Greece, the Eurozone and the Debt Crisis

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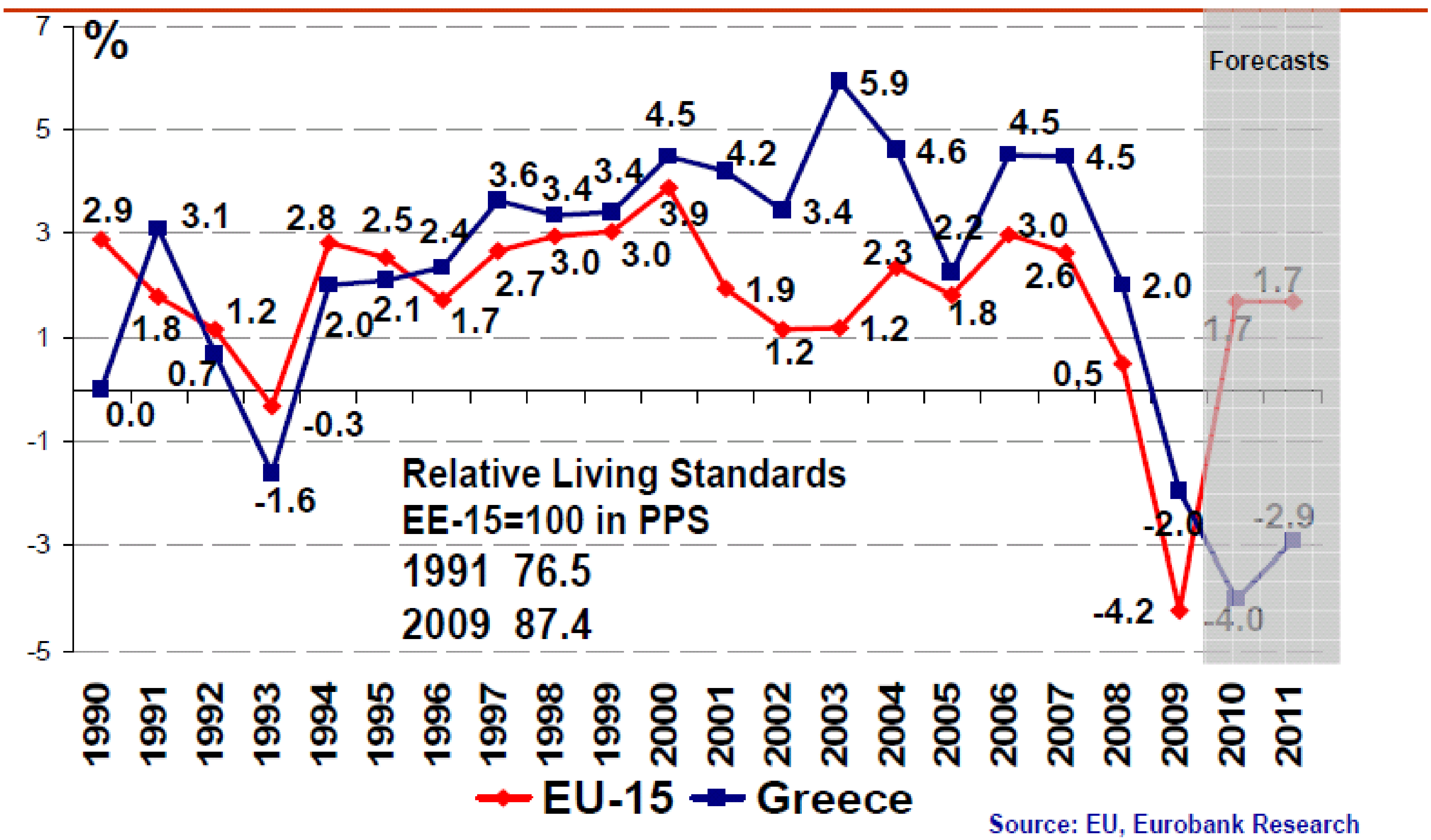
A World of Crisis and Shifting Geopolitics
Fletcher School of Law and Diplomacy
October 28, 2011

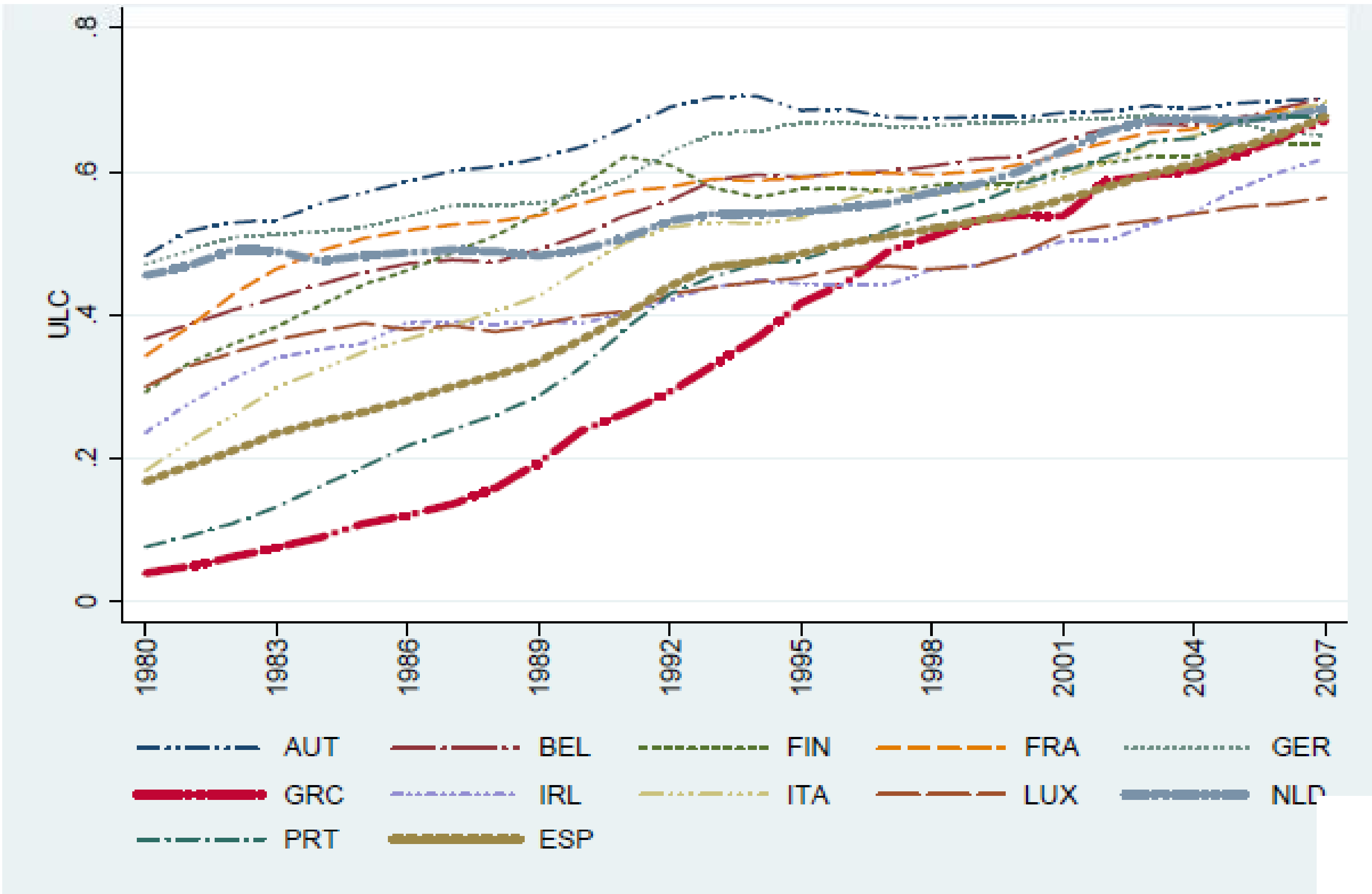
Growth Rates: Greece and EU-15

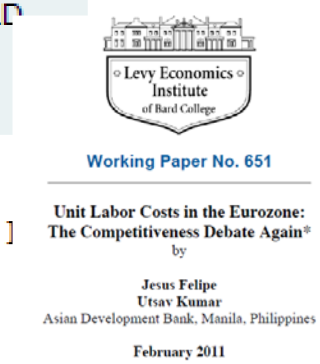


Was Greek growth sustainable?

- Rapid growth 1994-2007
- B U T Greece lacked (and failed to develop) institutions needed to *sustain* growth
  - Education
  - Investment in R & D
  - Rule of law
- A N D increasingly expensive place to produce – Rising *unit labor costs* (average cost of labor per unit of output)

Unit Labor Costs – Eurozone 1980 - 2007




Levy Economics Institute of Bard College

Working Paper No. 651

Unit Labor Costs in the Eurozone: The Competitiveness Debate Again*

by

Jesus Felipe

Utsav Kumar

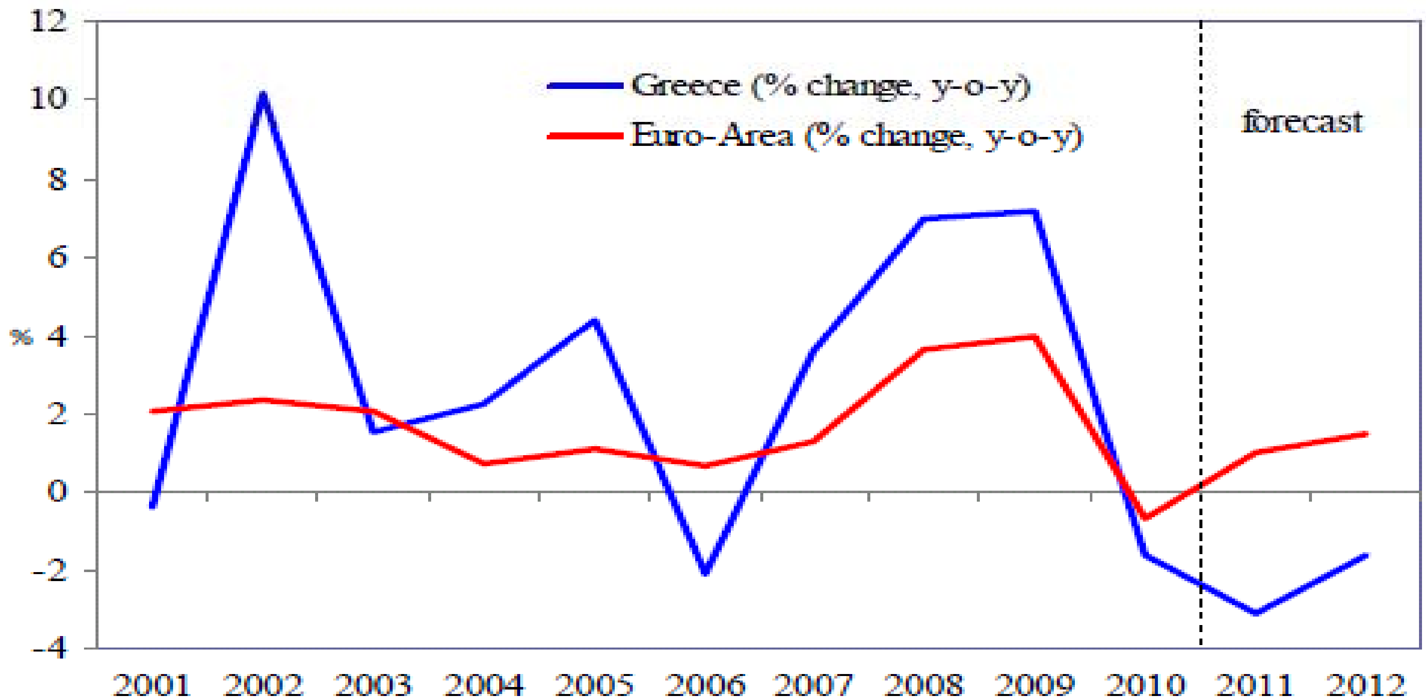
Asian Development Bank, Manila, Philippines

February 2011

Source: OECD and authors' estimates

Note: AUT-Austria, BEL-Belgium, FIN-Finland, FRA-France, GER-Germany, GRC-Greece, I
ITA-Italy, LUX-Luxembourg, NLD-Netherlands, PRT-Portugal, ESP-Spain

Growth of nominal unit labor costs to 2010
and EU forecast 2011 – 2012



Source : Commission services.

(% change year-on-year of unit labor costs)

GDP Growth and Total Factor Productivity Growth: Greece, Portugal, Ireland, Italy

Total Factor Productivity Growth

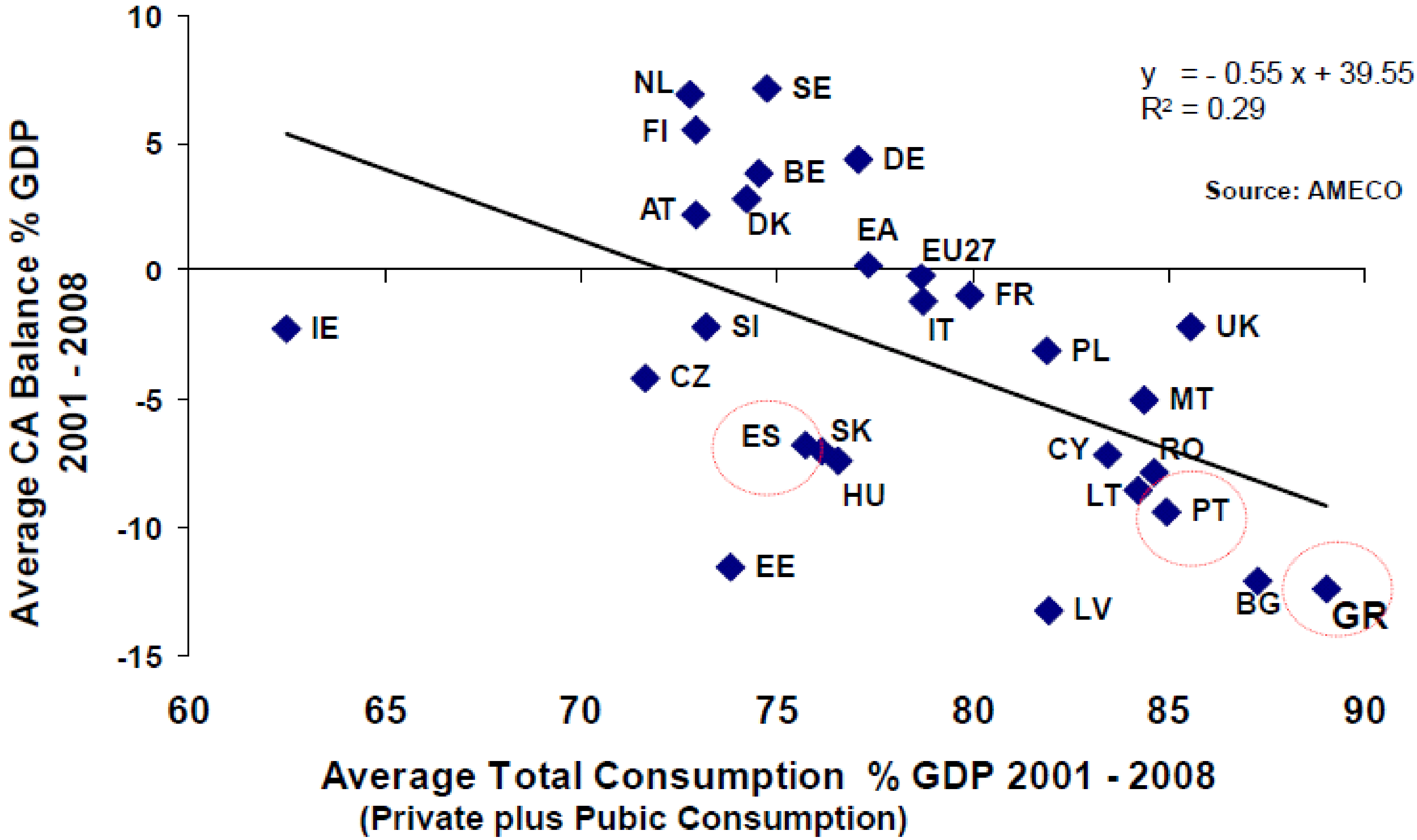
- Data from Antonakopoulos and Sakellaris, *Information Economics and Policy* 21 (2009) 171191.

GDP Growth rate versus TFP Growth, 1986–1995, 1996–2003
Greece, Portugal, Ireland, Italy

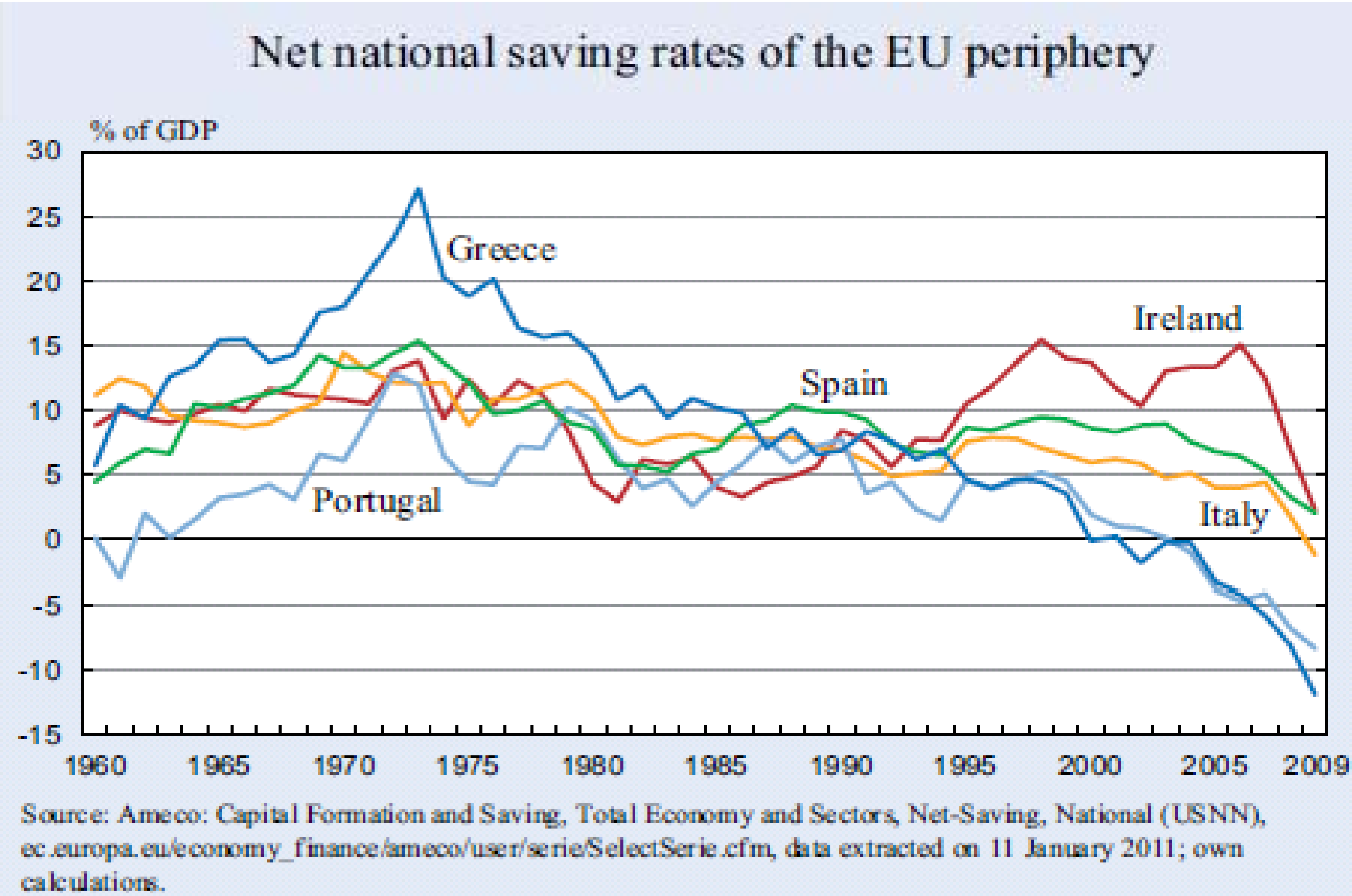
	86–95 GDP	86–95 TFPG	96–03 GDP	96–03 TFPG
GR	1.428	-.136 , -.410	3.672	1.346 , 1.106
PT	2.985	1.489	2.525	.395
EI	5.478	3.723	7.989	3.552
IT	1.827	0.806	1.549	-.346

Consumption and the Current Account Balance:

The EU North was saving more than the EU South



Savings declined in the EU South – and particularly in Greece



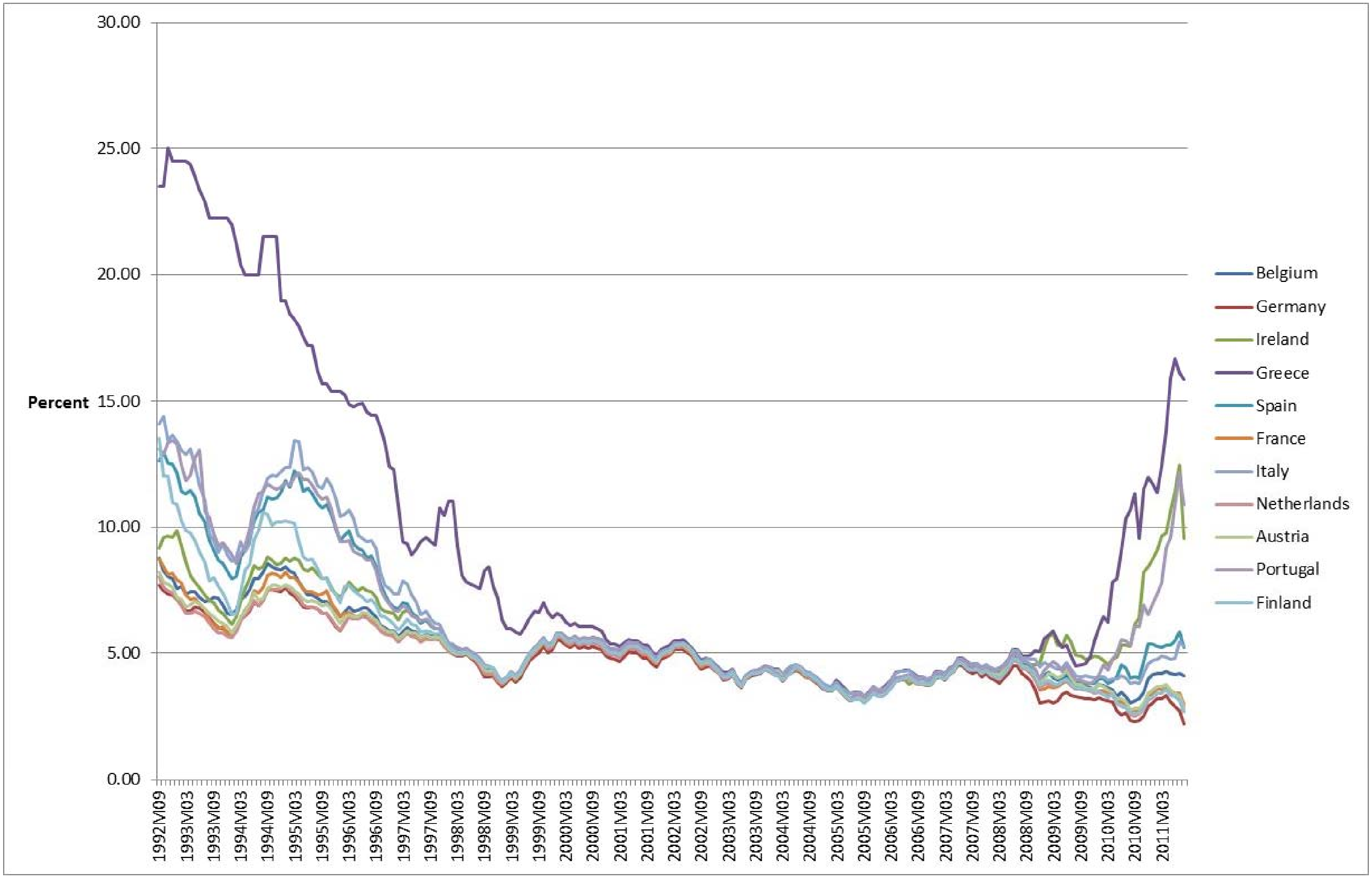
Consumption and Current Account Data

- Intrinsic property of the Eurozone : capital-rich lending to capital-poor South?
- But if the EU South had developed, it would be running trade surpluses from selling to the North
- Example of Finland comparable to the EU South until the late 20th century

After 2001 the Eurozone brought low interest rates for Greece: 1998-2009

Bond Yield Greek Gov't 10 yr– Euro 10 yr (GECU10YR) _ http://www.fullermoney.com/content/2009-01-19/greece.png

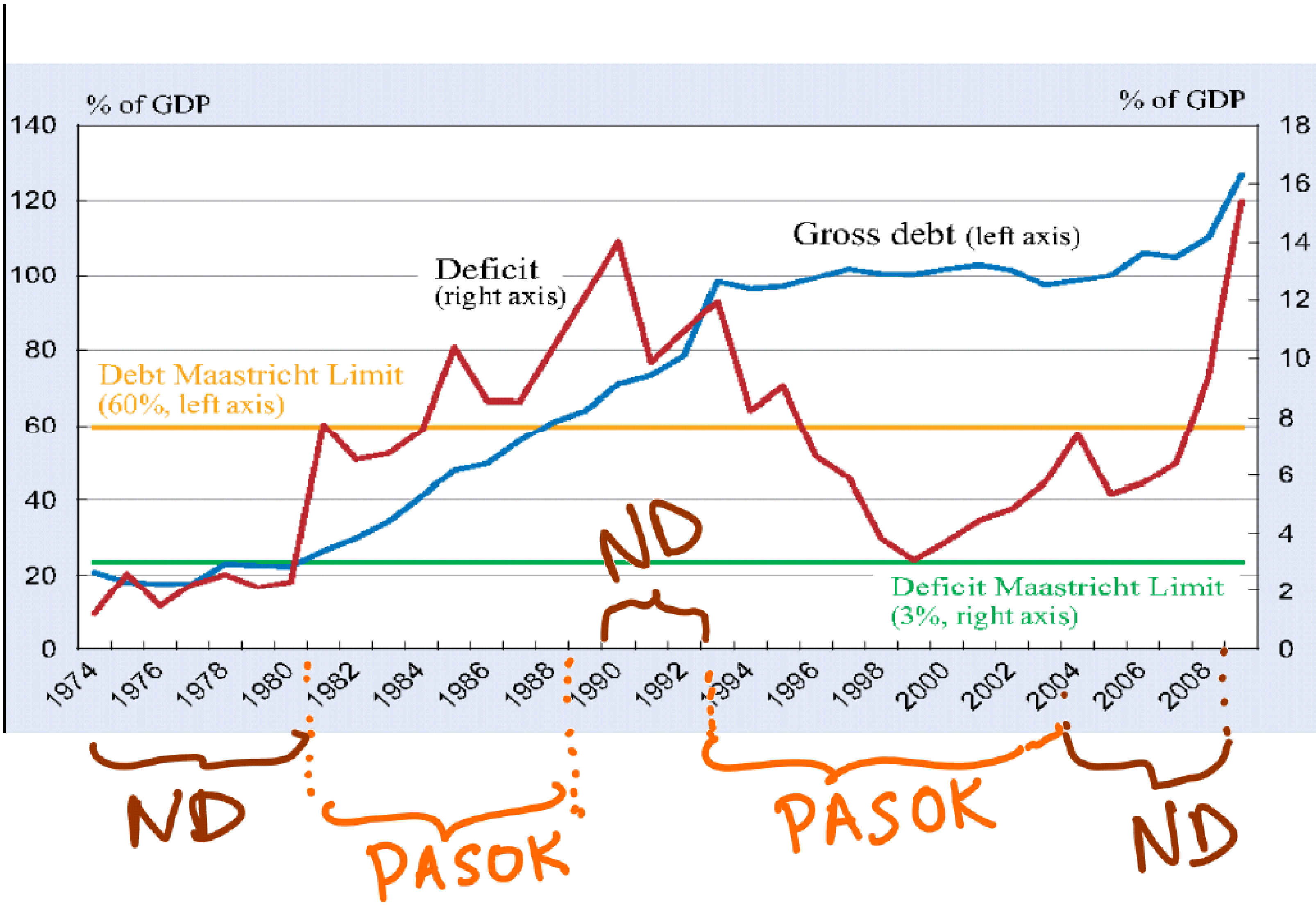
Not just Greece:
Euro-Zone 10-year bond yields 1992-2011



Can Greece – and the South – grow?

- Argument that the North retains its advantage, because it was there first.
- Yes, but comparative advantage is powerful: all you need is to be **relatively** better, more efficient

Greek Deficits and Debt: 1974-2010



Why the increase in public debt 1990—2009?

Net change in Greek public debt made up of :

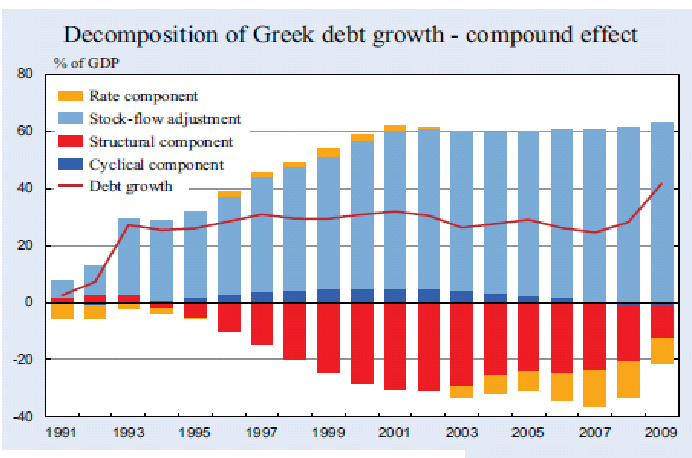
Structural component (full employment) **-13%**

Cyclical component **-2%**

Interest rate -growth rate GDP **-7%**

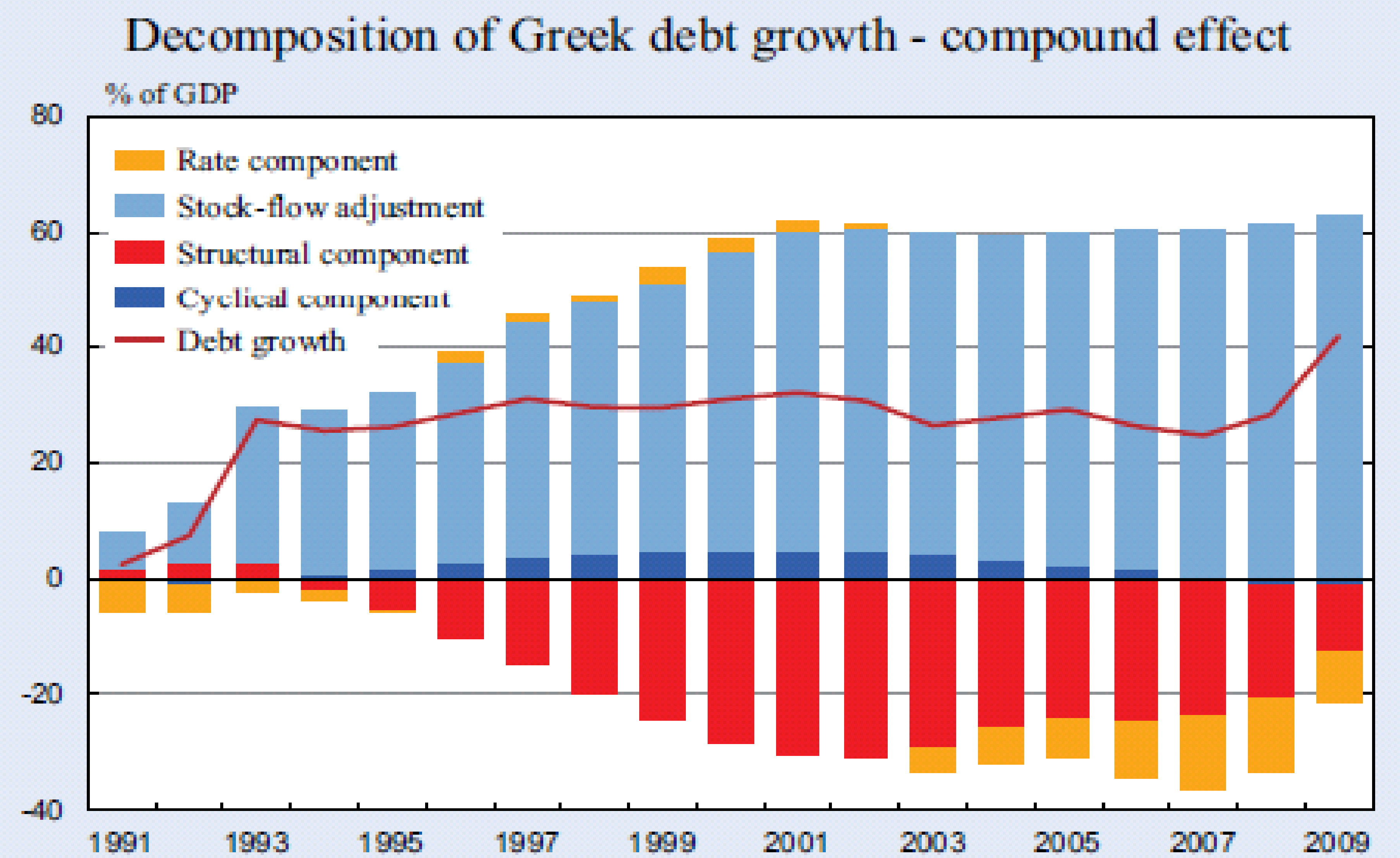
New obligations* **+ 62%**

*New Obligations: e.g. Assumption of losses and debt of public corporations + Olympic Games + Social spending i.e. public consumption (not investment)



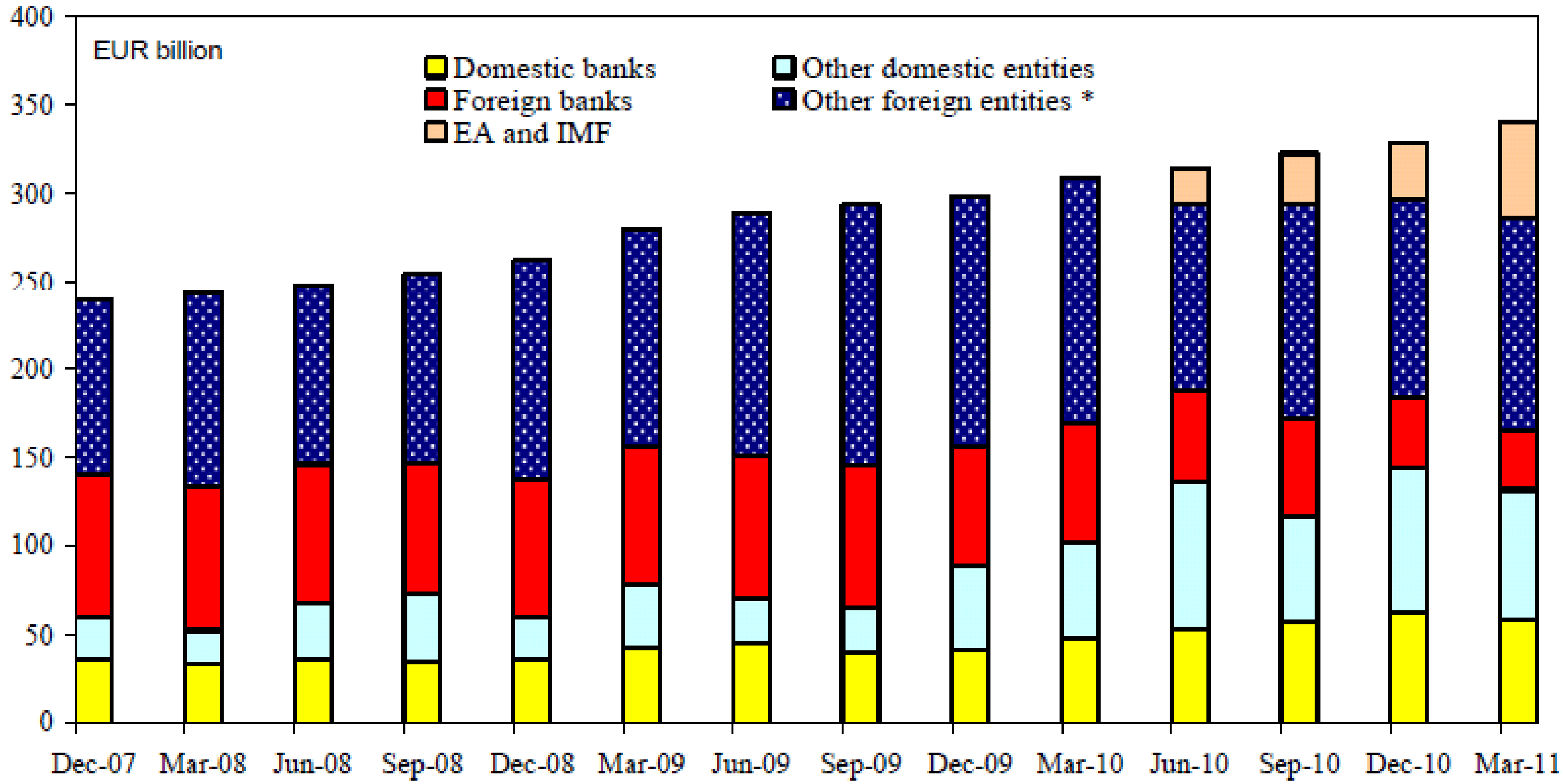
Source: Moutos and Tsitsikas (2010)

What does increase in public debt reflect? 1990—2009



Source: Moutos and Tsitsikas (2010), p. 182.

Who owns Greek Government Debt?



Note: "Other foreign entities" includes ECB.
Source : Commission services.

Greek Government Debt, in Euros

- Today:
- Total: 366 Billion Euro, of which:
  - Troika 78 Billion
  - European Central Bank 62 Billion
  - Private sector 202 Billion
    - Of which Greek banks 48.5 Billion, Greek pension funds 29 billion, Greek insurance companies 3.9 billion

What went wrong since the May 2010 Agreement with the EU/ECB/IMF (a.k.a. Troika)?

- Latest report (October 2011) is devastating; reforms **stalled.**
- What can we say about the program design and outcome?
- **Its designers ignored and/or neglected major rigidities and dysfunctionalities** (economic and political) in the Greek economy
- The population **never took ownership** of the program
- **Expectations collapsed**
- **Investment collapsed**
- Outcome: **10% decline in national income** in 18 months

October 26 2011: What was agreed?

- “An agreement that should secure the decline of the Greek debt to GDP ratio with an objective of reaching 120% by 2020.
- “Euro area Member States will contribute . . . up to 30 billion euro. The nominal discount will be 50% on notional Greek debt held by private investors.
- “A new EU-IMF multiannual programme financing up to 100 billion euro . . . accompanied by a strengthening of the mechanisms for the monitoring of implementation of the reforms.”
- “A significant strengthening of economic and fiscal coordination and surveillance. A set of very specific measures, going beyond and above the recently adopted package on economic governance, will be put in place.”
- “Ten measures to improve the governance of the Euro area.”

The broader political and historical context

How did we get here: the burning question in 1945 was how to avoid another world war

- Who was responsible for WW II? How to avoid mistakes of end of WW I
  - Many answers (not my subject)
- Among the solutions proposed:
  - Morgenthau Plan – "Neutered Germany"
  - Communism
  - European integration as a restraint on Germany
    - – European economic integration, largely successful (save the monetary part)
    - – Success not at all a certainty, when first conceived late 1940s

Brief historical review

- After WW II, US forgave French WW II debt
- Britain paid off its Lend/Lease debt to the US completely (and very expensively)
- In 1953 *all German creditors* forgave German Debt
- US also forgave German pre-WW II debt

theguardian

Any new Marshall plan will founder in the minds of Europe's hesitant leaders

What the EU desperately needs is the willingness and vision to argue for redistribution and take on financial institutions

Mark Mazower
guardian.co.uk, Tuesday 5 July 2011 16.30 EDT

"The members of today's political class in Europe are **Margaret Thatcher's heirs, not George Marshall's** . . . They find it hard to understand that **the markets need to be saved from themselves** if Europe is to survive in anything resembling its present form . . . They forget that **Germany** itself **was allowed to cancel its prewar debts in 1953**, one of the preconditions for its subsequent boom, ... **Poland in 1991, [was] allowed to write down their debts** ... they too prospered."

A New Marshall Plan For Europe?

Should debt be written off?

- What **are** the intentions of European electorates?

  What **should** European electorates do?

- Original Marshall Plan: $13 Billion = 5% of US 1948 GDP.
- Total debt of Greece, Portugal and Ireland:

  4.5% of EU GDP today
- Same ballpark as Marshall Plan!

Occasional reminders:
1. Former Chancellor Helmuth Schmidt
2. *Die Welt,* Sept 17, 2011: "Does Germany owe Greece 70 Billion Euro?"

Artikel drucken Bilder ausblenden

WELT ONLINE

REPARATIONEN

17.09.2011 | Autor: Sven Felix Kellerhoff

Schuldet Deutschland den Griechen 70 Milliarden?

In Griechenland heißt es, man habe Deutschlands Hilfe mehr als verdient. Immerhin seien aus dem Weltkrieg noch Rechnungen offen. "Welt Online" hat nachgerechnet.

Hitlers Vorstoß in Jugoslawien und Griechenland

FOTO: PICTURE-ALLIANCE / AKG-IMAGES

Nur elf Tage liegen zwischen Hitlers Befehl an die Wehrmacht, einen Angriff auf das Königreich Jugoslawien vorzubereiten, und dem Einmarsch im Morgengrauen des 6. April 1941. Der Feldzug führt zu einer blutigen Besatzungsherrschaft, die teilweise bis 1945 währt.

EU/EZ should do **nothing**:

Unless Greece is placed under virtual receivership

(Agreement Oct. 26 talks of "Monitoring Capacity on the ground" in the new MoU)

Recognize need to **amend** constitution

overhaul **education** and **labor union law**

shrink and rationalize public sector

Prosecute egregious embezzlers of public funds

And other kinds of corrupt practices

The US Federation works in part of federal authority in prosecuting Rod Blagojevich …

And, unless growth starts, nothing will happen.

Corruption: The Picture in 2010 (178 countries)

Source: Transparency International Annual Report, 2010

RANK	COUNTRY/TERRITORY	SCORE
1	Denmark	9.3
1	New Zealand	9.3
1	Singapore	9.3
4	Finland	9.2
4	Sweden	9.2
6	Canada	8.9
7	Netherlands	8.8
8	Australia	8.7
8	Switzerland	8.7
10	Norway	8.6
11	Iceland	8.5
11	Luxembourg	8.5
13	Hong Kong	8.4
14	Ireland	8.0
15	Austria	7.9
15	Germany	7.9
17	Barbados	7.8
17	Japan	7.8
19	Qatar	7.7
20	United Kingdom	7.6
21	Chile	7.2
22	Belgium	7.1
22	United States	7.1
24	Uruguay	6.9
25	France	6.8
26	Estonia	6.5
27	Slovenia	6.4
28	Cyprus	6.3
28	United Arab Emirates	6.3
30	Israel	6.1
30	Spain	6.1
32	Portugal	6.0
33	Botswana	5.8
33	Puerto Rico	5.8
33	Taiwan	5.8
36	Bhutan	5.7
37	Malta	5.6
38	Brunei	5.5
39	Korea (South)	5.4
39	Mauritius	5.4
41	Costa Rica	5.3
41	Oman	5.3
41	Poland	5.3
44	Dominica	5.2
45	Cape Verde	5.1
46	Lithuania	5.0
46	Macau	5.0
48	Bahrain	4.9
49	Seychelles	4.8
50	Hungary	4.7
50	Jordan	4.7
50	Saudi Arabia	4.7
53	Czech Republic	4.6
54	Kuwait	4.5
54	South Africa	4.5
56	Malaysia	4.4
56	Namibia	4.4
56	Turkey	4.4
59	Latvia	4.3
59	Slovakia	4.3
59	Tunisia	4.3
62	Croatia	4.1
62	FYR Macedonia	4.1
62	Ghana	4.1
62	Samoa	4.1
66	Rwanda	4.0
67	Italy	3.9
68	Georgia	3.8
69	Brazil	3.7
69	Cuba	3.7
69	Montenegro	3.7
69	Romania	3.7
73	Bulgaria	3.6
73	El Salvador	3.6
73	Panama	3.6
73	Trinidad and Tobago	3.6
73	Vanuatu	3.6
78	China	3.5
78	Colombia	3.5
78	Greece	3.5
78	Lesotho	3.5
78	Peru	3.5
78	Serbia	3.5
78	Thailand	3.5
85	Malawi	3.4
85	Morocco	3.4
87	Albania	3.3
87	India	3.3
87	Jamaica	3.3
87	Liberia	3.3
91	Bosnia and Herzegovina	3.2

Very Clean
9.0 - 10.0
8.0 - 8.9
7.0 - 7.9
6.0 - 6.9
5.0 - 5.9
4.0 - 4.9
3.0 - 3.9
2.0 - 2.9
1.0 - 1.9
0.0 - 0.9
Highly Corrupt
No data

Azariadis, Ioannides, Pissarides "17 Proposals"

Kathimerini, Oct. 12th, 2010

- 1981 Greece: 9,080 Euro. Finland: 9,770 E, Ireland, 6,170.
- 1994 Ireland surpasses Greece. Finland already ahead of Greece (in spite of Finland's "Great Depression", 1990-94).
- 2008 Greece: 29,290. Ireland: 37,440. Finland: 37,820
- Differences due to development of economic and social forces. Greece needs to emulate Finland, modernize institutions
- Choice between "virtue" and "vice"
- "Virtue" → Greece, Mediterranean Tiger
- "Vice" → Tax evasion, inequality, poverty, social unrest, a republic/oligarchy of labor unions and special interests nightmarish scenario AND → Greek rank by income declines to Slovakia at best

Some favorable factors

- Huge public debt, but
- Greek households, firms not overdebted
- Private loans, only 110% GDP, small for the EU
- Private debt only 81% GDP + a lot of private wealth
  (that generally evades taxes)
- Eurobank study shows internal devaluation most important for manufacturing and agriculture

EU vis-à-vis rest of the world: a fairly closed economy

- Austerity in Germany to avoid inflation:
  – Reduces imports from the South
  – Reduces income in the South
  – Which in turn reduces imports from Germany
- Vicious cycle through inherent fiscal interdependence
- A little inflation would have made it much easier for Greece, esp. with right policies, to keep its unit labor costs growing more slowly than in the North [Krugman].

Inherent Design problem in the Euro zone

- [De Grauwe] With national currency:
  - Borrow in your own currency to carry out fiscal policy
  - If bondholders sell, your currency depreciates, improves competitiveness, currency does not leave economy, liquidity does not fall.
- With the Euro: no access to borrowing in your own currency
  - Borrowing costs (in Euros) go up – but no improvement in competitiveness
  - Risk of self-fulfilling prophecy: Increasing interest rates, worsening deficits, taxes rise to close the deficit, income declines: country trapped in high-yield, low-borrowing area.
- *Unless* there is assistance from the federation without need to negotiate in each case, and the markets know it.

The problem

- Fiscal federation works to stabilize the federated economies, by transferring income automatically between states when one is doing well and another badly
- The US federal fiscal system provides automatic, mechanical transfer of income
- Protects economy AND markets know it
- B U T Fiscal union requires substantial *political* integration

Agreement Oct. 26th No. 25. p. 7

"Being part of a monetary union has far reaching implications and implies a much closer coordination and surveillance to ensure stability and sustainability of the whole area. The current crisis shows the need to address this much more effectively. Therefore, while strengthening our crisis tools within the euro area, we will make further progress in integrating economic and fiscal policies by reinforcing coordination, surveillance and discipline. We will develop the necessary policies to support the functioning of the single currency area."

This falls far short of endowing ECB mandate to act as lender of last resort and guarantor of financial stability, as well, not price stability. EFSF is a strange institution.

Economists unhappy with the fundamental design of the EMU, still unhappy.

SO Without serious steps towards fiscal union the Euro will fail

- EU institutions need real ‘teeth’
  - E.g., the EU Court of Auditors must have real teeth.
- Investment means investment: governments should not get away with diverting their use
  - EU resources in Greece functioned like petrodollars in petroleum-rich countries, diverted to consumption instead of investment