

THE GREEK CRISIS: WHO IS FAILING WHOM?

Kevin Featherstone
Hellenic Observatory, LSE



Greece & the biggest crisis in history of the 'euro' currency:

- ▣ A *single currency* for the European Union was agreed in the Maastricht Treaty in 1991; people started using the euro from 1 January 2002. A novel *experiment* in modern international relations: marked by uncertainty & risks.
- ▣ My argument: the sovereign debt crisis of 2010 exposes *design flaws* in how 'euro' was set-up & its not clear that the lessons are being learnt. Also exposes '*Greek realities*'.

Explaining the Greek crisis:

- ▣ Why Greece *failed*: domestic explanations about the weakness of the Greek economy & the Greek State.
- ▣ Why the €-system *failed*: external explanations about limits of governance & imbalances within €-zone.
- ▣ *Lessons* about: Germany; ECB; credit rating agencies; making domestic adjustment feasible.



Domestic structural account (1)

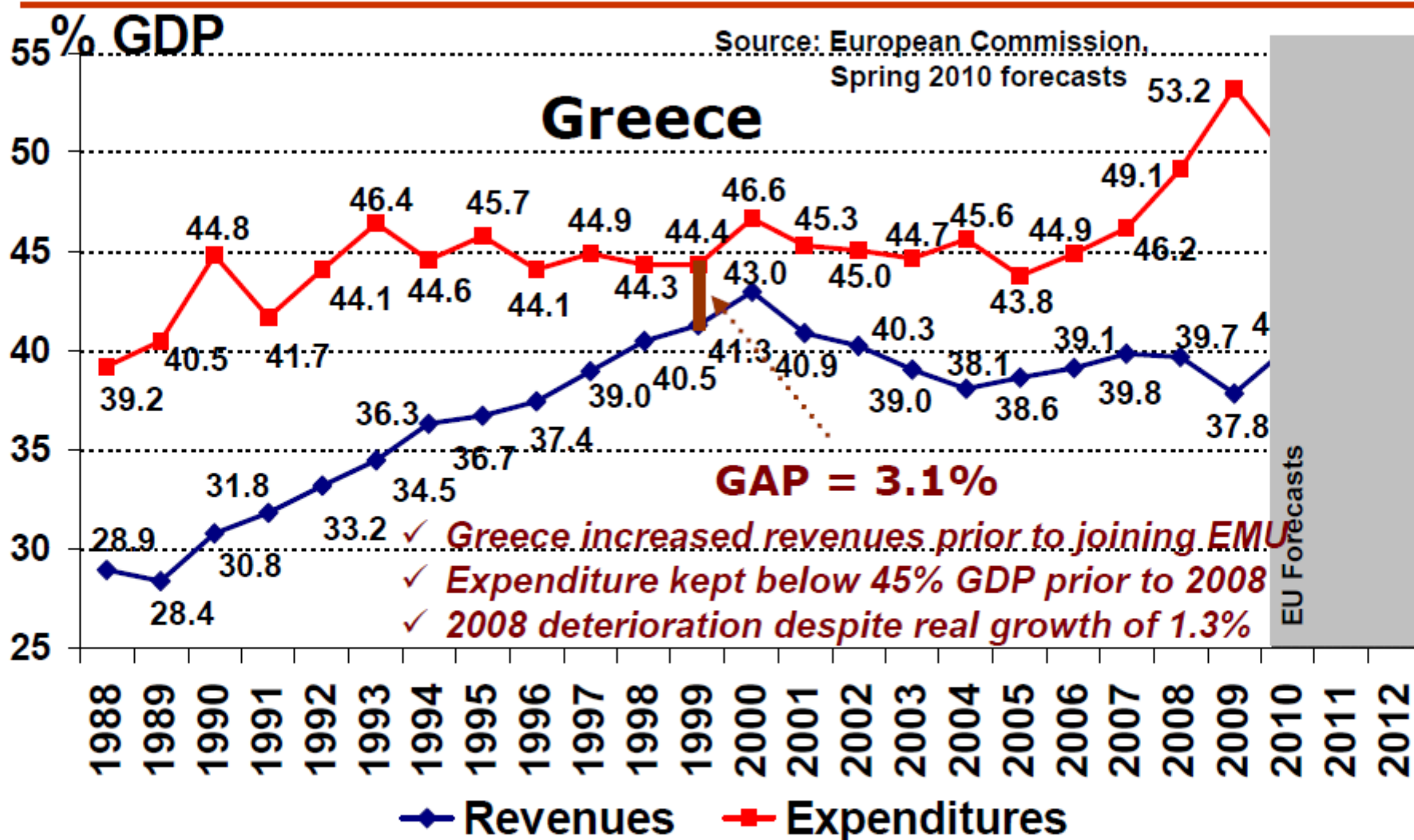
A vulnerable economy in a more turbulent int'l system:

- Low competitiveness.
- Government deficit tripled. Market alarm
- Markets waited, then credit rating agency downgrades. Maturing debt in May 2010.

III. Almost always in fiscal trouble, but fiscal mess grew prior to the onset of the 2009 recession



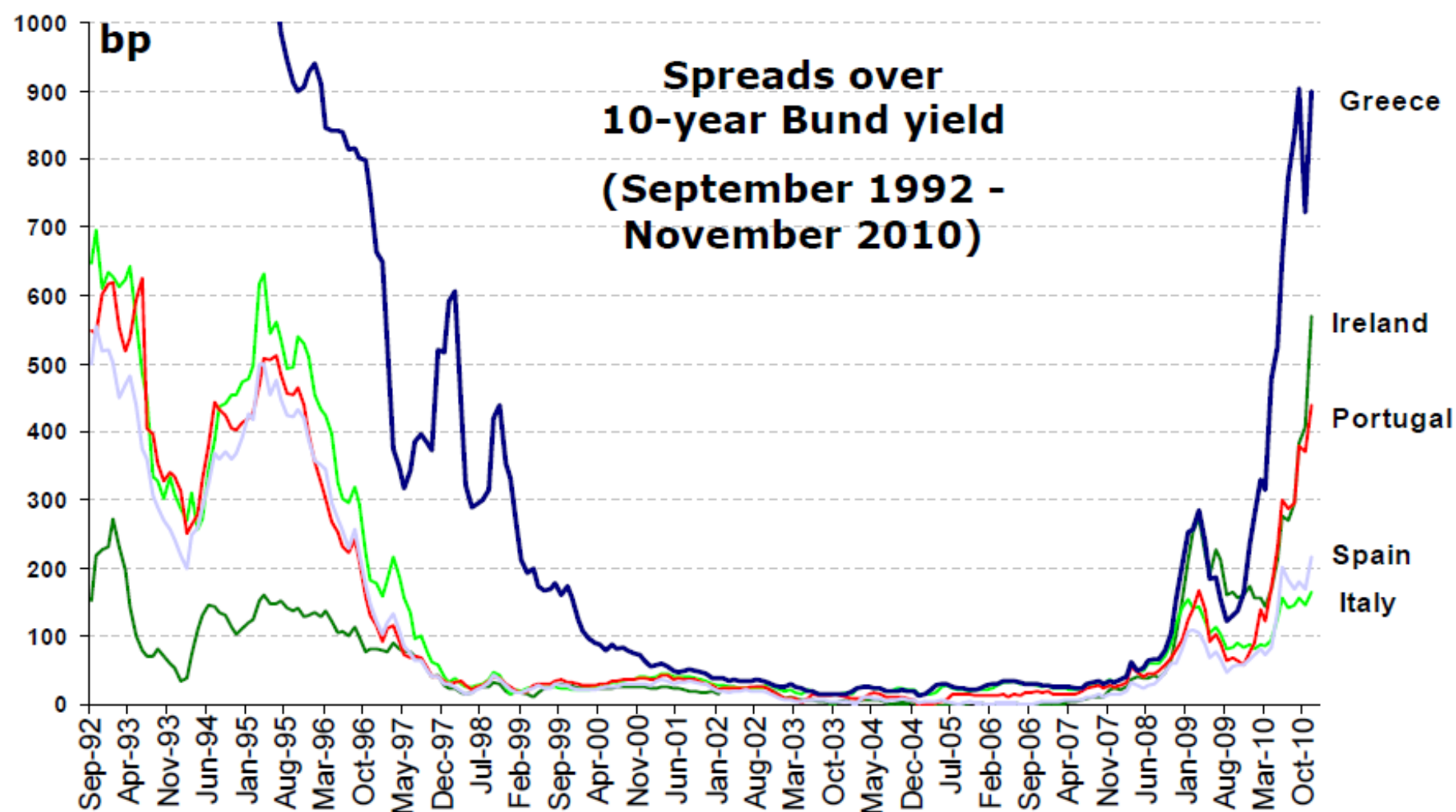
Eurobank EFG



- ✓ 1999 is examination period for entering EMU: Deficit erroneously revised to 3.1% of GDP, with ex-post switch in military expenditure accounting



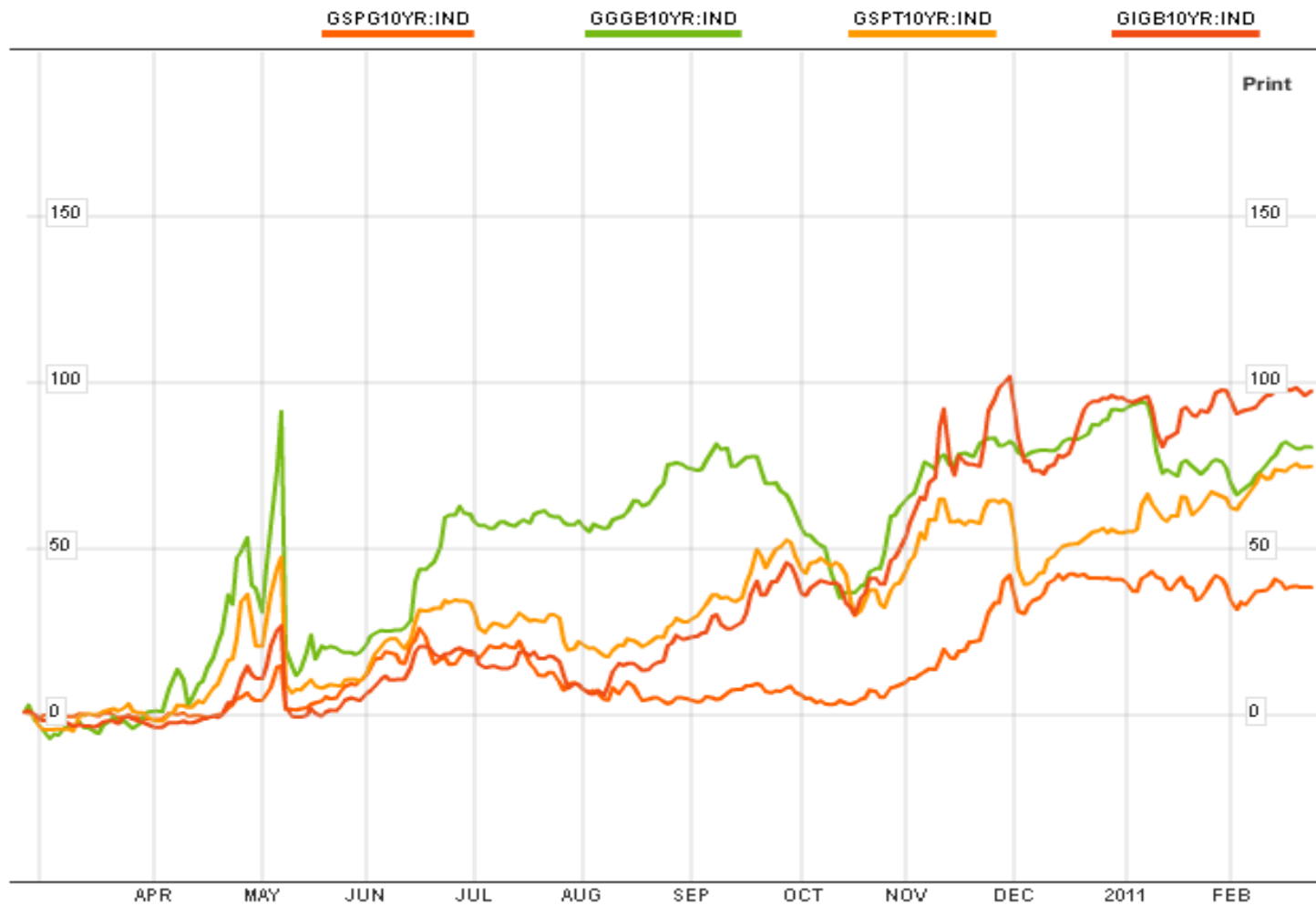
II. The evolution of the 10-year Bond Spreads



Note: Monthly Averages; Annualized yields to maturity on fixed coupon bonds.
Eurostat estimates whenever monthly 10-yr yields were not available.

Source: Eurostat

**Graph – 1 10 Yr Govt Bond Spreads with Germany: Greece, Portugal, Spain, Ireland
(April 2010-February 2011)**

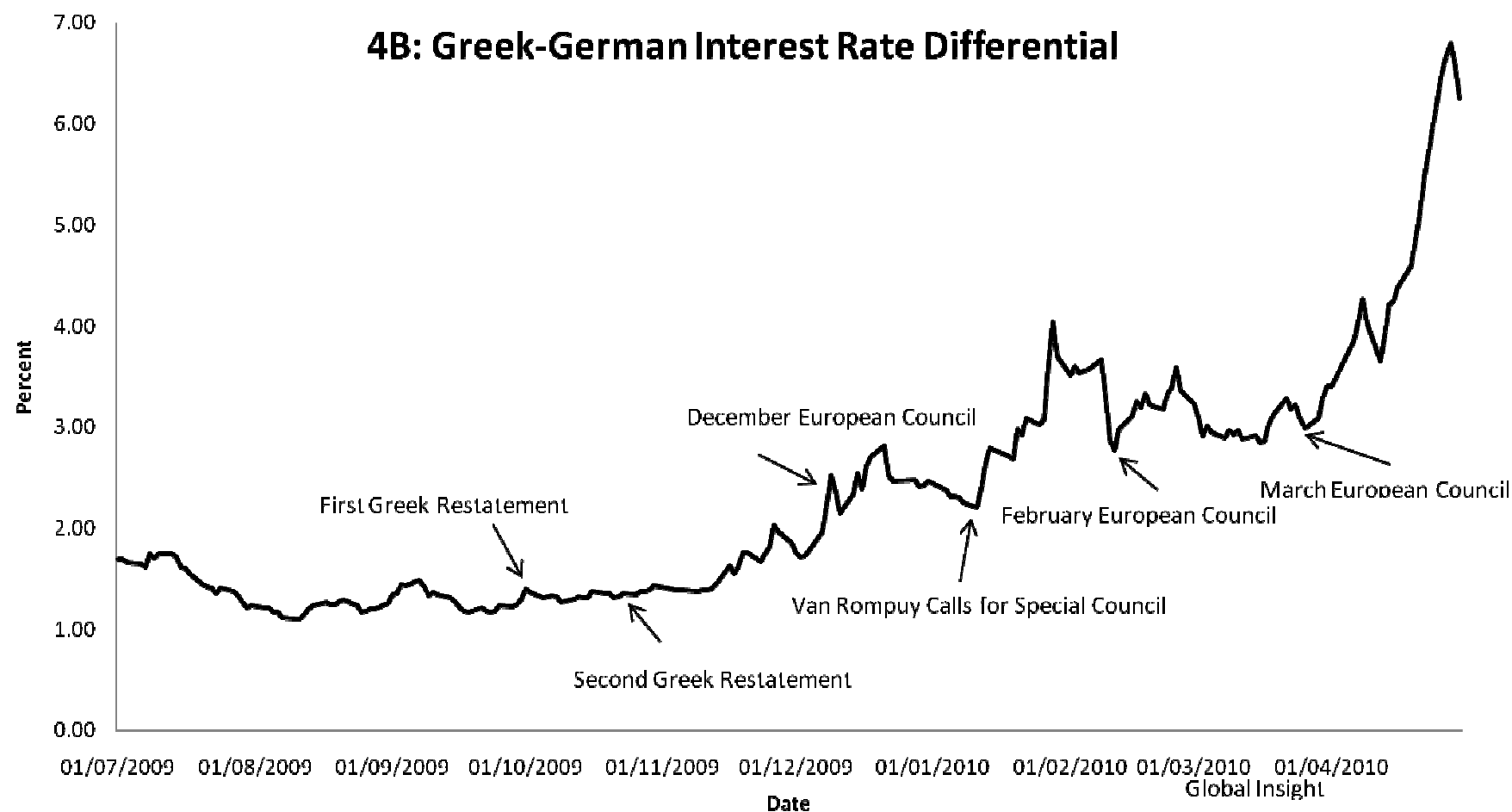


Spain: GSPG10YR:IND
 Portugal: GSPT10YR:IND
 Greece: GGGB10YR:IND
 Ireland: GIGB10YR:IND

Source: Bloomberg

Market anxieties rise with EU delays...

[Source: E. Jones, EUSA paper 2010]



'External' structural accounts (I)

1. Problems of €-zone governance:
 - ▣ Absence of '*un gouvernement économique*'.
[cf. EMU of 1970s]
 - ▣ *Ordo-liberal* influence.
 - ▣ Inadequate €-zone level *crisis management* capacity.



Lesson 1: a different Germany.



- ▣ Domestic constraints
- ▣ Acted consistent with 'ordo-liberalism'.
 - 'a deep-seated mistrust that began with the Greeks and ranged through Italy, Spain, and Belgium to include France' p372
 - 'The fundamental point remained that the German model failed to offer an adequate basis for a sustainable EMU', a 'new sense of solidarity that would support 'burden-sharing' within EMU' was likely to prove elusive, as 'EMU's Achilles' heel was the prospect of people being asked to make sacrifices for others with whom there was a weak sense of identity' (Dyson and Featherstone, 1999: 796).



Lesson 2: EMU governance less predictable

- ▣ Maastricht rules on discipline & penalties: unenforceable (Buiter *et al*, 1993: 58, 90)
- ▣ There was a bail-out (€110b); & later, EFSF of €750b.
- ▣ Fears of ECB independence contradicted by politicisation, monetisation of deficits.
- ▣ Abrupt termination of ECB help (revert to high standards of accepting collateral) exacerbated Greek crisis.

External 2. €-zone imbalances

- ▣ Demand imbalances: Germany (with high domestic savings & high exports) exporting credit dependence to (importing) periphery (Tsakalotos).
- ▣ Periphery cannot live with €-zone core: one size does not fit all.
- ▣ Greece in 2009 not unique: deficit lower than Ireland, approx. to UK, US.
 - But difference was high public debt.

Lesson 3: Credit Rating Agencies – reform?

- ▣ New IPE of *credit rating agencies*; oligopoly of Moody's; S&P; Fitch.
- ▣ 'governance without government' (Sinclair, 1994), power over sovereign states.
- ▣ Poor forecasting, pro-cyclical.
- ▣ Fitch's downgrade (8.12.09) & S&P's 'junk' status (27.4.10) deepened Greece's crisis.

Domestic structural account (2):

Problem of Low Reform Capacity:

- *Bertelsmann Stiftung index.*

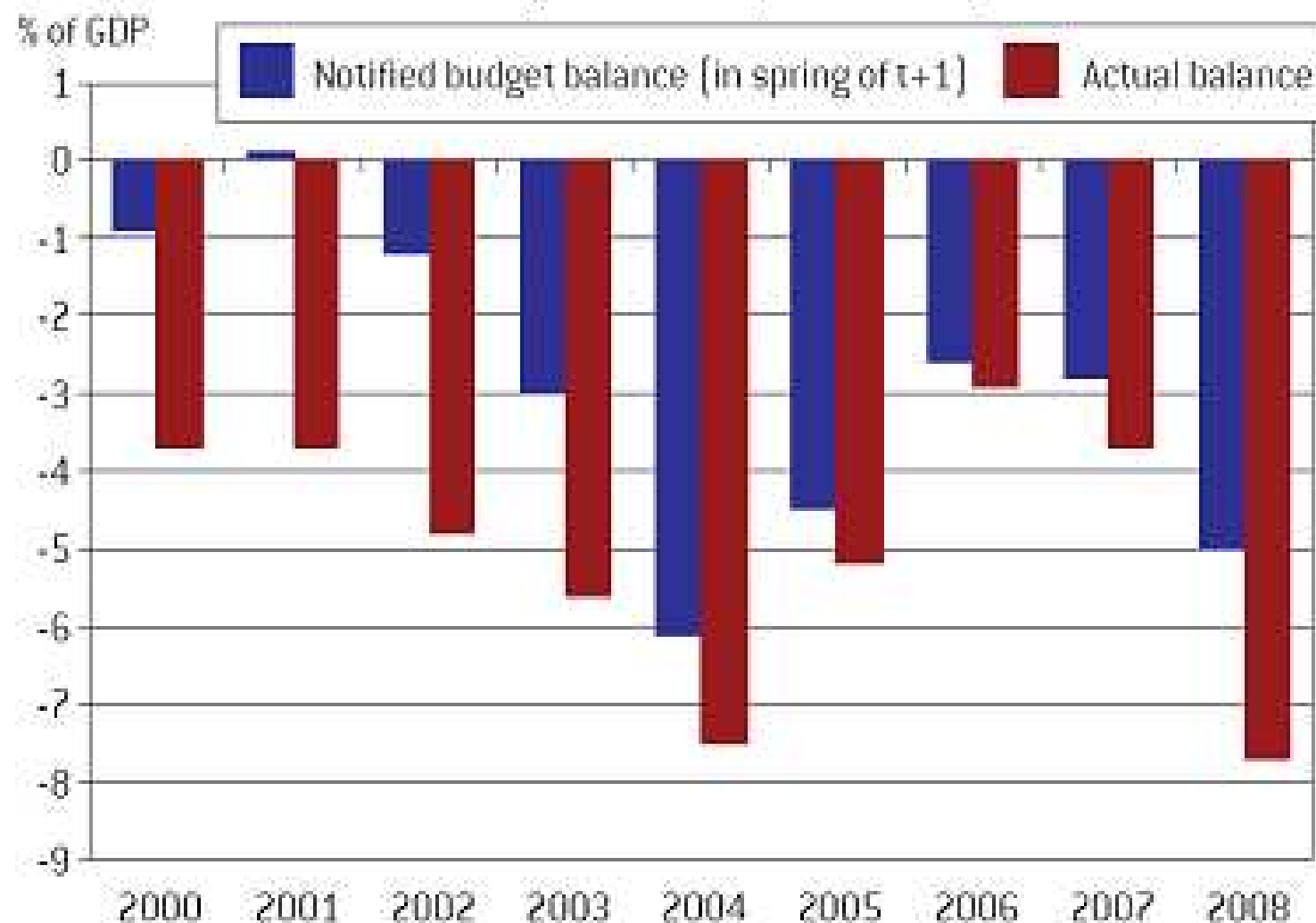
▣ *Political Economy:*

- 'Disjointed corporatism' (Lavdas) creates *immobilisme*
- 'Mixed Market Economy' (M Rhodes): not sustain social pacts.
- Extensive, but weak state: [cultural] rent-seeking.
- History of reform via external constraints.
- Poor budget management.

The true Greek fiscal position was worse than reported



Greece: notified vs. actual budget balances, % of GDP, 2000 – 2008



Source: Bruegel Policy Brief, March 2010.



Greece v. the markets

Finance Minister to Parliament, 5.5.10:

“In less than two weeks, a 9 billion-euro bond comes due and the state coffers don’t have this money...As we speak today the country can’t borrow it from foreign markets and the only way to avoid bankruptcy and a halt on payments is to get this money from our European partners and the IMF.”

Dual signal: domestic & to €-partners.

Greece under EU 'tutelage':

- ▣ Unprecedented *monitoring* & tough conditionality
- ▣ France & Germany: bailout Greece or bailout your banks.
- ▣ Bailout agreed – after delay – with tough conditions.

f1

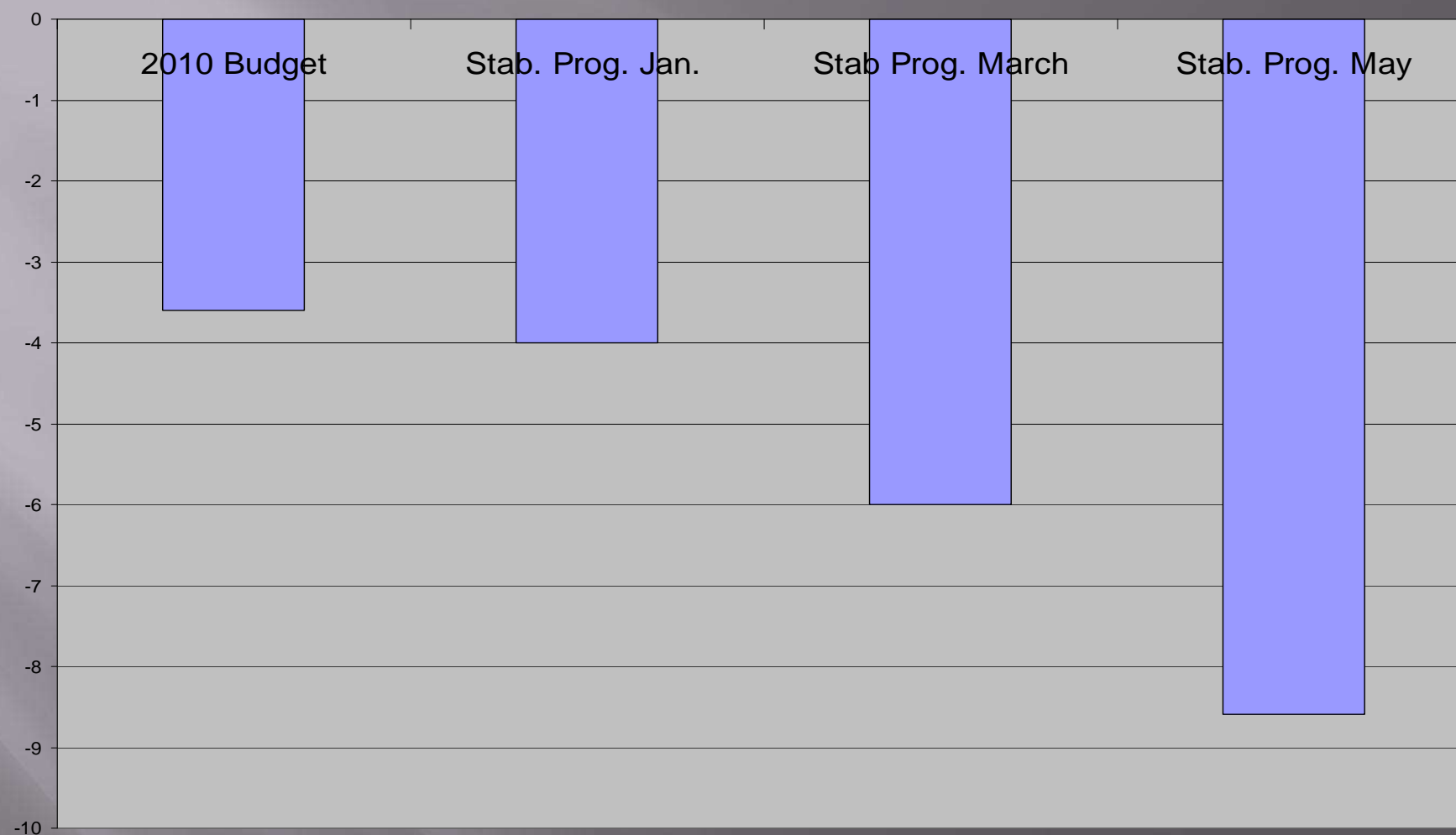
Slide 17

f1

Greek economy represents just 2.7% of €-zone GDP, 2.0% of EU GDP. But fear of contagion to rest of 'PIGS'.

featherk, 29/05/2010

Deeper & deeper budget cuts (%GDP)



Notes:

Source: Ministry of Finance, www.mnec.gr.



Lesson 4: making domestic adjustment feasible

- ▣ Domestic empowerment from 'Memorandum'
- ▣ Troika's domestic interventions.
- ▣ EU support: after 2013?
 - EFSF to be replaced by European Stability Mechanism after June 2013.
 - 'Economic Governance'.
 - € bonds?
 - Competitiveness Pact? Constitutional limits on debt?

Conclusions

- ▣ €-zone/EU stimuli to domestic adjustment: less effective than we thought.
- ▣ €-zone more prone to crisis: inadequate rules.
 - 2 sets of (separate) literatures: EMU imbalance + Greek state *immobilisme* = crisis predictable.
- ▣ Current € reform path largely within paradigm: doubts for future crisis management.
- ▣ Actions so far have not been fully convincing, so questions remain: can Greece avoid default? Can €-zone allow it to happen?

II. Current S&P country ratings

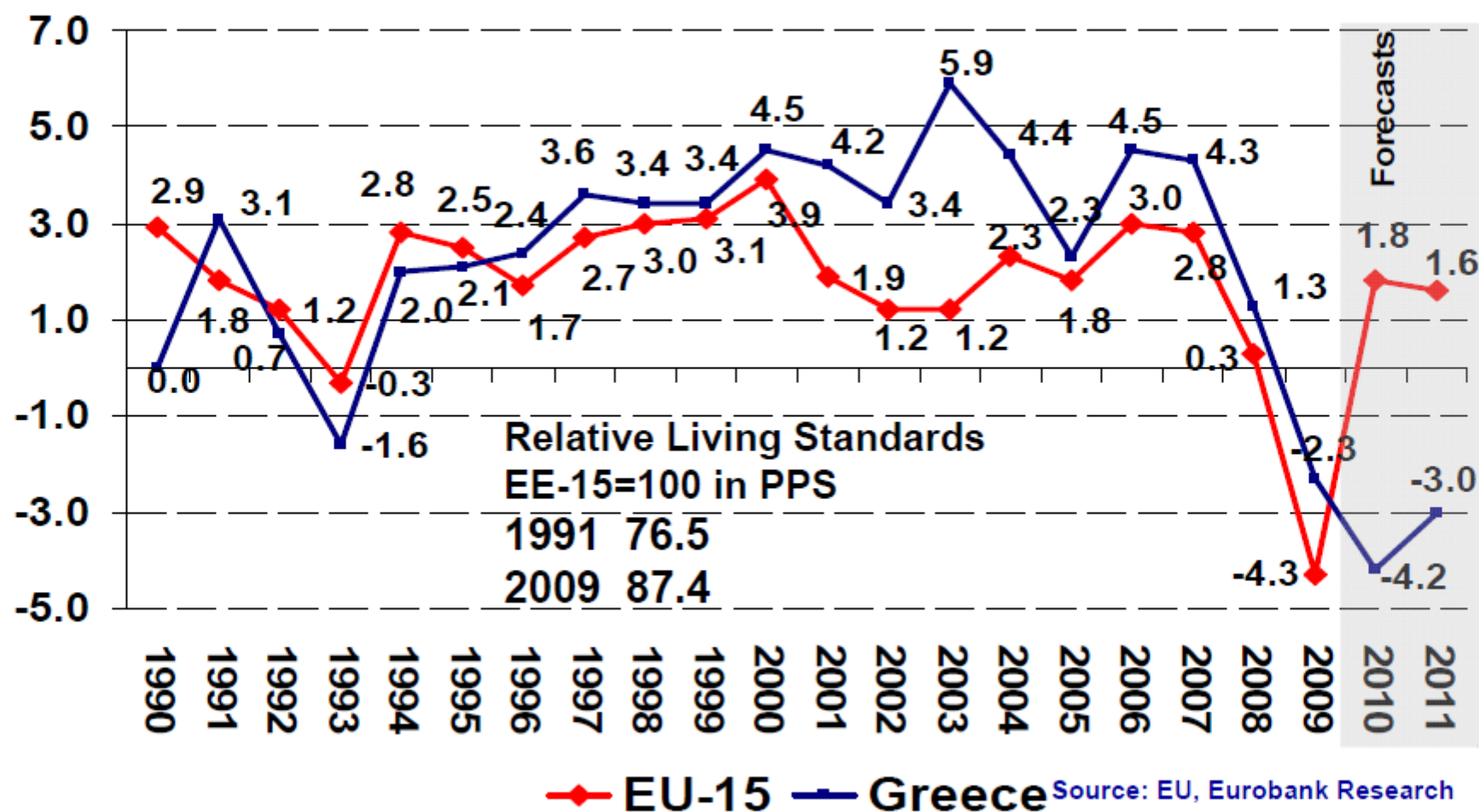
EU-27 Long Term Credit Rating

(S&P Ratings, January 10, 2011)

AAA	LU	NL	SE	UK	AT	DK	FI	FR	DE
AA+	BE								
AA	SI	ES (A+)							
AA-									
A+		SK	IT						
A	CZ	EE	MT	IE (AA)	CY (A+)				
A-	PL	PT (A+)							
BBB+									
BBB	BG	LT							
BBB-	HU								
BB+	RO	EL (A-)		LV (BB) ↑					Junk status
BB									
BB-									

Note: In parentheses, different older Ratings as of October 31, 2009

III. Real growth rates in Greece were higher than in EU-15 from 1996 through 2009



Greece: From boom to bust & market worries, How come?
Answer: Not an equilibrium growth