

LSE Hellenic Observatory
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COMMENTS ON:
“WHO’S TO BLAME FOR GREECE”,
T. PELAGIDIS & M. MITSOPOULOS

DIMITRI VAYANOS

LSE, CEPR & NBER

Book Summary



- Why Greece's adjustment programme has failed?
- Book has three main parts:
 - ▣ **Part 1:** Policy thinking in Greece prior to Euro adoption. Comparison with adjustment efforts in 1990-1993.
 - ▣ **Part 2:** Review of policy actions undertaken during adjustment programme in 2010-2014.
 - ▣ **Part 3:** Why internal devaluation failed to kick-start export-led growth.
- Insightful analysis and lots of useful information.

Greece's Economic Decline



- Greece's GDP per capita has dropped from 13th in the EU28 in 1985 to 19th in 2015.
 - ▣ Greece has been overtaken by the Czech Republic, Estonia, Ireland, Malta, Slovakia, Spain.
- At least as worrisome is that Greece ranks poorly on determinants of long-run growth such as institutional quality and innovation/R&D.

Rankings

Criterion	Rank (year)
Ease of doing business (World Bank)	26 th within EU28 (2015)
Product market regulation (OECD)	31 st within OECD34 (2013)
Efficiency of courts (World Bank)	27 th within EU28 (2015)
% of population having completed secondary education (OECD)	24 th within OECD31 (2007)
PISA tests for 15-year olds	24 th in reading, 27 th in mathematics and science within OECD31 (2007)
R&D expenditure as % of GDP	29 th within OECD31 (2007)

- Significant improvements are needed on the above dimensions to avoid further declines in GDP rankings.

Greece's Economic Fundamentals Before the Crisis

	ES	GR	IT	PT
Decline in real GDP per capita 2007-2014	10.0	26.3	12.0	7.9
Net exports 2007 (% of GDP)	-6.0	-12.4	-0.4	-7.6
Net indebtedness to foreigners to GDP 2007 (% of GDP)	-82.3	-99.9	-28.5	-94.5
Gross government savings 2007 (% of GDP)	6.8	-4.1	2.1	-0.6
Government debt 2007 (% of GDP)	35.5	103.1	99.7	68.4
Loans of domestic banks to domestic firms and households 2007 (% of GDP)	162.8	92.4	90.3	138.2

- Greece's fundamentals were worse than those of the other countries.
 - ▣ Designing an adjustment programme was a big challenge.
 - ▣ A drop in GDP smaller than 15% would have been unlikely.
- Yet, a 26.3% decline was overly large.

Adjustment Program: Shortcomings

- Internal devaluation led to overly large decline in GDP.
- Tax rises vs. expenditure cuts.
- Fiscal adjustment vs. structural reforms.
- Domestic ownership.

But, some successes as well:

- Adjustment did happen: Trade deficit and government deficit were almost eliminated by 2014.
- Greece remained in the Eurozone.
- Some structural reforms took place.
- Banking system was recapitalized successfully.

Internal Devaluation

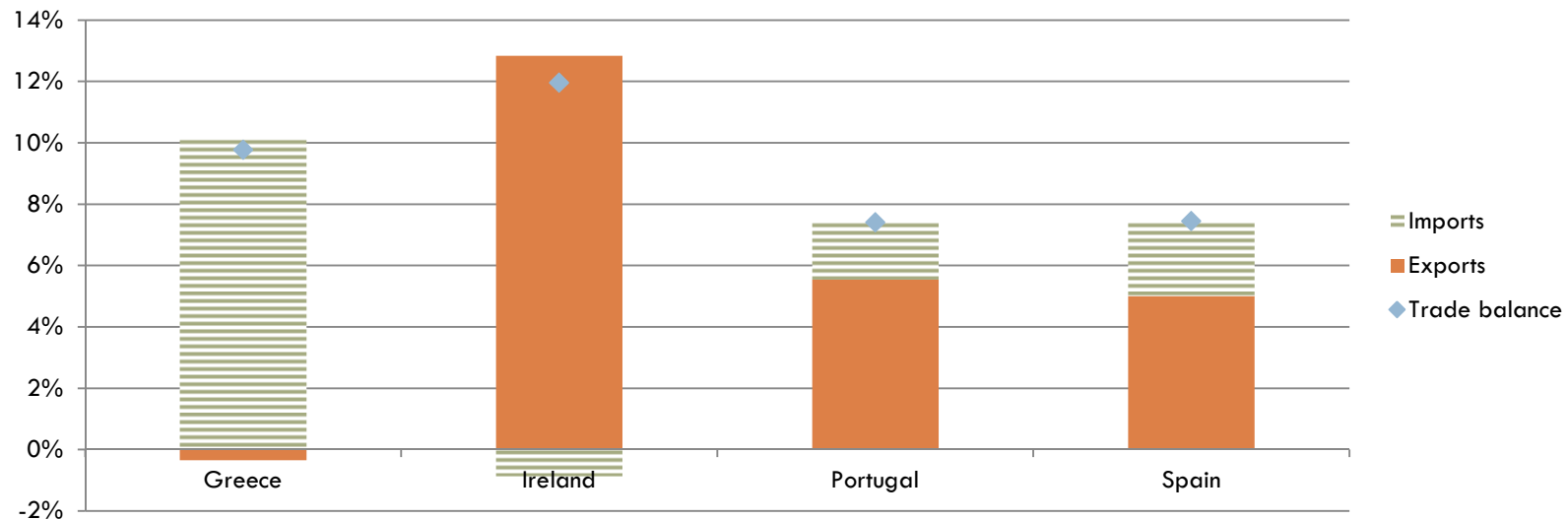
- Greece had to adjust to a zero trade deficit.
- Wages and prices had to fall.
 - ▣ Drop in prices makes exports more competitive and imports less competitive.
 - ▣ Drop in wages reduces domestic demand, including for imports.
 - ▣ Mathematically:
$$\begin{array}{c} \text{Exports (p)} = \text{Imports (p , w)} \\ + \qquad \qquad - \quad - \end{array}$$
- Troika opted for policies that reduce domestic wages (internal devaluation).
 - ▣ Emphasis on labour market deregulation.

Outcomes

	ES	GR	IE	PT
% decline in wages between 2007-2012	-7	13	1	7
% decline in prices between 2007-2012	2	-2	11	4

- Wages declined sharply, but prices did not move (they slightly increased).
- Internal devaluation worked exclusively through domestic demand.

Exports and Imports



Source: C. Arkolakis, A. Doxiadis, M. Galenianos, (2016), "The Challenge of Trade Adjustment in Greece," in C. Meghir, C. Pissarides, D. Vayanos, and N. Vettas (eds.), *Crisis in the Eurozone: Policy Options for Greece*, MIT Press, forthcoming.

- Trade deficit was closed almost entirely through reduction in imports.
 - ▣ In absolute terms, not as % of GDP.

What Should Have Done Differently?



- Product-market reforms should have been given greater emphasis early on in the program.
- Investment was hampered by lack of access to finance and uncertainty about Euro exit.
- Corporate tax burdens, including labor tax, should have been made lower—not higher.
- Book has an insightful analysis of these issues.

Ownership



- Lack of domestic ownership was a key problem.
 - ▣ None of the big political parties sought to explain to voters why adjustment was necessary and reforms would be beneficial.
 - ▣ ➔ Lack of ambition in the design of the reforms.
 - Most ambitious reforms were those not required in the memorandum, e.g., Law 4009/2011 (“Diamantopoulou Law”) on higher education.
 - ▣ ➔ Inadequate implementation of the reforms.
- Lack of ownership was exacerbated by the perception that program was missing its targets.
 - ▣ Overly ambitious targets and design shortcomings.

Summary



- Adjustment program had successes and failures.
- Failures concerned both the program's design (Troika) and its implementation (Greek government).
- Book provides an insightful analysis into these issues and lots of useful data.
- Next book: Dig more into political-economy aspects.
 - ▣ How to design and sequence reforms so that there is enough domestic support and ownership?

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