

The Greek crisis: An autopsy

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The Greek crisis is one of the worst in history, even in the context of recorded ‘trifecta’ crises – the combination of a sudden stop with output collapse, a sovereign debt crisis, and a lending boom/bust. This column quantifies the role of each of these factors to better understand the crisis and formulate appropriate policy responses. While fiscal consolidation was important in driving the drop in output, it accounted for only for half of that drop. Much of the remainder can be explained by the higher funding costs of the government and private sectors due to the sudden stop.

For its sheer intensity and duration, the Greek crisis has been quite unprecedented. One measure says it all – real income per capita declined every single year between 2007 and 2013, a cumulated drop of 26%. Since then, it has barely risen.

Much has been written about the drivers of the crisis. Some say that it was the inevitable consequence of the boom that preceded the crisis, a boom fuelled by unsustainable fiscal profligacy and cheap foreign capital. Others point to the collapse of the Greek banking system saddled with non-performing loans, and the uncertainty about euro exit, depressing investment and aggregate demand. Some blame the nasty regimen of fiscal austerity imposed by the country’s creditors, while yet others emphasise the strictures of the common currency, compounded by a lack of wage and price flexibility that make it difficult to restore competitiveness.

Quantifying the role of each of these factors is a difficult yet essential task for understanding the crisis and for formulating appropriate policies going forward. This is what we attempt to do in a recent paper (Gourinchas et al. 2016). We build a tractable but realistic DSGE model of the Greek economy, which we use to replicate the evolution of key macroeconomic variables from 1999 onwards.

We find that, while an unavoidable fiscal consolidation was the most important factor driving the drop in output, it accounted for only for half of that drop. Much of the remainder can be explained by the higher funding costs of the government and the private sector due to the sudden stop. Lower leverage would have cushioned the Greek economy somewhat from the sudden stop. The peak-to-trough decline in output would have been smaller by about a third if Greece’s levels of debt were half of their pre-crisis values. More flexible prices and wages would also have softened the effects of the drop in domestic demand – the peak-to-trough decline in output would have been smaller by about 40% if prices and wages could adjust twice as fast.

Gourinchas, P-O, T Philippon, and D Vayanos (2016), “[The Analytics of the Greek Crisis](#)”, *NBER Macroeconomics Annual*, forthcoming (also CEPR DP No. 11334). The full article was first published on VOXEU on 05 August 2016 and it is available online <http://voxeu.org/article/greek-crisis-autopsy> .

A research seminar by Professor Vayanos presented the paper before a wider audience. It took place on November 8, 2016 at the Hellenic Observatory – [read more here](#).