



Greece in crisis:

A personal account of the economic, political and social turmoil in Greece



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Roadmap for this talk

- A (brief) look at Greek history.
- How did Greece get in this mess?
 - Proximate causes: Macroeconomic facts and figures.
 - Ultimate causes: what's wrong with Greece?
 - Deeper roots of the Greek problem.
- Greek problems and euro crises.
- Crisis management: First, do no harm!
- Where do we go from here? Thoughts and hopes.

A primer in modern Greek history

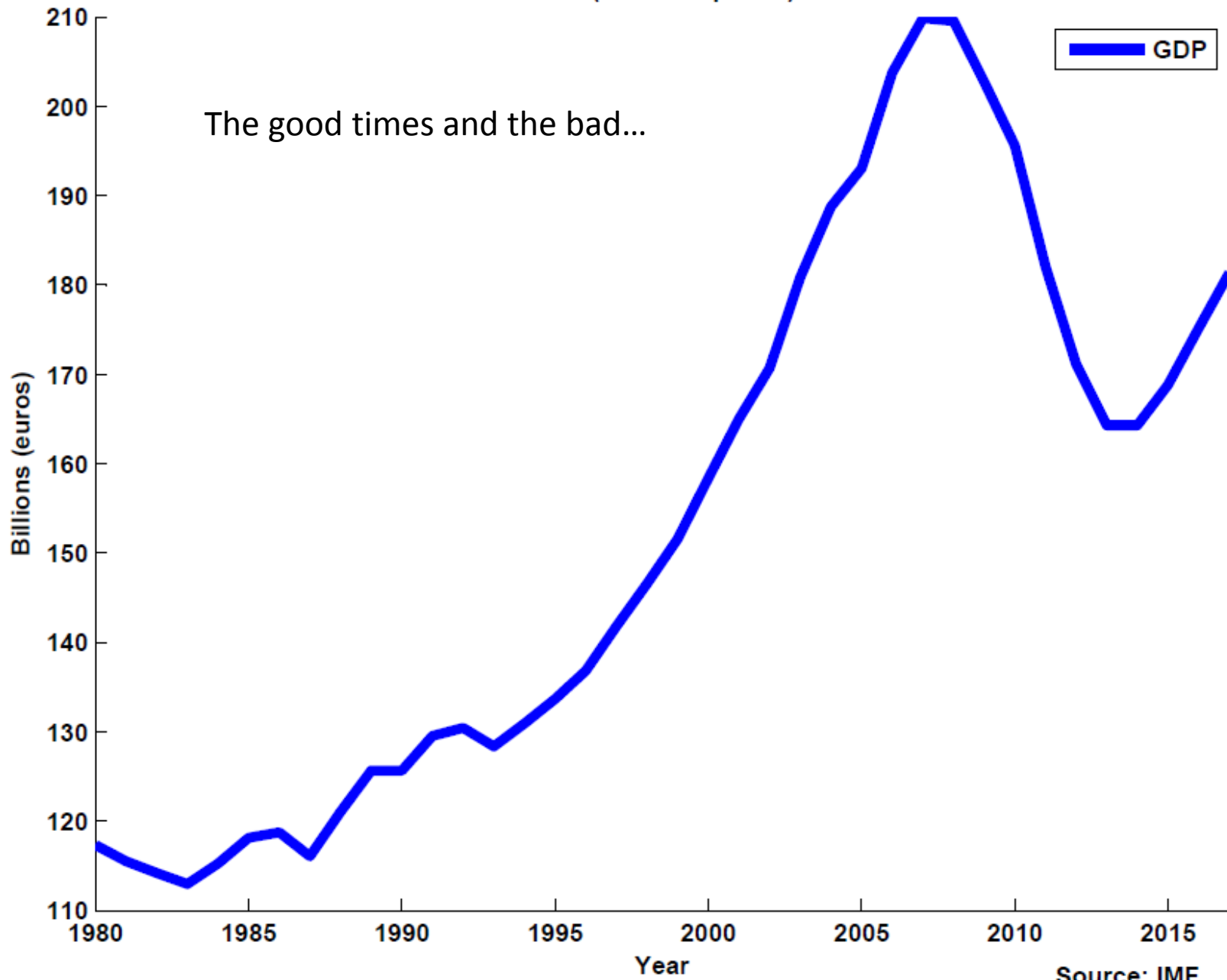
- Greek war of Independence in 1820s-30s.
- First Governor of Greece, Ioannis Capodistrias, was assassinated.
- Greece was recognised as an independent state in 1832, and given a Bavarian king (King Otto was kicked out 30 years later and replaced by a Danish king, whose descendants were also kicked out in the 1970s after a referendum).
- Exchange of population in 1922-1923
 - institutionalised ethnic cleansing
 - forced displacement sponsored by the League of Nations
 - 1m Greeks came from Anatolia, 3-4 thousand muslims went to Turkey
- Civil war in the 1940s, right after WWII
- Greek economic miracle of the 1950s
- 1967 military coup, dictatorship
- 1974 third wave of democratisation (Greece, Spain, Latin America)
- Joined the EEC in 1981, and adopted the euro in 2001.

So how did we get in the current mess?

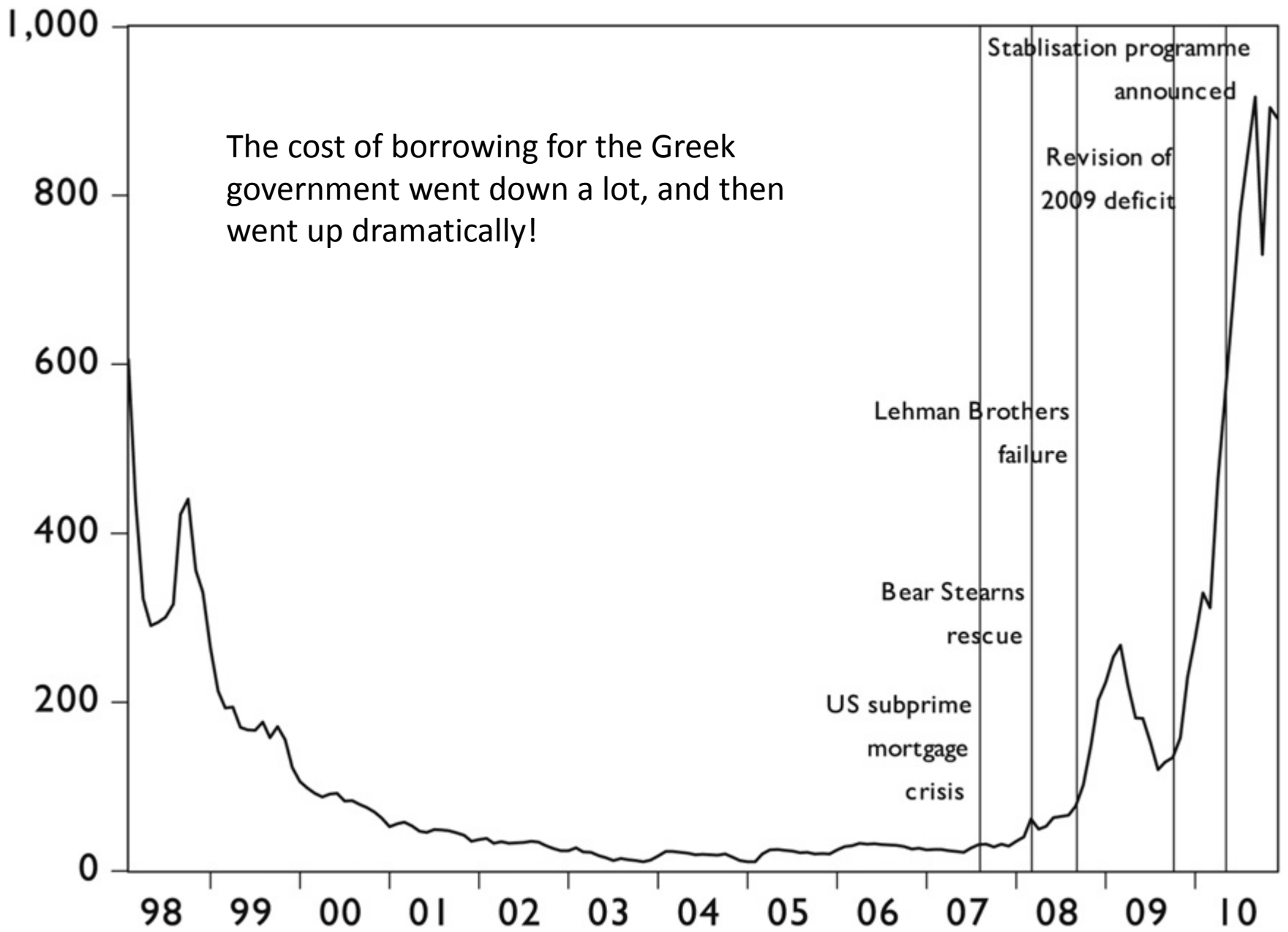
The good years: 1981 to 2007

- Euro entry in 2001 made borrowing much cheaper for the Greek government.
- At the same time, currency devaluations were no longer possible in order to restore competitiveness.
- Growing fiscal and current-account deficits since euro entry in 2001, aka “the twin deficit”.
- Pro-cyclical fiscal policy: we were running a deficit in the good times!
- At the same time, competitiveness dropped sharply, by 20-25%, because wages and prices increased faster than the EU average.
- These imbalances were understated by official fiscal data in real time, only to be updated later.

GDP (constant prices)

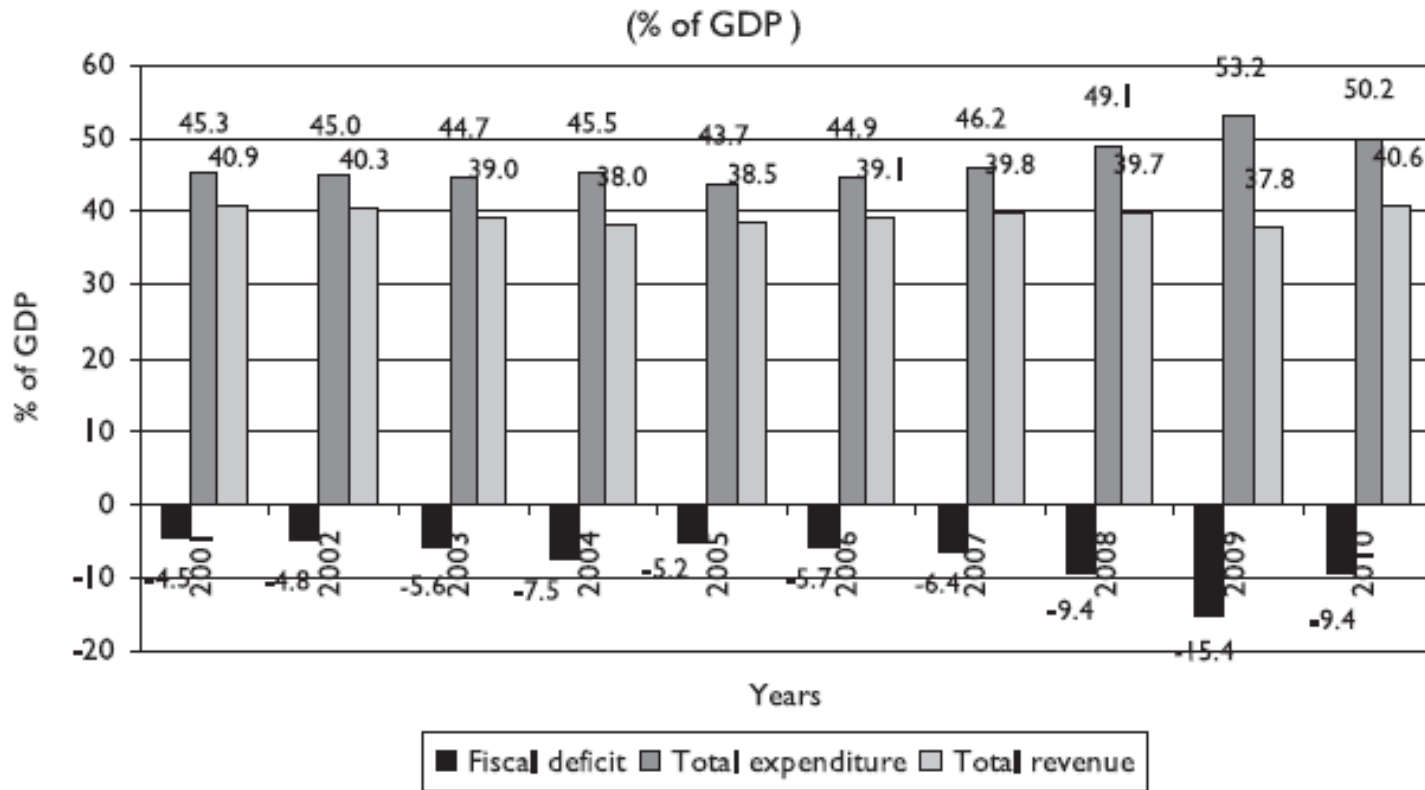


Source: IMF



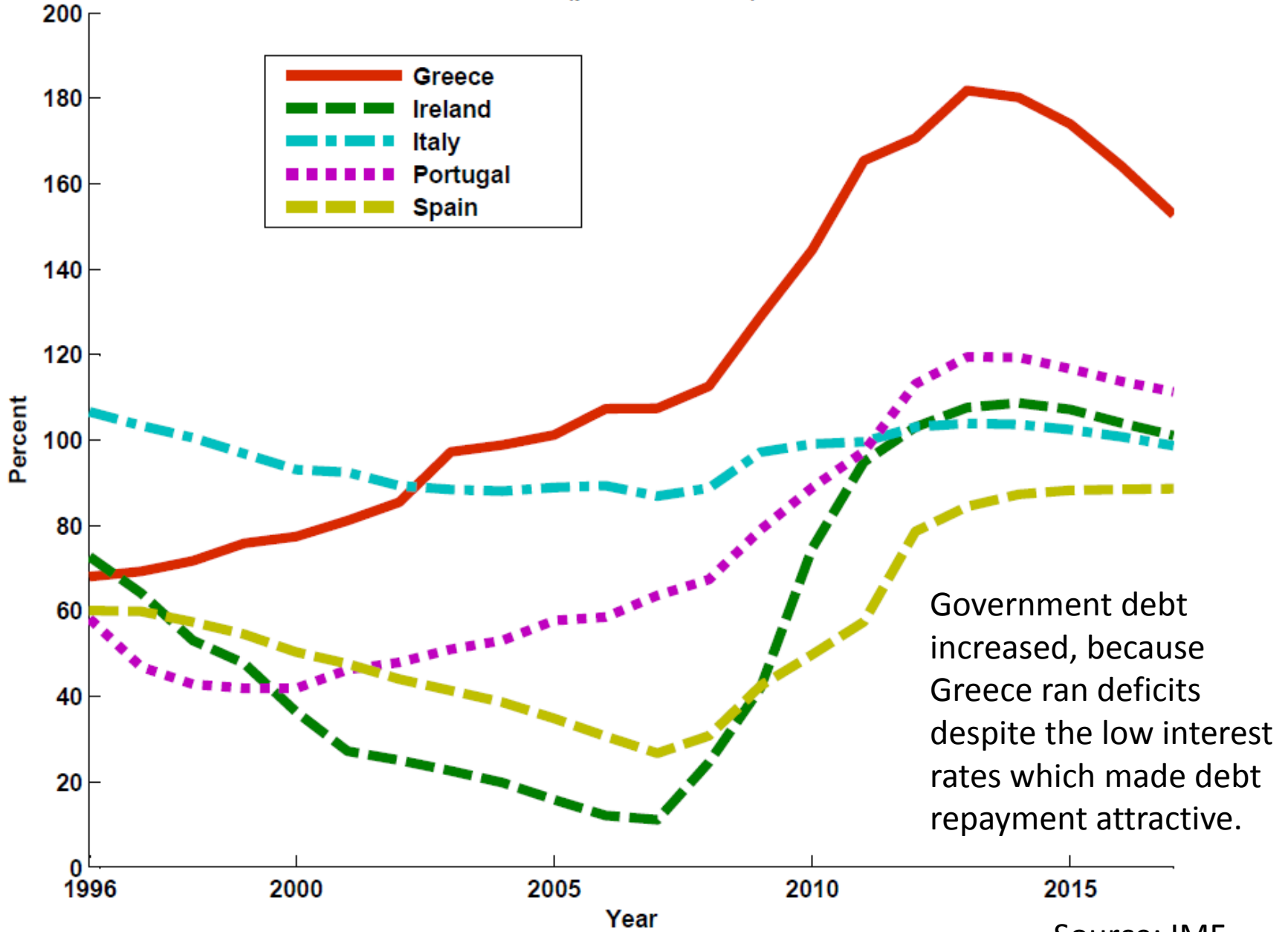
Greek Spreads: yields on Greek over German 10-year benchmark bonds
[Figure 1 in Gibson et al. (2012)]

Fiscal deficit, total expenditure and total revenue as % of GDP [source: Fig. 2 in Gibson et al. (2012)]



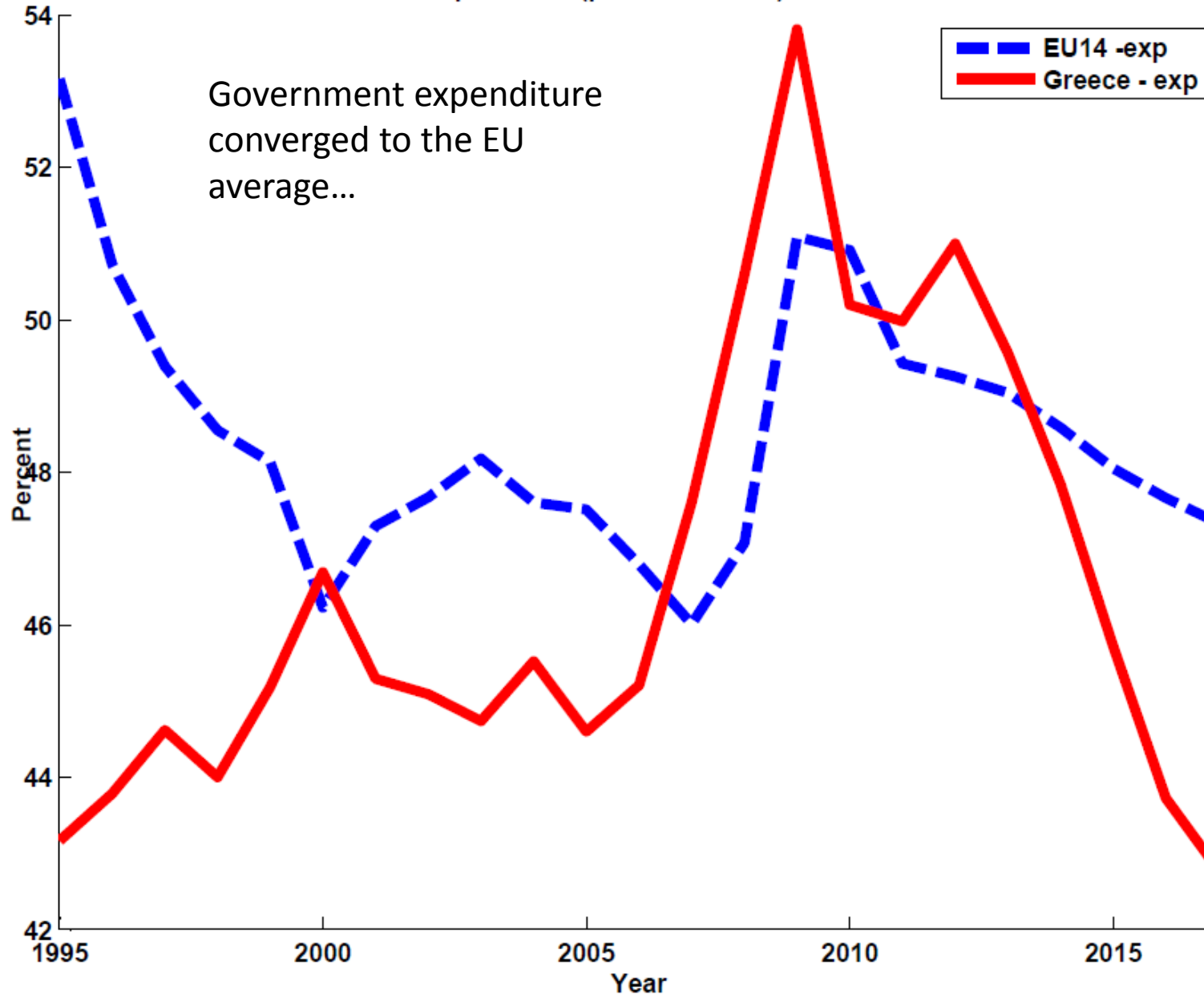
Notice that GDP was growing until 2008, but the deficit was growing too!

Debt (percent of GDP)

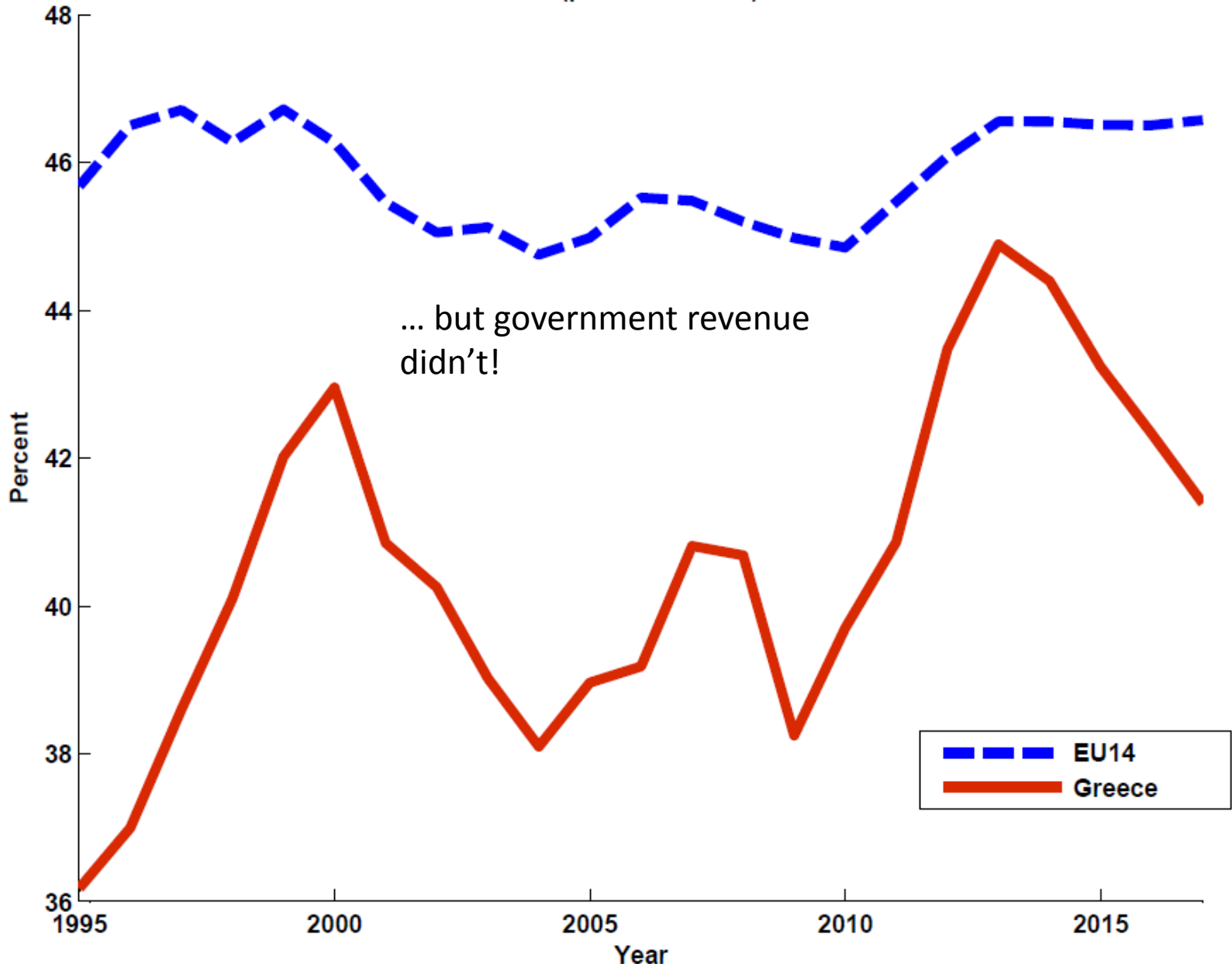


Government debt increased, because Greece ran deficits despite the low interest rates which made debt repayment attractive.

Government expenditure (percent of GDP): Greece and EU14

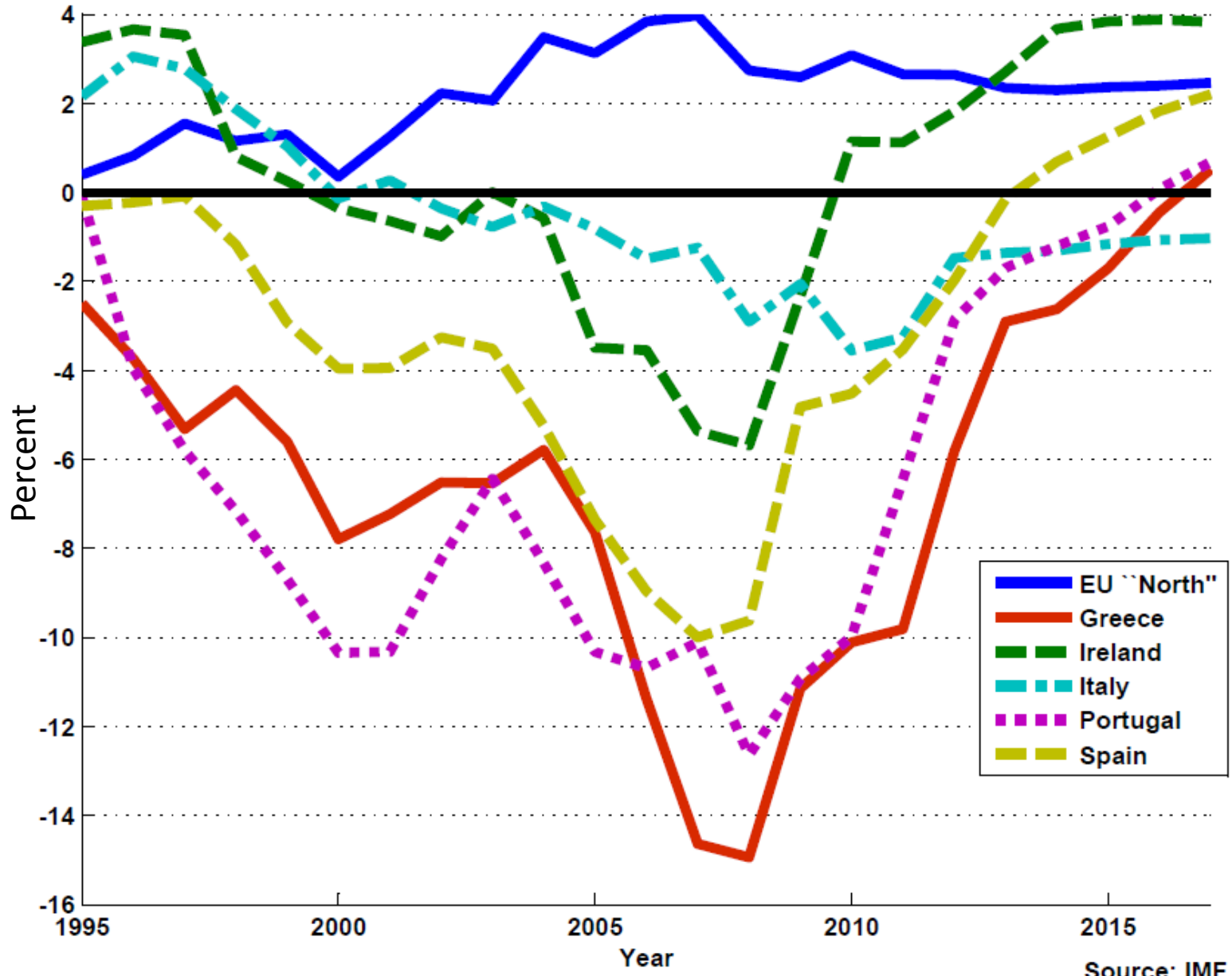


Government revenue (percent of GDP): Greece and EU14



Source: IMF

Current account (percent of GDP): Greece vs EU countries



Source: IMF

2007-2009: Things turn sour

- Global financial crisis erupted in 2007, starting with the US subprime mortgage crisis.
- Initially no effect on Greek spreads, but...
- In autumn 2009 the newly appointed Finance minister announced that fiscal deficit that year would be double than that projected by the previous government (from 6% to 12% of GDP).
- Partly due to different accounting, this number later rose even further, making people in Brussels talk about “Greek Statistics” (15.4% of GDP).
- At around the same time, Dubai World asked for 6-month debt moratorium, leading to increased risk aversion in credit markets.
- Greek full-blown crisis erupted in late 2009, credit markets effectively becoming unavailable for the Greek government.

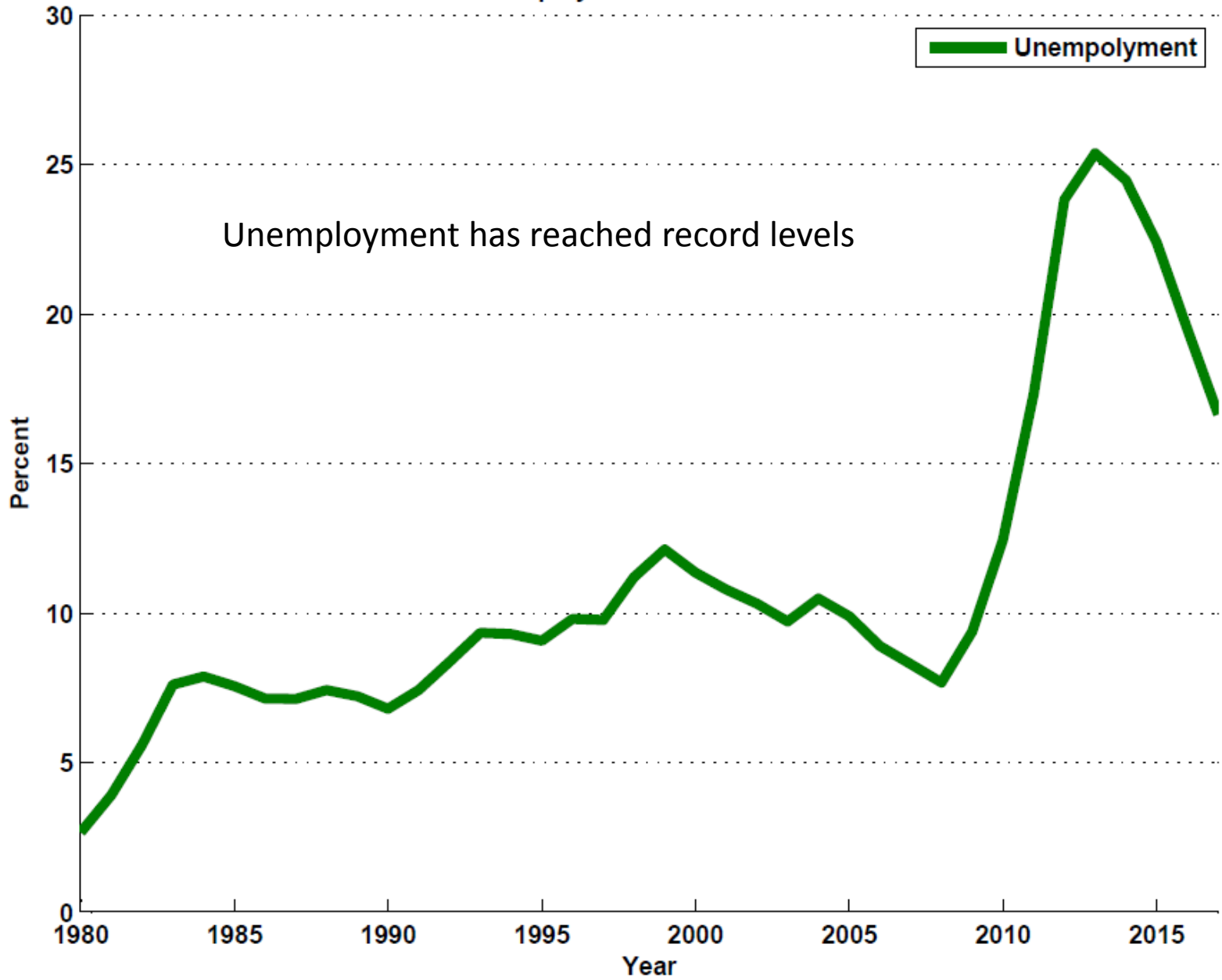
2010-present: Full-blown crisis

- May 2010: agreement of Greek government with troika (EU, IMF, ECB) for a three-year adjustment loan of €110bn.
- The loan had very strict conditions of deficit reduction (through austerity and privatisations) and structural reforms.
- Second bailout package of €130bn in October 2011 (ratified in Feb 2012) brings the total loan to €240bn. Who will pay???
- Some debt relief with PSI (Private Sector Involvement), estimated at €110bn (lots of Greek citizens lost €€€).
- Plans for re-entering the markets are looking very optimistic, relying on big income from privatisations.
- Will probably need another round of debt reduction and some people talk about third bailout.
- And so the saga continues...

Full-blown crisis, continued...

- Big drop in real incomes
- Unemployment
- Social unrest
- Rise of extremism
- Credit system has stopped working
- Widespread uncertainty

Unemployment rate 1980-2017

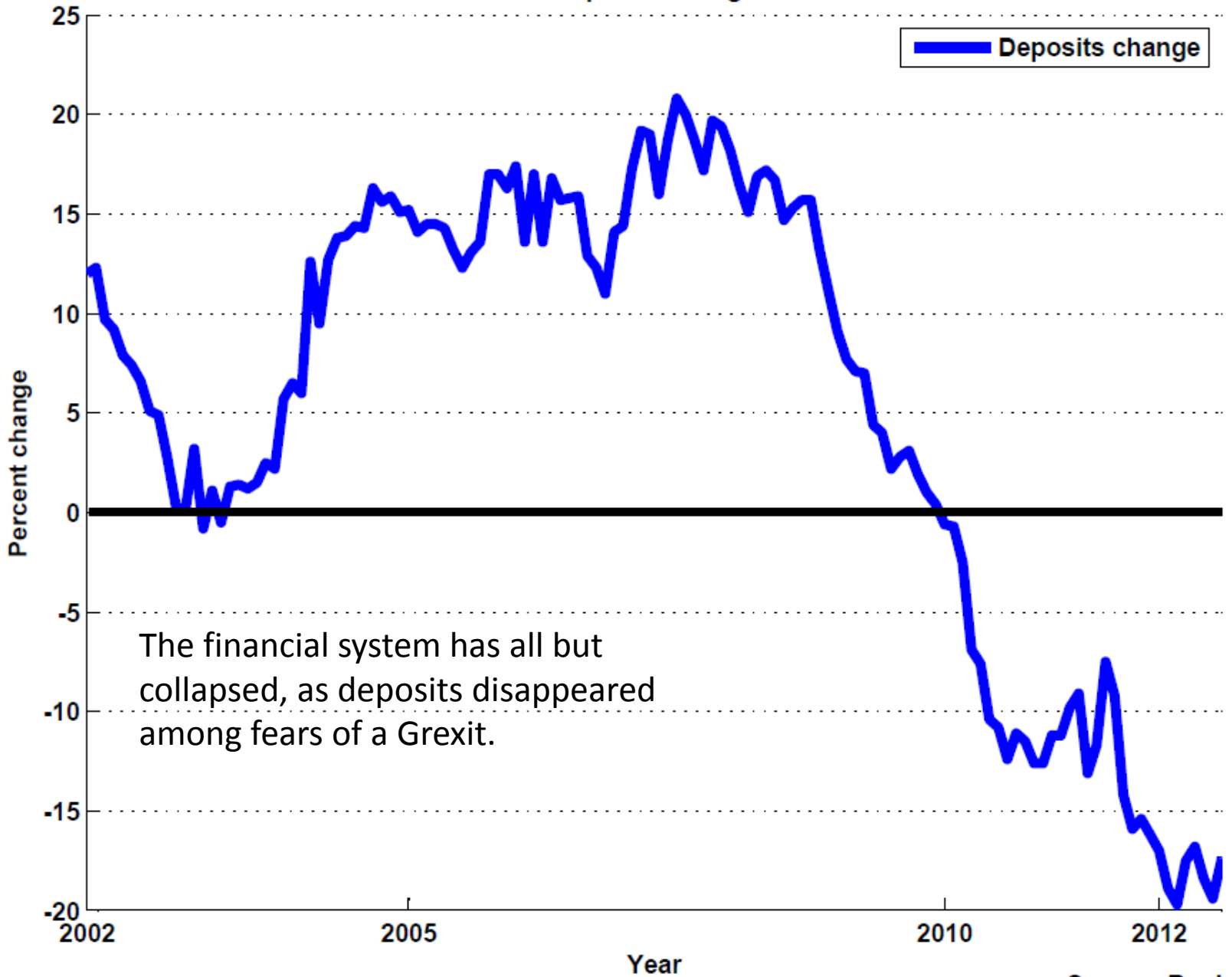


Source: IMF

Inflation rate



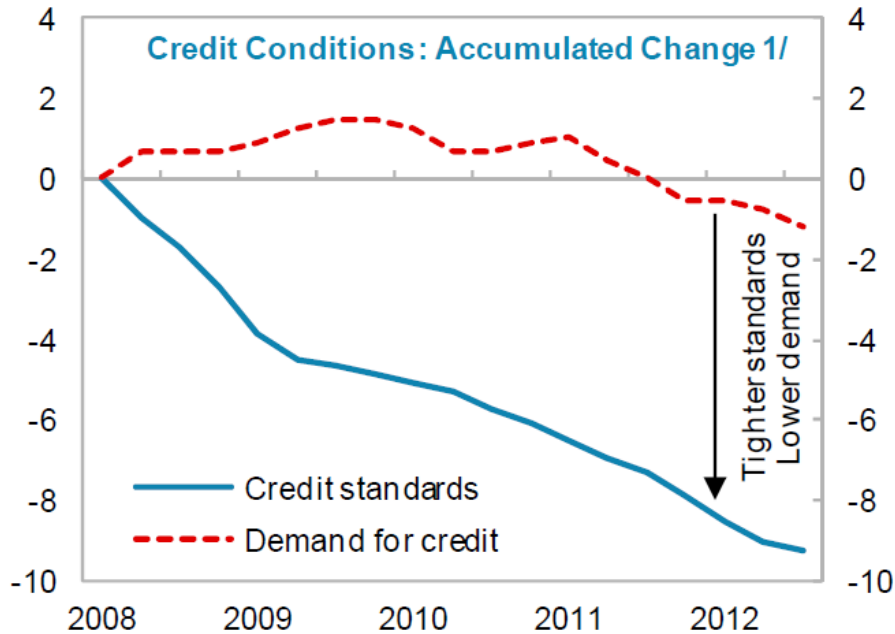
Deposits change



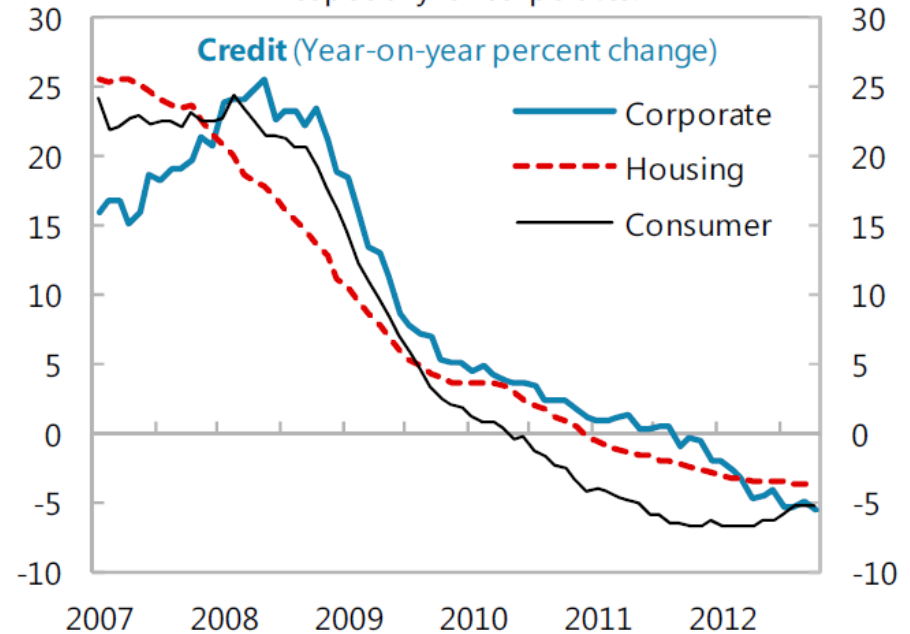
The financial system has all but collapsed, as deposits disappeared among fears of a Grexit.

Greek banks are in a really bad shape...
... and this affects business.

Lending standards have tightened
and demand for credit has declined...



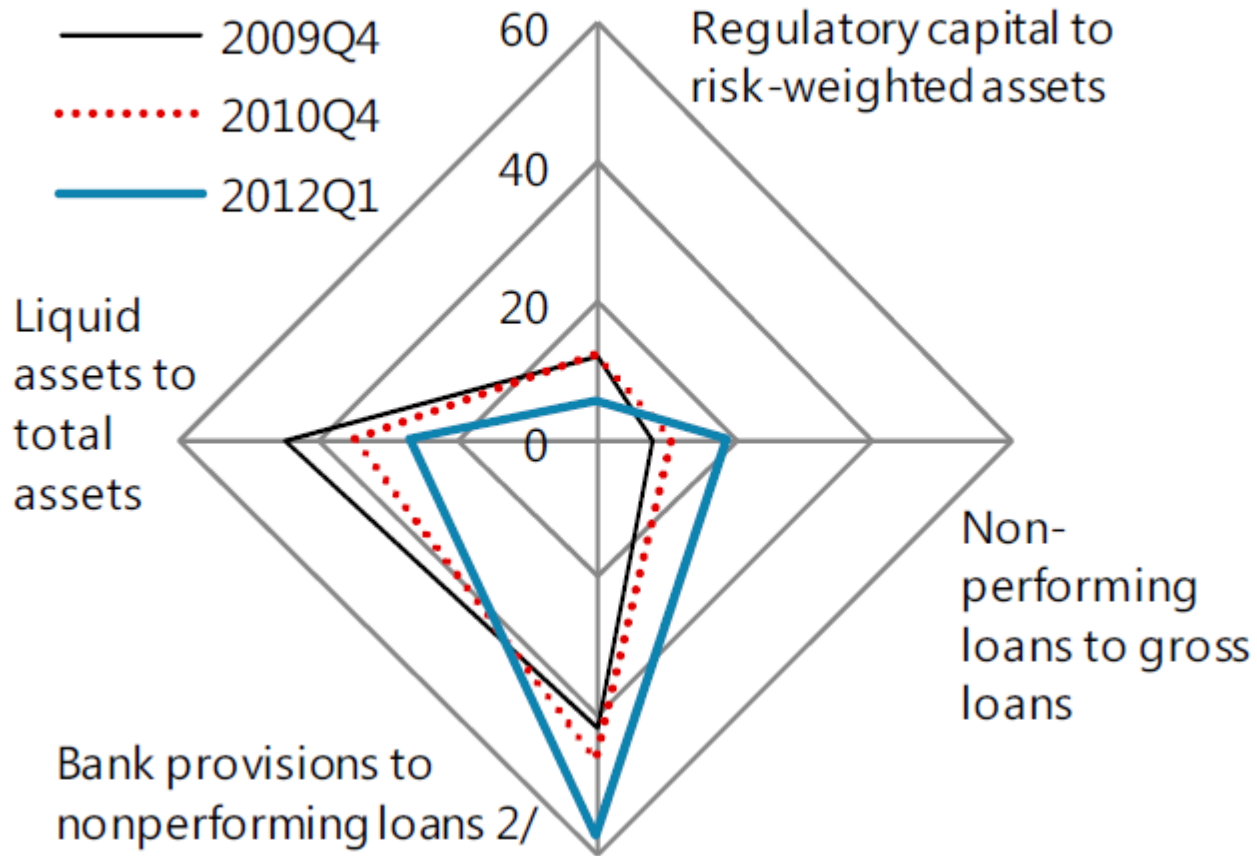
...and credit continues to contract,
especially for corporates.



Source: IMF

...and bank health has declined.

Financial Soundness Indicators



Source: IMF

What's wrong with Greece?

- So we know the mechanics of the crisis: twin deficit, market panic, bailouts, yada yada yada...
- But why did Greek governments run such high deficits?
- Why didn't anyone in Greece predict this and try to stop it?

Ultimate causes of the crisis: tax evasion

- We saw that though public expenditure increased in the 2000s, revenue didn't.
- This is due, at least partly, to **widespread tax evasion**.
 - Bad inspecting mechanisms, especially for self-employed.
 - Impunity for tax evaders and slow justice system.
 - Very low perceived value for taxpayer money.
 - Low sense of civic duty, strange sense of patriotism!
 - Current lower bound estimate of evaded income for self-employed: €28bn! [source: Artavanis, Morse and Tsoutsoura 2012]
 - Foregone tax revenues account for 31% of 2009 budget deficit, 48% of 2008 deficit. [source: Artavanis, Morse and Tsoutsoura 2012]

Ultimate causes of the crisis: corruption, clientelism and oligopolies

Corruption permeates every aspect of Greeks' dealings with the state.

- Embezzlement of public funds at all levels of administration (healthcare, public infrastructure projects, ...). The MP expenses scandal would be a joke in Greece!
- Clientelism at all levels of politics.
- Protection of vested interests, oligopolies.
- Strong unions have opposed labour market reforms or incentive-based paying schemes in the public sector.
- Mass media are part of the problem.

Ultimate causes of the crisis: stifling of innovation and entrepreneurship

It is very hard to do honest business in Greece

- Lots of red tape and bureaucracy
- High set-up costs and hard to grow as a company
- Inflexible labour markets
- High levels of taxation and social security payments
- Given the low probability of getting caught, it paid off to cheat!

Ultimate causes of the crisis: inefficient state

Public services offer a very bad value for taxpayer money

- No incentives for productivity in public sector.
- People get hired for the wrong reasons.
- More teachers per head than EU average, but low quality of schooling.
- Universities lag behind their counterparts.
- High number of doctors per head, but lack of nurses.
- Slow justice system.
- Overflowing offices when there are not enough workers in other areas (e.g. police).

Ultimate causes of the crisis

In two words, the ultimate cause of the crisis lies in the **poor institutions** that can be seen in every aspect of the public sphere.

The question then is:

Why did these institutions arise?

Roots of the crisis

- In order to think about institutions, one needs to think about Greek history and the culture that has emerged from it.
- The Greek state has never been good at protecting its weaker citizens, and the elites have often looked only after their narrow interests.
- Greeks have traditionally relied on their family to provide the support that is provided by the state in other countries. This has generated a culture of mistrust towards the state and those in power, which has often been self-fulfilling.
- This is what social scientists call “low civic capital”.
- Most people are a product of their environment. Greeks are no different: they respond to incentives!
- If you know you can get away with it, why wouldn't you tax evade if you think that your money would end up paying for an MP's lavish lifestyle anyway? [I'm not condoning, just trying to understand it!]

European or Greek crisis?

- Greek profligacy is not what caused the euro crisis: Governments in Ireland and Spain were not profligate, but were hit hard.
- The Euro has fundamental flaws. Until those are addressed, this will keep happening, even if Greece exits.
- The PI(I)GS' current account deficits are the mirror image of the German (and other Northern European) current account surpluses.
- The Eurozone was never an optimal currency area.
- You cannot have a monetary union without some kind of fiscal union. The Stability and Growth Pact is not a fiscal union!

Crisis management

- The eurocrisis, or rather the response of the EU to the crisis, arguably made the Greek crisis worse.
- The insistence on austerity (as opposed to structural reforms) has proved ineffective. It is also more socially unfair.
- Europeans and the IMF underestimated the role that the Greek state had in the running of the economy, thus underestimating the consequences of austerity.
- The widespread fear of Grexit further undermines recovery and deteriorates both the domestic credit system and the prospects for investment and significant revenue from privatisations.

Crisis management: big banks

- The interest rate for Greek bonds was too low in the good times: government thought they would always have it easy.
- This is of course a problem of the Greek government, but it is also a problem of the banks who lent the money at interest rates that did not correspond to the fundamentals.
- “If you owe the bank £100, it’s your problem. If you owe the bank £1m, it’s the bank’s problem.”
- Europeans are trying to protect their banks, which are a big and important part of the European economy.
- This is another aspect of the eurozone’s structural faults: as long as northern europeans save, somebody will have to consume!
- This is understandable, but how far does one go protecting bad business? You don’t want to set a bad precedent!

Where do we go from here?

- This crisis is far from over. Watch this space!
- But big crises are opportunities for change.
- The Eurozone needs to change.
 - Better bank supervision is essential.
 - Need for mechanisms to cope with differential shocks among its member states.
 - Ever closer union?
- Greece needs to change too, of course. No return to status quo possible.

What is the way out for Greece?

- We, of course, need to eliminate the deficit and decrease the debt.
- Even if all our debt were forgiven tomorrow, we would soon be in the same situation, since we currently consume more than we produce.
- Growth and structural/institutional reform must become a priority.
- Ways to reduce deficit/debt:
 - External source of demand: increase in value of exports, strategic thinking/positioning and product diversification.
 - Change the model of the economy: go from “frappé economy” of small family companies to producing higher value added products and services that we can trade internationally.
 - Improve institutions: hard but essential!

What is the way out for Greece?

- We need a complete rethink and reform of the productive model.
- Public sector priorities:
 - Changes in healthcare, justice, education.
 - Provide incentives for increased productivity in public sector.
 - No tolerance for tax evasion, corruption and embezzlement of public funds.
 - Constitutional reform to make innovation easier.
 - Reduce taxation. It is clear that we are way right of the Laffer curve optimum!
 - Crack down on oligopolies.
 - Build civic capital: challenging but very important. Can exploit traditional Greek values?
- Could push growth in certain sectors, but beware of Greeks seeking rents!
- In the end, no country in history has gone out of such a big crisis without increasing public spending. But it needs to be clever spending, and not the kind of spending we've seen in Greece in the past 30 years!

“Εάν αποσυνθέσεις την Ελλάδα, στο τέλος θα δεις να σου απομένουν μια ελιά, ένα αμπέλι κι ένα καράβι. Που σημαίνει: με άλλα τόσα την ξαναφτιάχνεις.”

“If you deconstruct Greece, in the end, you will see, what remains is an olive tree, a grapevine, and a boat. What this means is that, with as much, you can reconstruct her.”

Odysseas Elytis

