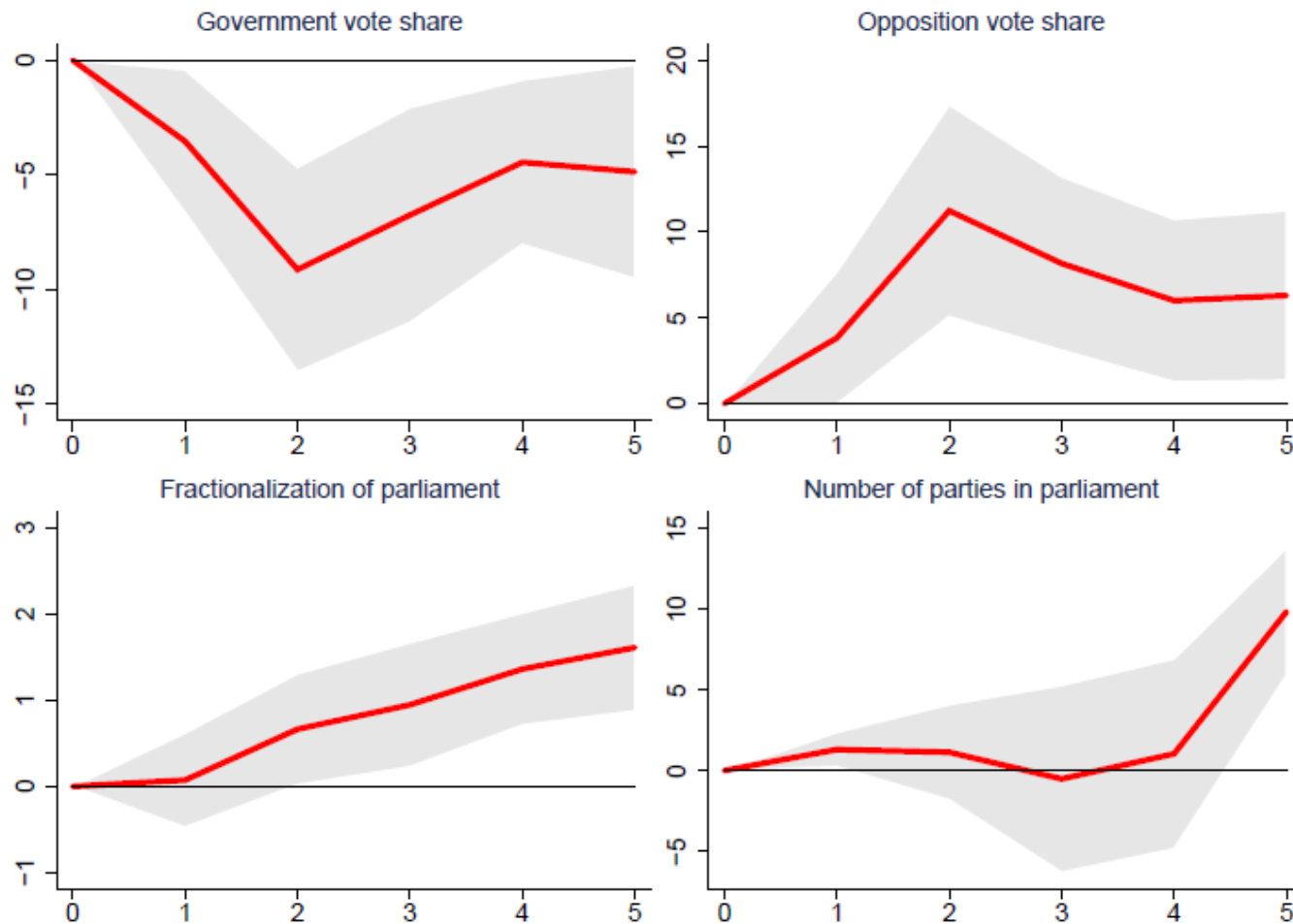
Cost of capital: Interest rates national difference with euro area average mark/confirm the above/risk



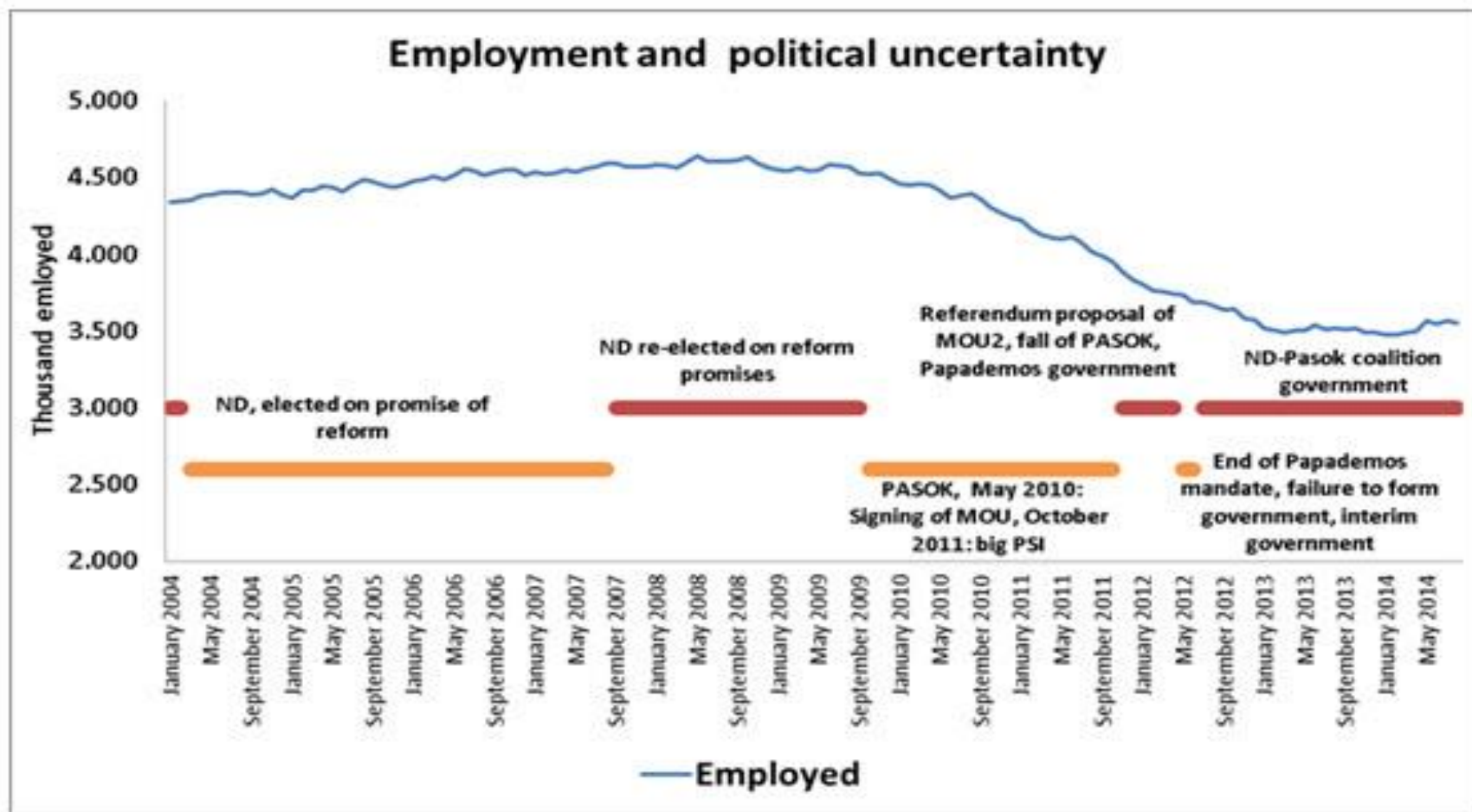
+ Political extremism: Voting outcomes

(post-WWII crises). Look like Greek politics today

Trebesch-Schularich-Funke 2015

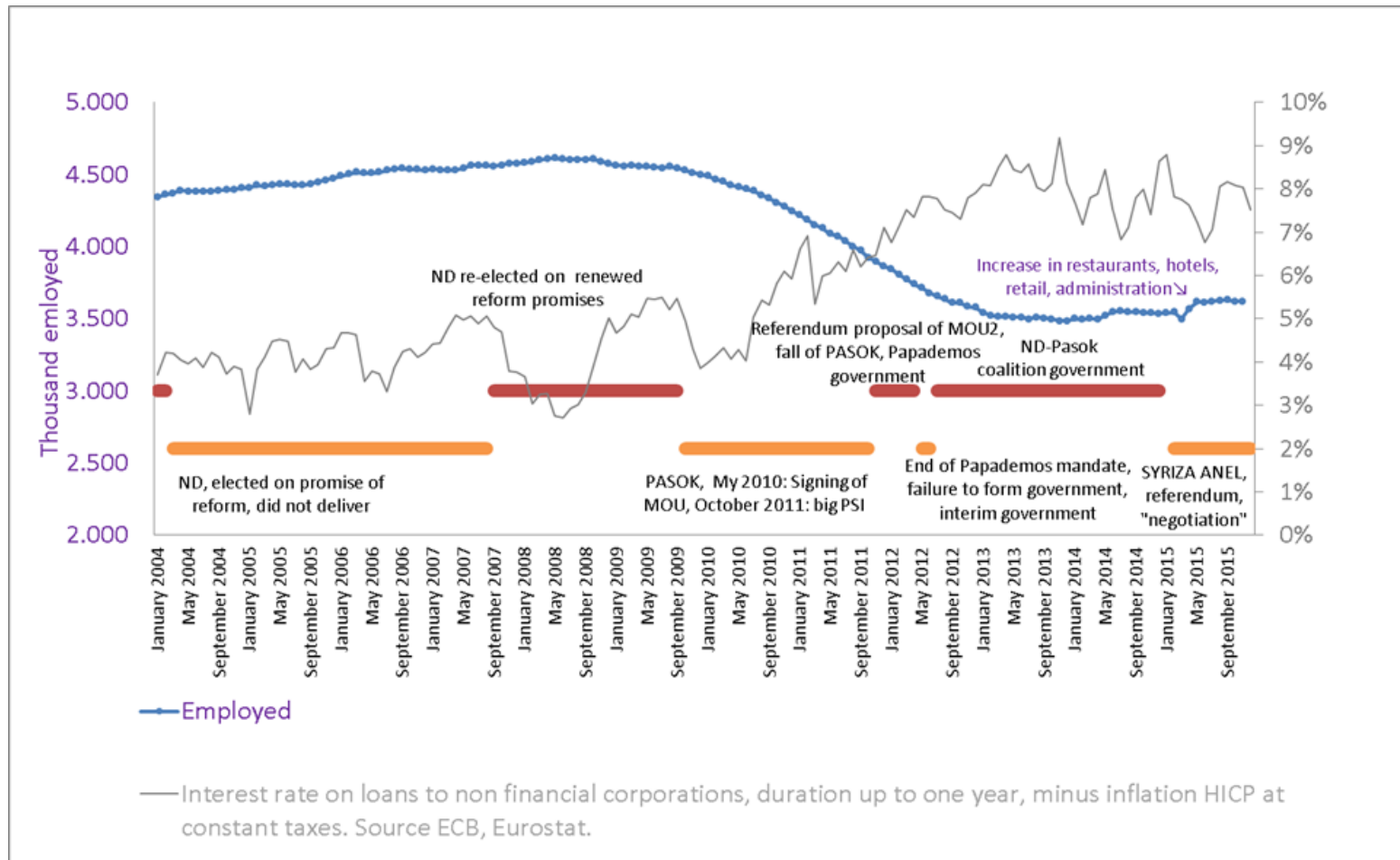


Employment and political uncertainty



Adding interest rates...

Political risk is killing the economy!



On debt sustainability and political risk

Both IMF & the Greek government say debt unsustainable

Greece and Peer Unfunded Debt Service Comparison

			2016	2017	2018	2019	2020	Total
	Interest Payments							
1.	Greece		1.2	3.3	3.6	3.8	4.0	
2.	Portugal		8.2	8.2	8.2	8.2	8.2	
3.	Ireland		6.6	6.6	6.6	6.6	6.6	
4.	Spain		33.1	33.1	33.1	33.1	33.1	
5.	Italy		69.4	69.4	69.4	69.4	69.4	
	Principal Payments							
6.	Greece		6.3	8.6	3.7	12.8	3.5	
7.	Portugal		11.7	9.0	13.5	17.5	16.0	
8.	Ireland		13.2	6.4	13.3	14.5	19.9	
9.	Spain		112.2	108.7	86.8	78.0	78.5	
10.	Italy		184.2	219.3	167.4	157.8	143.0	
	Debt Service							
11.	Greece		7.5	11.9	7.3	16.6	7.5	
12.	Portugal		19.9	17.2	21.7	25.7	24.2	
13.	Ireland		19.8	13.0	19.9	21.1	26.5	
14.	Spain		145.3	141.8	119.9	111.1	111.6	
15.	Italy		253.6	288.7	236.8	227.2	212.4	
	Amount Unfunded							
16.	Greece		0.0	0.0	0.0	16.6	7.5	24.1
17.	Portugal		19.9	17.2	21.7	25.7	24.2	108.7
18.	Ireland		19.8	13.0	19.9	21.1	26.5	100.2
19.	Spain		145.3	141.8	119.9	111.1	111.6	629.7
20.	Italy		253.6	288.7	236.8	227.2	212.4	1,218.8
	Amount Unfunded	2015						
	% of 2015 GDP	GDP						
21.	Greece	173.2	0%	0%	0%	10%	4%	14%
22.	Portugal	178.8	11%	10%	12%	14%	14%	61%
23.	Ireland	204.5	10%	6%	10%	10%	13%	49%
24.	Spain	1,079.3	13%	13%	11%	10%	10%	58%
25.	Italy	1,635.2	16%	18%	14%	14%	13%	75%
26.	Peer Average		13%	12%	12%	12%	12%	61%
27.	Greece % of Peer Avg		0%	0%	0%	83%	36%	23%

Notes: Assumes 2016 interest for full period. Interest Payment and GDP data from EC AMECO database (accessed 10 Jan 2016), except Greece Interest Payments adjusted for deferrals, rebates, and interest received. Principal Payments data from Bloomberg, Greece Ministry of Finance, EC, and IMF.

Undermining business confidence for political reasons by saying that debt is unsustainable? A vicious circle of political risk and debt unsustainability. Greece debt metrics are a fraction of peers, but its borrowing costs are almost 1000 bps greater.

WHY? The political risk again is the answer!

No debt problem for the next at least 10 years
(Numbers Even better if u use PV instead of FFV..)

Greece and Peer Debt Service Ten-Year Projection Comparison
(1 of 2)

	Debt Service Percentage of GDP	Net Interest Percentage of GDP
Greece as % of Peers	59%	70%
Greece (2016-2025 Avg)	7%	2.6%
Peer Average (2016)	12%	3.6%
Portugal	11%	4.5%
Ireland	9%	3.0%
Spain	13%	3.0%
Italy	15%	4.1%

What to do

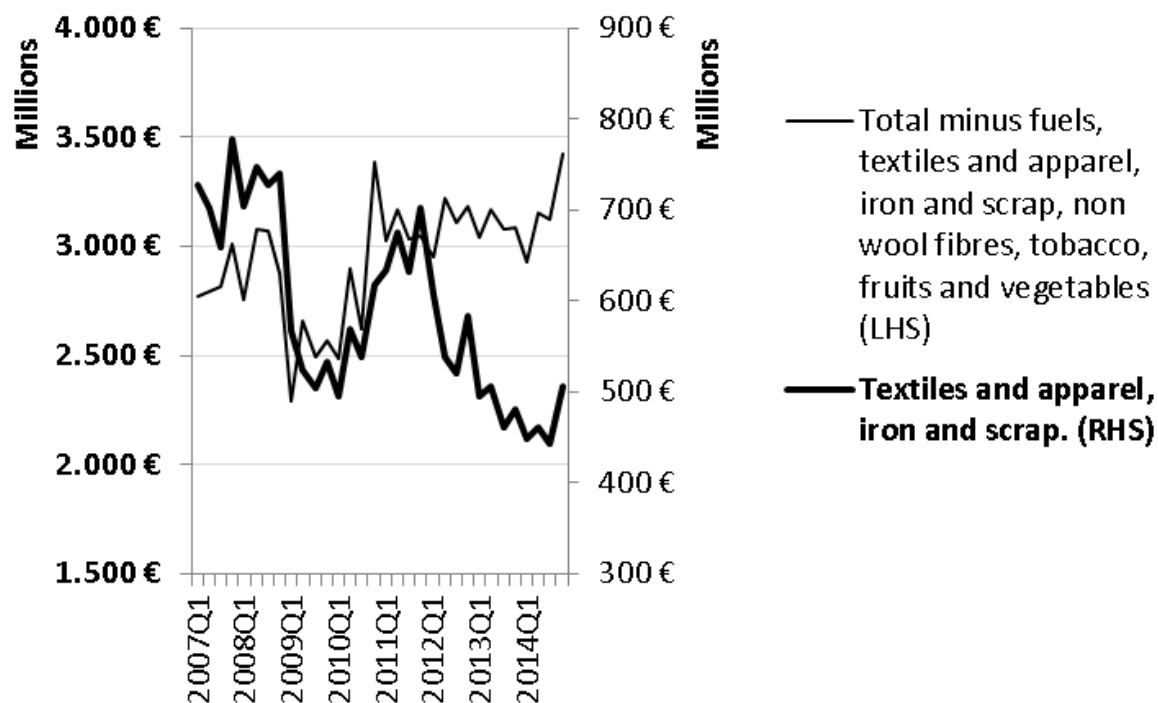
Confidence v. Risk

“Moreover, Greece deters investors by depicting itself as crushed by a crippling debt mountain and a victim of predatory creditors rather than as a land of opportunity for business.” Reuters (6 Dec 2015)

2nd part of presentation

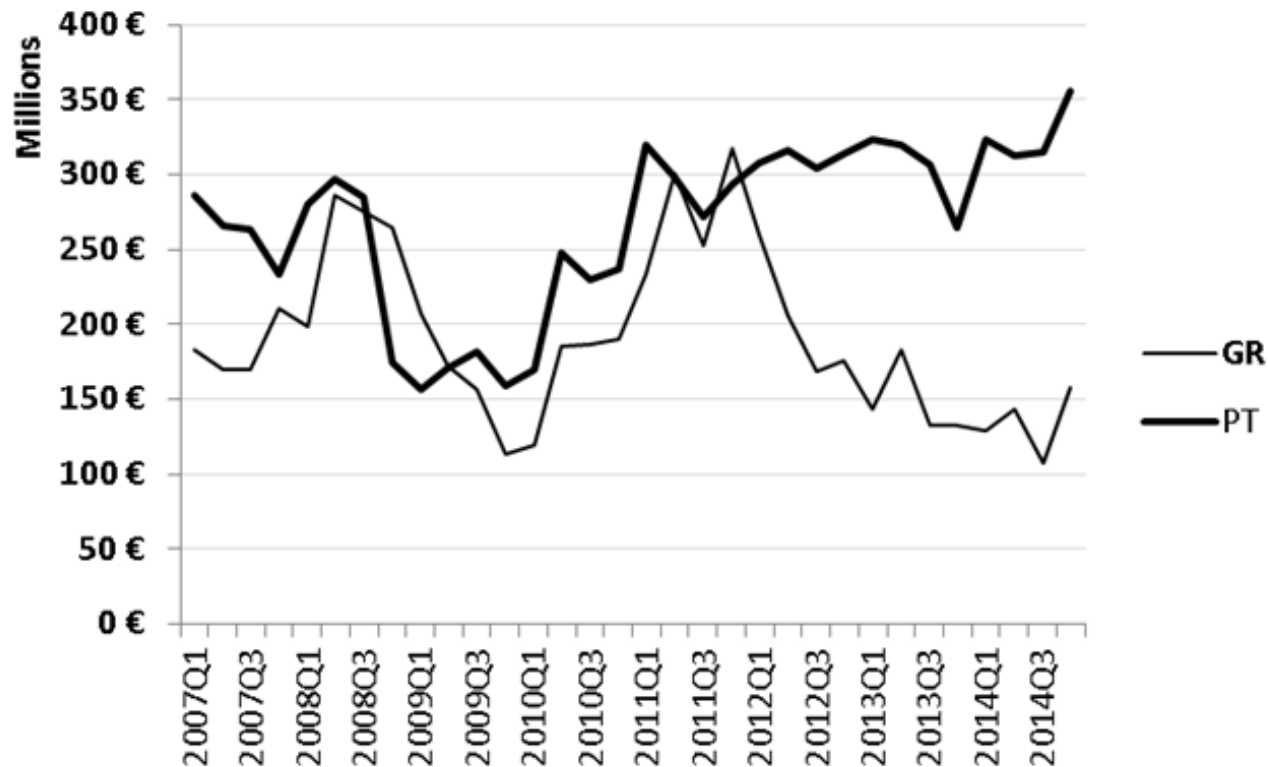
1. Exports: How key sectors affected negatively the sum of exports, even while other sectors did well.

Exports of energy intensive and non-energy intensive goods, Greece.



Source: Eurostat

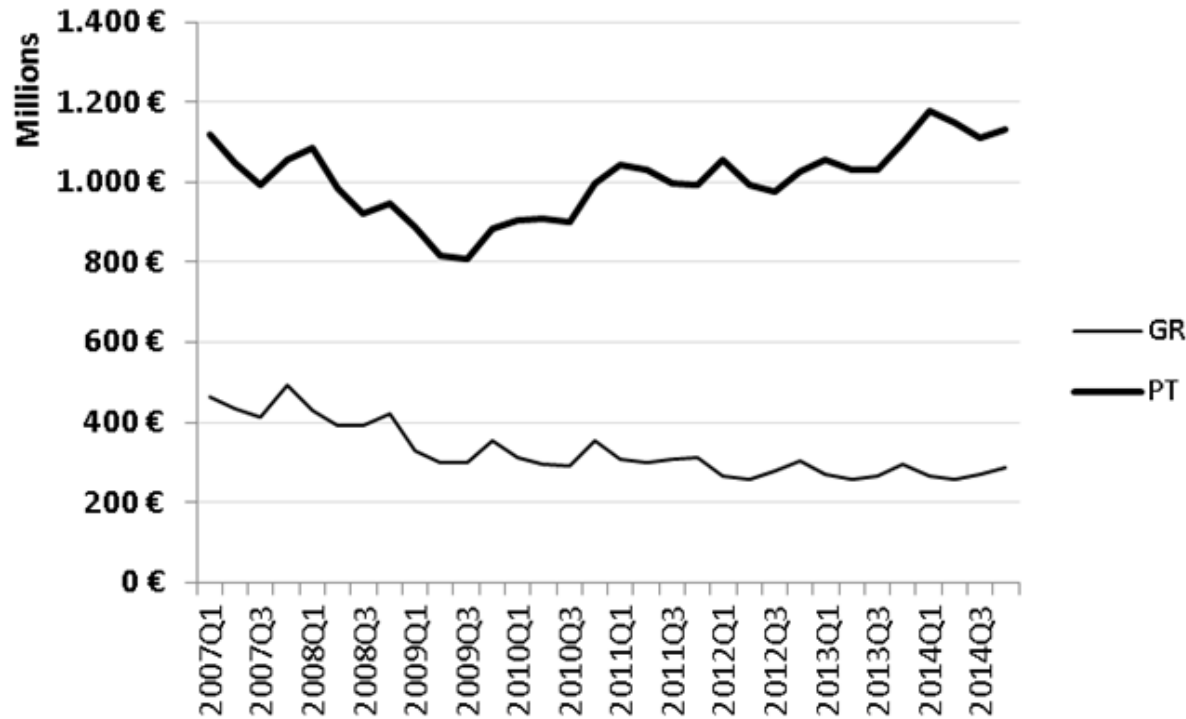
Exports of iron and steel products, Greece and Portugal (2011, taxes on energy increased).



Source: Eurostat

Exports in textiles, yarn, apparel, accessories etc.

(2011 taxes on energy increased but were already high for the sector)



Source: Eurostat

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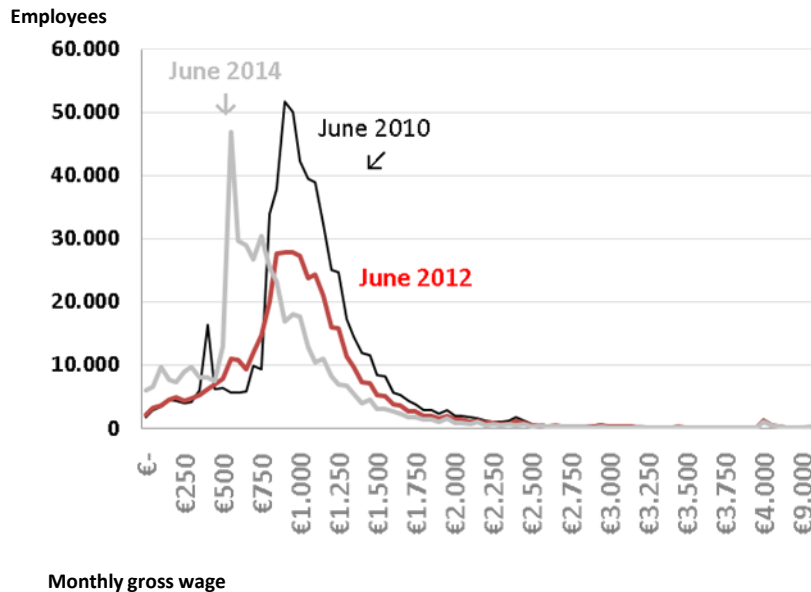
Greeks are failing to increase exports



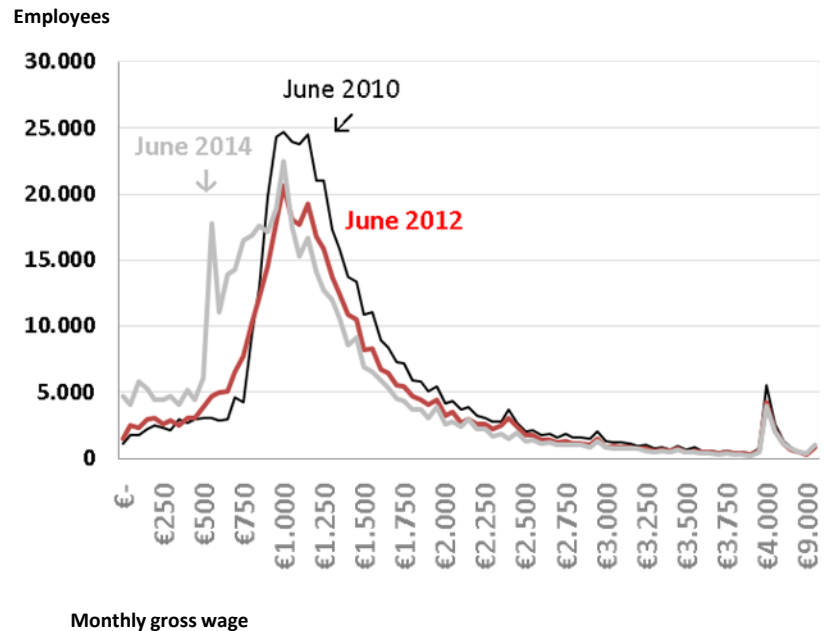
2. Labour market reforms: Much needed flexibility especially for SME's that tried to survive the tsunami.

Distribution of employees insured at IKA per bracket of gross monthly wage (2012 implementation of reforms).

Companies with up to 24 insured. Full time employment only.



Companies with 25-249 insured. Full time employment only.

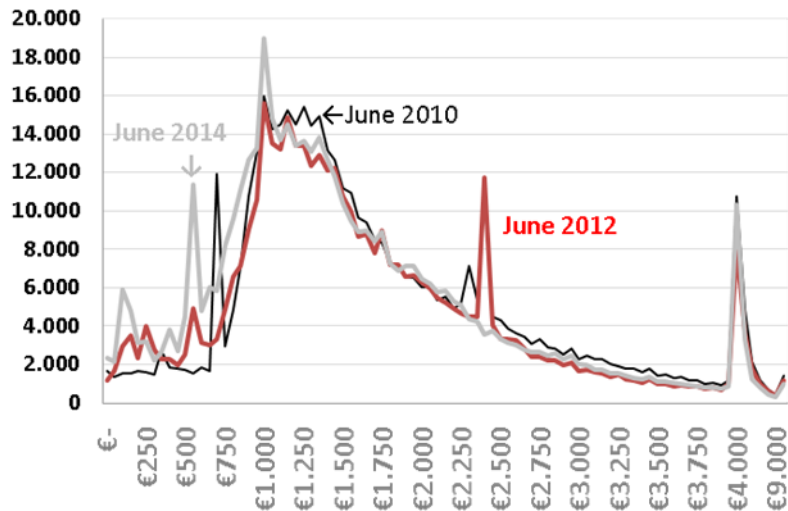


Source: Data provided by IKA (www.ika.gr), analysis by author.

Distribution of employees insured at IKA per bracket of gross monthly wage. (2012 implementation of reforms).

Companies with over 250 insured. Full time employment only.

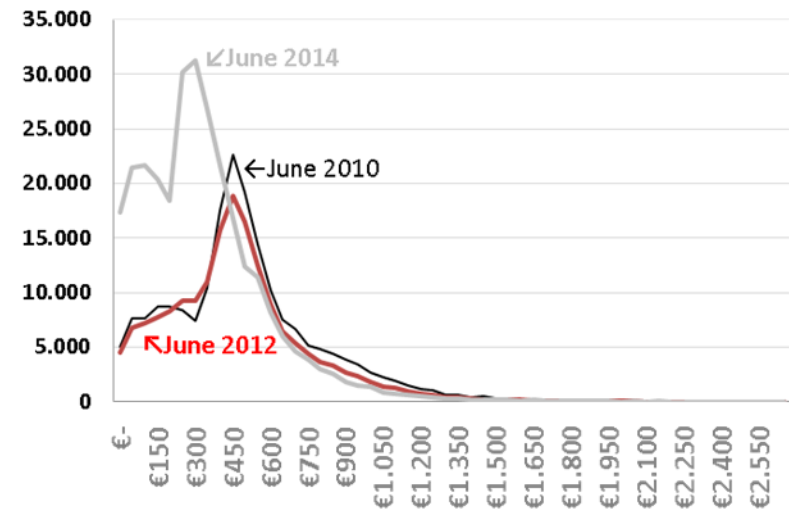
Employees



Monthly gross wage

Companies with up to 49 insured employees. Part time employment only.

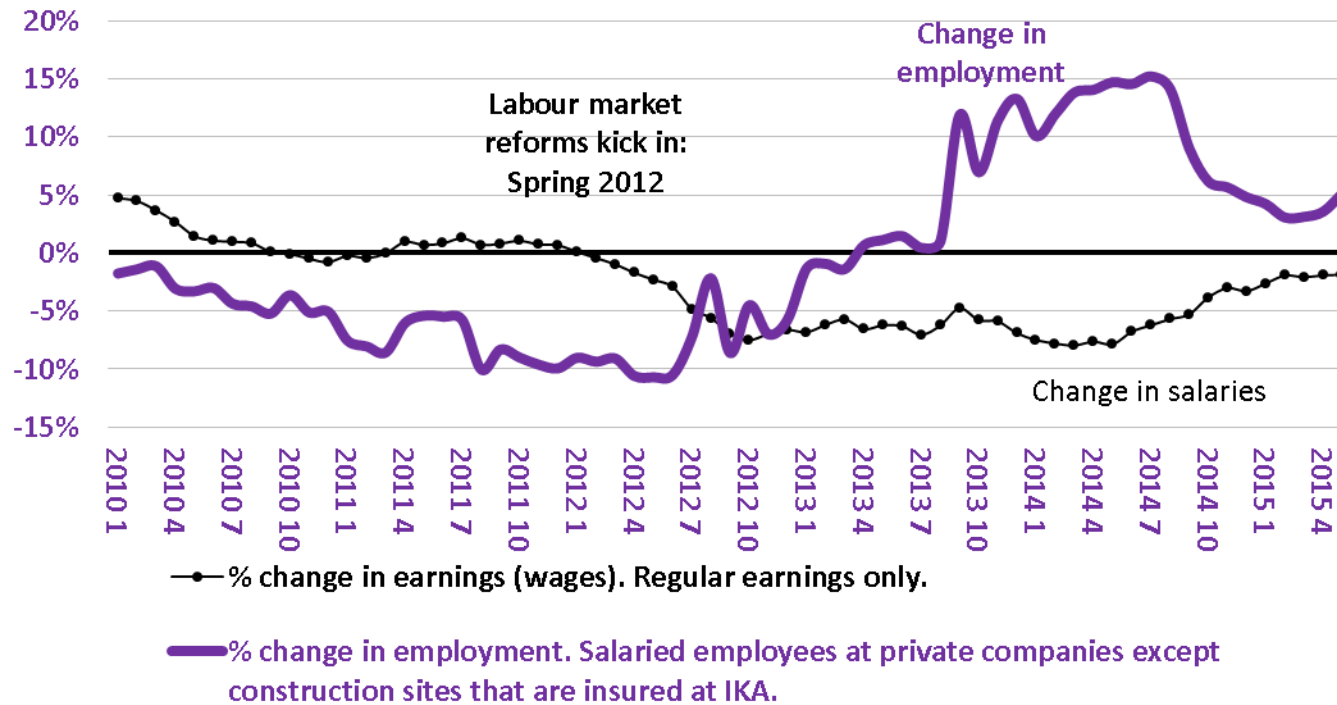
Employees



Monthly gross wage

Source: Data provided by IKA (www.ika.gr), analysis by author.

Employment and basic salary. % YoY change. (2012 implementation of reforms).



Source: Data provided by IKA (www.ika.gr), analysis by author. Basic and regular earnings without overtime, bonuses etc that include employee social security contributions only. Enterprises that exclude construction sites.

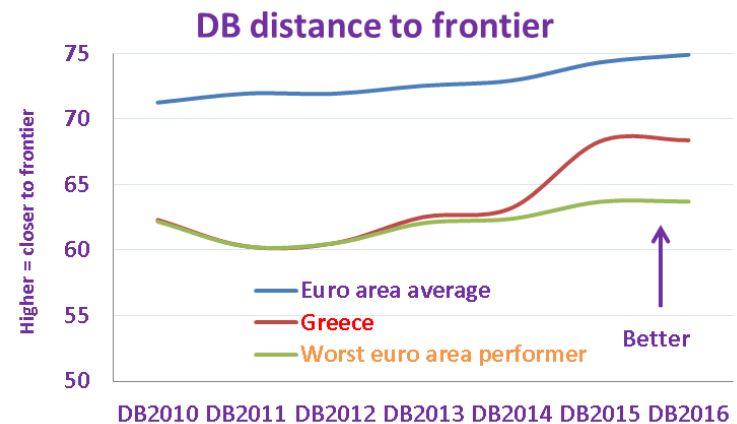
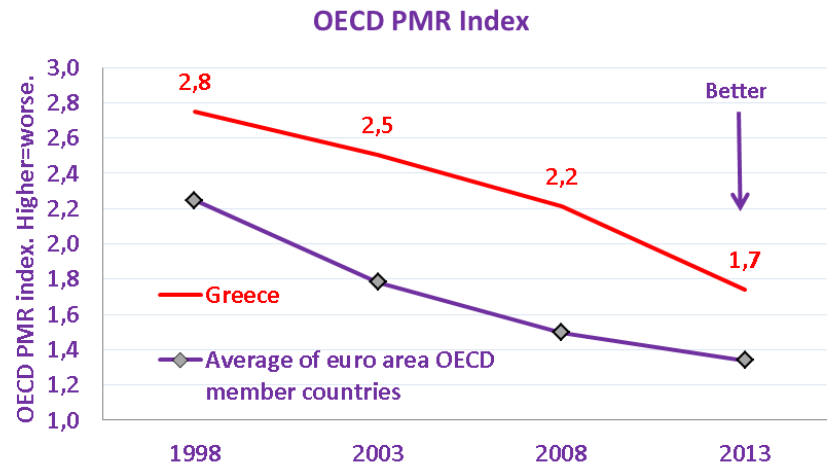


Labor market reforms are irrelevant in Greece



3. Product market reforms: Key to success, Greece has done a lot, has a lot to do, did very little in the past 12 months.

OECD PMR indicator & Doing Business. Greece and average of euro area countries



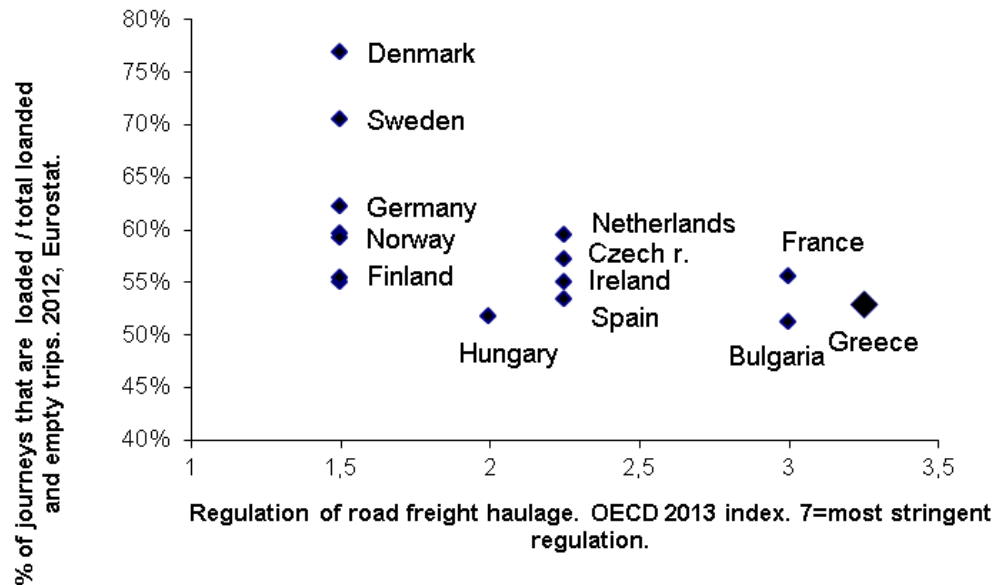


- Greeks needs no more structural reforms
- Greece has not done any structural reforms



Journeys and regulation of road freight haulage. National transport, all account and for hire trucks.

(2010 on paper reform, partial implementation since)

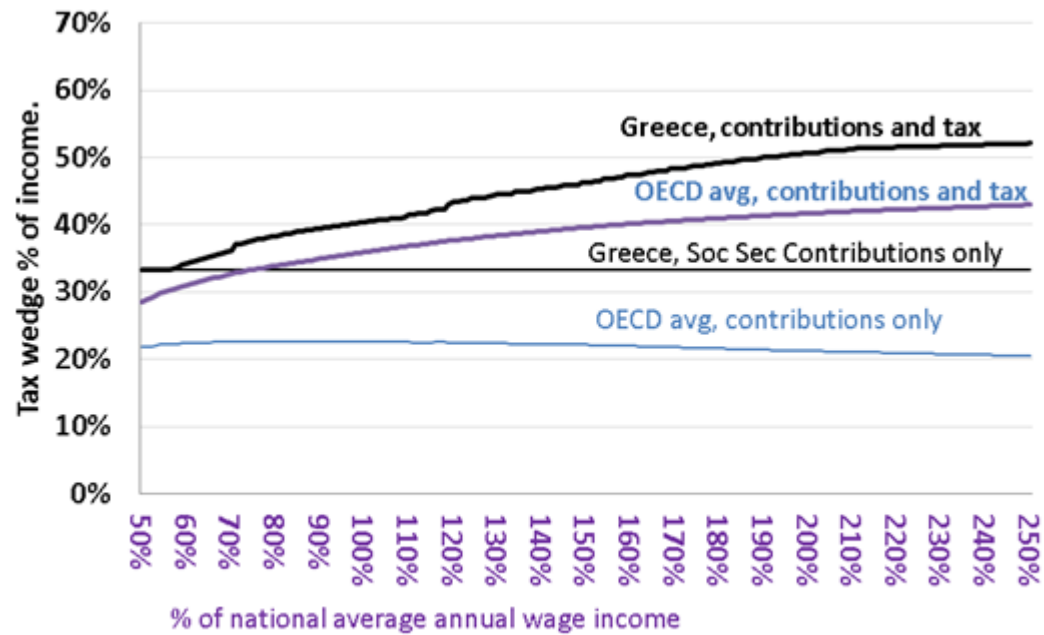


Source: OECD PMR index and Eurostat data, author analysis.

4. Taxation: Taxes that are too high, tax revenue that is too low.

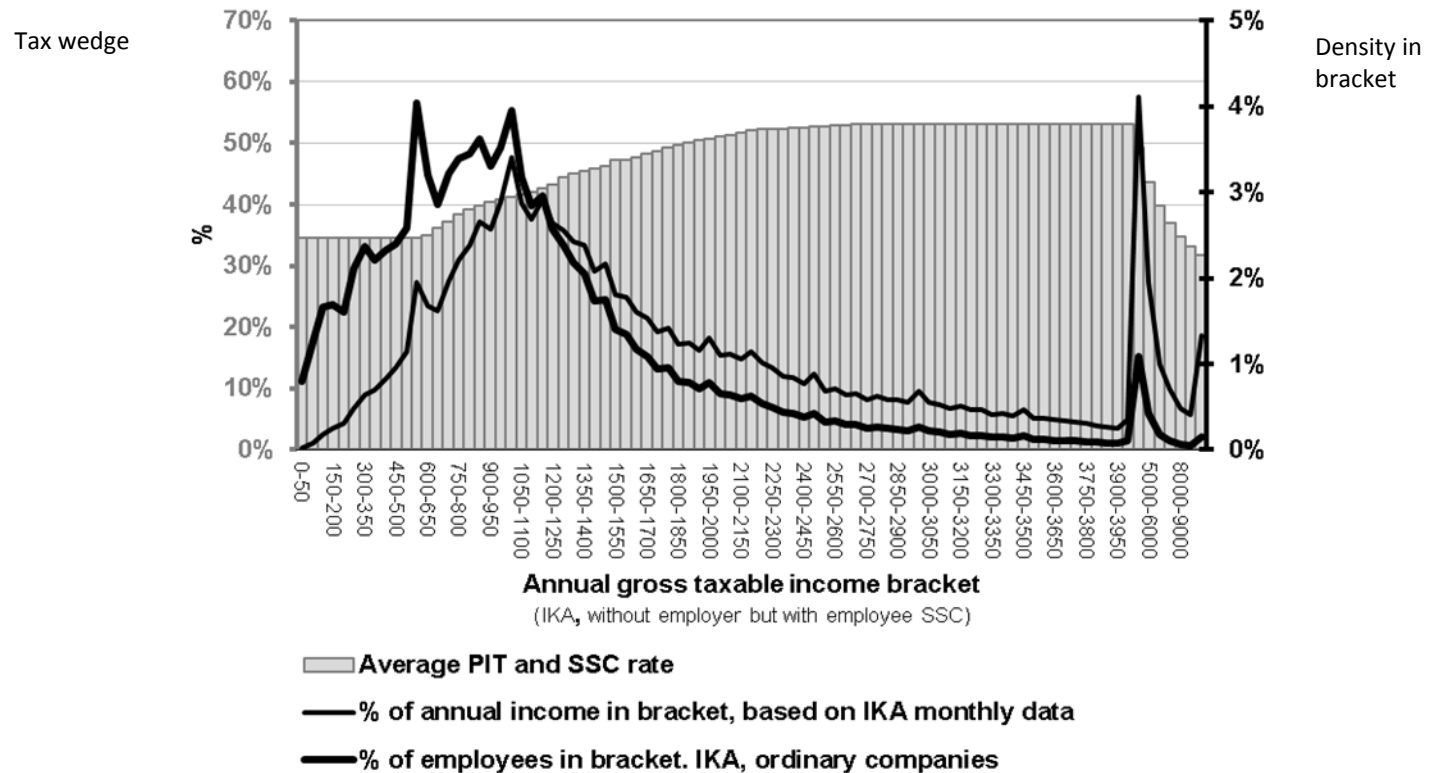
The “sick man of Europe” syndrome:
Personal income tax to GDP ratio low,
but ...

Tax wedge in Greece, 2014



Source: OECD. One earner family with two children.

Wage income and distribution of private sector employees (2013)



PIT and SSC rate, LHS. Density of distribution per income bracket, RHS.

Source: IKA data, OECD tax wedge data, Greek tax and social security laws.



Rich Greeks pay no taxes (2015)

BUSTED

Income bracket, €	Taxpayers 1.000	Σ%	Declared income, € mil.	Σ%	PIT and levy, € ΕΚΔΤ.	Σ%	Average tax rate	Income per capita €	Tax per capita €
0	1.176	100%	0	100%	22	100%		0	18
0 - 1.000	1.305	86,2%	249	100,0%	68	99,8%	27,2%	191	52
1.001 - 5.000	1.503	70,9%	4.617	99,7%	232	99,0%	5,0%	3.071	155
5.001 - 10.000	1.758	53,2%	12.674	93,4%	334	96,3%	2,6%*	7.209	190
10.001 - 15.000	1.116	32,6%	13.831	76,3%	875	92,5%	6,3%	12.393	784
15.001 - 20.000	849	19,5%	14.726	57,6%	1.557	82,4%	10,6%	17.348	1.834
20.001 - 30.000	542	9,5%	12.789	37,7%	1.917	64,5%	15,0%	23.577	3.535
30.001 - 100.000	249	3,1%	11.013	20,4%	2.597	42,4%	23,6%	44.159	10.413
100.001 +	18	0,2%	4.036	5,5%	1.093	12,6%	27,1%	223.022	60.396
Total	8.517		73.934		8.694		11,8%	8.681	1.021

Source: leaks to the press of the tax return data filed in 2015

BUSTED

Young talented Greeks working abroad

ICAP SA, June 2015 (1300 survey answers)

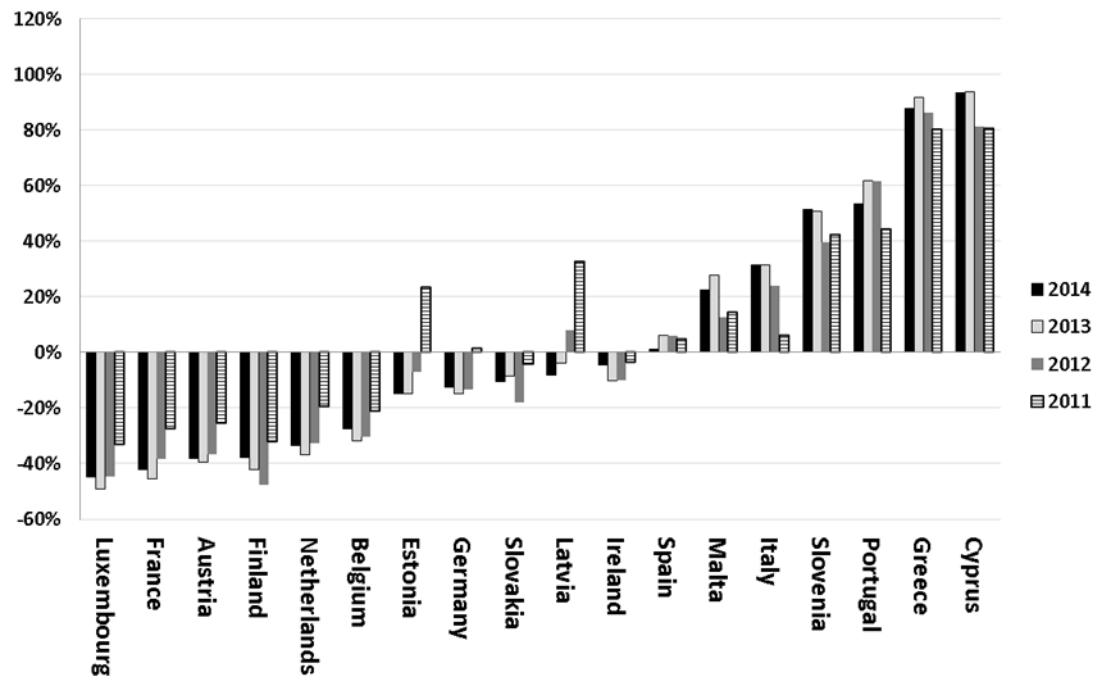
- 200.000 left during crisis
- 150.000 work abroad, rest study
- 71% unmarried
- 73% with graduate studies or PhD
- 47% had worked in Greece
- 61% work as employees
- Lack of meritocracy, corruption, crisis were key reasons to leave
- 30% plan never to return, 51% not before 3 years
- **Multiplying them with the salary that would make them return leads to over 4.6 billion euros in “direct lost income” and almost 2 billion euro / year in “lost social security contributions and personal income taxes”, without the extraordinary taxes.**

Facts:

- High taxes plus high uncertainty about their stability and implementation scares away serious companies and high talent, high income individuals that are internationally more mobile.
- But the above are the “taxman’s best customers” – they pay the lion’s share of taxes (and rightly so, as they have the highest income).
- The key is to tax them enough to earn money for social policies, but not so much as to force them out of the country.
- **A stable, reasonable and credible tax regime has to be offered, and the government and the lenders have to stick to it – otherwise this won’t fly.**

5. Financing of the private sector:
Andrew Mellon would approve, you
just revived 1929!
(but he would disapprove of overtaxation...)

Interest rates, national difference with euro area average. Loans to non-financial corporations. (This is medium, not short term!)



Source: ECB. Outstanding amounts, loans up to 1 million.

Random Effects FGLS Regression results

- **Y: Employment in manufacturing**
- **X1: Real interest rate,**
- **X2: Goods market efficiency WEF GCI,**
- **X3: Manufacturing nominal yearly compensation per employee.**

Euro area countries, 2006-13

					St/zed	Correlation
Variable	Estimate	Std. Error	t-value	P> t	Estimate	with Dep Var
-----	-----	-----	-----	-----	-----	-----
CST	0.004153	0.001511	2.749456	0.007	---	---
X1	-0.001272	0.000323	-3.932735	0.000	-0.293291	0.008600
X2	0.014383	0.002757	5.217292	0.000	0.397326	0.563276
X3	-0.001086	0.000176	-6.177334	0.000	-0.505253	-0.564267

- Goods market efficiency is a composite indicator from the World Economic Forum Global Competitiveness Index that includes both hard data and survey answers from an equally balanced strata of larger and smaller companies regarding the intensity of competition, effectiveness of anti-monopoly policy, market dominance, taxation, the business environment, FDI, tariffs, foreign ownership, buyer sophistication and other dimensions.
- Euro area countries form 2006 till 2013. AMECO, WB and ECB data.

What does this mean?

- Given the change in real interest rates & wages, broadly what was won in manufacturing employment by wage decreases was lost by the worsening of the financing terms.
- **Restoring financing terms that are viable and at least somehow compatible with a single market in financial services is key to allow wage declines and implemented structural reforms show their positive potential.**



Private sector access to finance is a secondary problem, the fiscal issue and more labor market reforms are more important



6. Political risk reduction:

A necessary condition for Greece to
recover.

What political risk does:

puts you on a self-fulfilling prophecy to exit

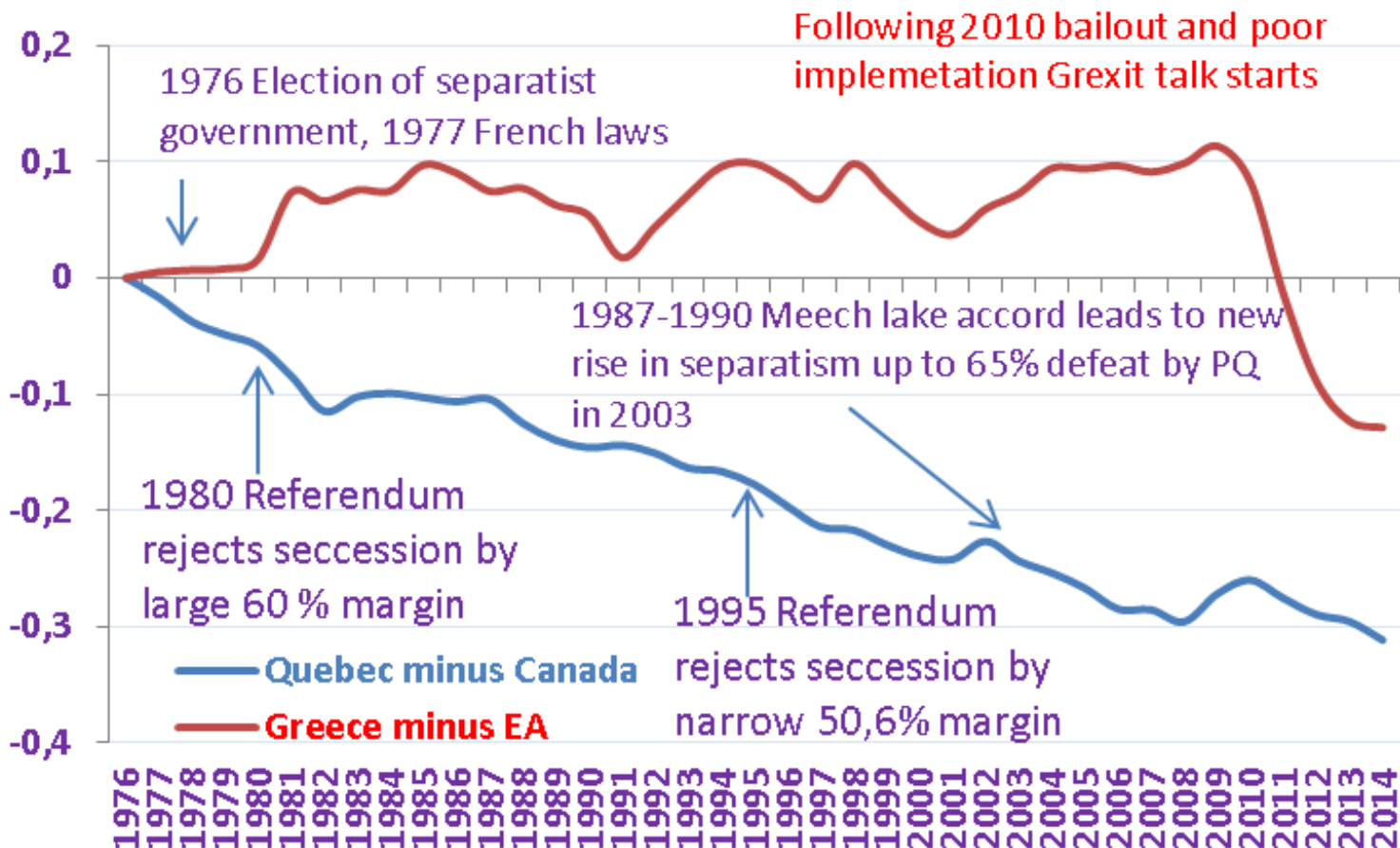
- During a weak conjectures increases investor fears.
- Leads to underinvestment.
- Leads to layoffs.
- Leads to a reduced tax base and increased social tensions.
- With the obsession on fiscal balance on the side of the lenders and the aversion to cut expenditure on the side of the Greek governments, leads to new taxes that fail to deliver.
- Leads to more before or behind doors exit talk.
- Scares away investors and amplifies divergent paths.

Europe and the crisis

- Many initiatives to increase bank supervision, resolution, supervision of public finances and macroeconomic imbalances.
- Minor steps to increase democratic legitimacy.
- **No steps to effectively increase “convergence in institutions” – very minor steps towards the “Single Market” cancelled out by financial market fragmentation and questions about the permanence of the euro & Union.**

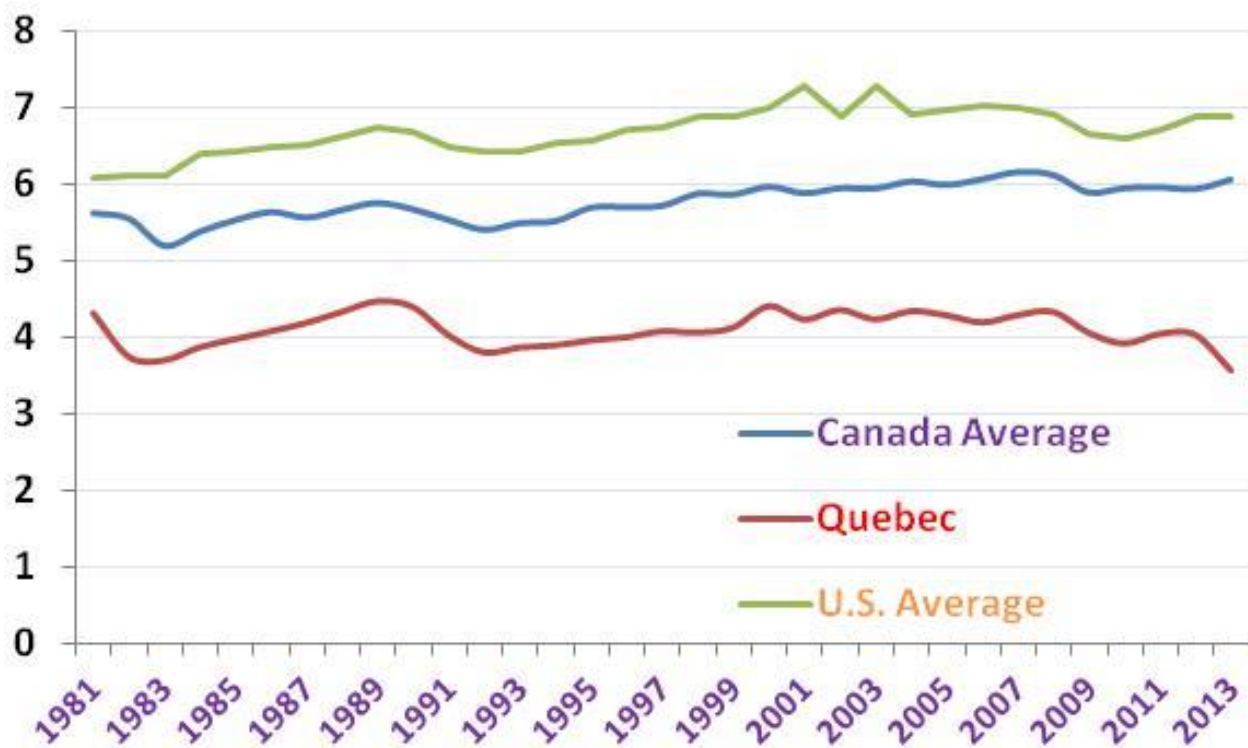
Lessons from Quebec - 1

1976 employment = 1, index deviations among areas



Lessons from Quebec - 2

Index of economic freedom for the Americas – higher means more free



Lessons Europe can learn from Quebec

- Both Greece and Quebec are tighter regulated economies (ie, lower long term growth) than their “union peer”, while the UK is visibly more liberal.
- Ideas of secession, once entrenched are difficult to deal with and cause uncertainty that is a further drag on employment.
- 1) Quebec receives high transfers (ie unemployment benefits) and 2) nobody believes a secession will turn it into a failed state.
- 1) Greece stands to have a large liquidity drain in the future (this will be a political challenge) and 2) institutionally severing it from the EU can lead to a socioeconomic implosion and political destabilization.

Suggestions for Europe

- Europe should try harder to reduce regulatory divergence among M-S so that “being an European” means similar things in basic dimensions like rule of law and the application of EU law.
- End thoughts about a euro breakup under distress – when a Greek passport or euro does not mean now and in the future the same thing as a German one, the Union exists no more.
- The way to do this is not more detailed EU law, but to make “basic” EU law more automatically and evenly enforceable and more permanent at the national level.

How to complete Europe

1. Europe means fiscal numbers – a member that stumbles is placed on the politico-economic path of a self-fulfilling prophecy towards exit. *How to deepen a union that endures only as long as fiscal performance is willingly coordinated by countries that are differently integrated and apply to very different degrees basic EU law?*
2. Europe means common basic principles – if Europe works basically as an anchor for the minimum quality of national institutions and market regulations and ensures a relatively homogenous application of basic EU law there will be no reason to leave under distress for fiscal reasons.



Advancing mainly the Financial and Fiscal Union is enough

