Towards a way out of the Greek crisis

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2011-7-7

INTRODUCTION: CONFLICTING ARGUMENTS AND FRACTURING SOCIAL COHESION

For the past 18 months, Greece has been under the intense, and ever intensifying, media spotlight for all the wrong reasons. After the bailout of 110m euros of May last year, a new assistance package may be decided in July, designed to keep Greece afloat until 2014 or 2015, when, the hope is, it will return to the markets on its own. The price for this (or these) bailout package(s) is drastic austerity – a new instalment of measures has recently (29/6/11) been voted by Parliament. At the same time, there is growing scepticism, indeed hostility, in large portions of society to the bailouts and the concomitant austerity. The popular anger towards the Papandreou government may be construed as an implicit dialogue between Greece and its European partners. Many in Europe will be dismayed at the feelings and overall stance of the Greek 'indignados' – anger and refusal to accept responsibility for the country's debts. I happen to think that the latter is rather dishonourable and in fact demeaning for Greek people themselves – the debts have been amassed by a sovereign, free and democratic state and therefore owned by the people, just like the decisions that led to them. But I have some sympathy for people's anger, and share some of their instinctive scepticism about the overall strategy of bailout-driven austerity.

IS THE AUSTERITY-BASED STRATEGY WORKING?

A year and more since the bailout package of May 2010, it is clear (even to an ardent initial supporter like myself) that the strategy is not working. The root of the problem is this. Standard economic theory suggest that the public debt is 'sustainable' and government 'solvent' if the outstanding debt can be matched (in a present-value sense) by future primary surpluses, i.e. surpluses in the budget excluding interest payments on government debt. Greece has had rare periods of budget surpluses, the only ones in the last 30 years being during 1994-2002. So, this is a huge task on its own. But it is not the end of the story. Creditors will not mind, theory says, if interest payments turn the primary surplus into an overall deficit, as interest simply keeps the debt constant, in a present-value sense. But with public finances at this parlous state, creditors will not heed such theoretical niceties! To judge the government as credit-worthy again, they will want to see *sustained* surpluses *after* interest payments have been made. Greek government's interest payments were about 5.5% of GDP for 2010, and have been of that order, if not more, throughout the 2000s. A sustained surplus (i.e., for several years in a row) after this kind of interest payments implies a primary surplus of the order of 6% and more. This is something that very few western governments have achieved in recent years (Belgium in the years 1985-2008 being one of the exceptions). As if this is not enough, there is a final hurdle. Theory again does not propose any concrete threshold in the debt-GDP ratio, above which debt is unsustainable. But Greece's debt, currently approaching 160% of GDP, is one of those cases of 'you know it when you see it'. Thus, solvency and a credible eventual return to markets requires that there be vigorous growth in GDP, such that the debt-GDP ratio should be falling via the rise in the denominator (GDP). So, as a prelude to the return to the markets, the economy should be producing sizeable surpluses *and* healthy growth. This is something similar to squaring the circle, as even 1st-year undergraduates in economics know.

More practically, Greece has made considerable progress in limiting the deficit, but the resulting austerity has greatly hampered tax collection, and has exacerbated the debt-GDP ratio. At the same time, the required structural reforms (modernisation of state structures, privatisations) need time. So, progress on one front, stalemate if not setbacks in others. The result is that the prospect of Greece having sound primary surpluses and vigorous growth by 2014, prerequisites of its return to markets, looks too optimistic. Thus, the mood has prevailed that the sacrifices are futile. There is a lingering suspicion that the bailouts are not for Greece's sake but to protect the creditors (eminent commentators, e.g. Paul Krugman, have leveled this charge against the Brady plan of the early 1980s), and the country is falling foul of voracious international financial markets. The constant indecision, dithering, sometimes wrangling, of European authorities (recalling Henry Kissinger's famous question: 'If you want to speak to Europe, who do you call?') only means that there a feeling of kicking the can down the road, not arriving at a definite settlement. A seemingly ideologically-driven and misguided insistence on rapid privatisations as part of bailout preconditions may only lead to state impoverishment: In a country with no experience of large-scale privatisations, weak or no regulatory structures, and where the stock market is a rock-bottom right now, the call is for a big privatisation every 15 days! Thus, the unspoken fear is that default will eventually not be averted, and that at that point the state will be too impoverished to be able to kick-start recovery again. Add to this the widespread anger of a young generation in despair, the plight of the unemployed (15% of the labour force and rising) and hatred of (widely perceived as) incompetent and corrupt politicians, and you get the toxic mix that produces the mayhem at Syntagma ('Constitution') Square. Frustration leads to behaviour that borders on self-destruction, as with the repeated strikes and images of chaos in the world media, all at the start of the tourist season.

A BLUEPRINT: THE SACHS PROPOSAL

Thus, the embattled PASOK government of George Papandreou and the new Finance minister Evangelos Venizelos find themselves in 3-way dilemmas: Striving to avert immediate bankruptcy will all its catastrophic consequences, facing active social hostility for its austerity measures, while being heavily pressurised by European partners to keep taking the bitter medicine of austerity. Meanwhile, during the long past 18 months of crisis, and while the country is bleeding pale from austerity amid signs of fracturing social cohesion, there has as yet been no decisive action or definite plan by the European authorities. It may be high time for the country to propose its own plan of action. This should be carried out in close association with European authorities, and in agreement with financial markets as much as possible.

What may be the outlines of such a plan? Some recent proposals by Germany and France point to this overall direction, amounting roughly to a partial voluntary 'rollover' of debt by private creditors (30 in the French plan), initially looked helpful but are now being heavily criticised (see Patrick Jenkins's 'Self-Serving French recipe is wrong fare for Greece', Financial Times, 4/7/2011; and Wolfgang Münchau's 'The Greek rollover pact is like a toxic CDO', also in the Financial Times 3/7/2011). The gist is that the Greek government is being called to make excessive payments, particularly in terms of interest, that eventually brings default closer. A really hopeful prospect can only be along the lines suggested in yet another FT piece, this time by renowned Harvard economics professor and architect of past sovereign rescue efforts, Jeffrey Sachs ('Greece can be saved – here's how to do it', FT, 30/6/2011).

The specifics of this proposal involve effectively a cap in interest payments according to a timetable. Sachs suggests a cap in real interest rates of 2% for 20 years (= a nominal interest rate of 3.5%, equal to that on German bonds, minus an inflation rate of 1.5%). An alternative scheme might envisage 1% for the first 10 years after 2014, then rising to 3% for the next 10, and 5% for the following 10. In any case, the cap applies to total interest payments (as a percentage over GDP), not to the interest rate. Interest payments to individual creditors will be made *pro rata*. Accordingly, the Greek government's budget office should work out the total amount of interest due every year if unfettered market conditions prevailed. If the total amount of interest is above these caps (as it will be), the amount of interest due to each individual creditor is scaled down (by the same factor) until total interest payments reach the required level, stipulated above.

The hope is that financial markets will voluntarily accede to this plan, which is better than any outright default, with all the hardship for the country and risks for the world economy. The plan will hopefully be acceptable to financial markets as there will be no 'haircut' or loss of capital; thus, there will be no 'credit event', in the terminology of the all-dictating but procedurally opaque rating agencies. If the scheme is not palatable to financial markets, there may be room for negotiations and for coaxing private creditors, particularly by a 'first come – first serve' scheme. Greece would then be able to proceed to fiscal consolidation without the need to make such onerous interest payments. Furthermore, its banks will not be unduly hurt, which is one of the serious dangers of bankruptcy or even partial default. It will create the incentive for all parties, Greece, European authorities and financial sector, to aid in the country's growth in the knowledge that higher GDP will entail higher interest payments (that are tied to it as percentages). In sum, the scheme proposes a viable way of splitting the burden between the EU authorities and private creditors, as well as the country itself, while posing minimum risk.

Meanwhile, the lifeline of the bailout package(s) should continue, averting financial collapse. At the same time, help for kick-starting Greece's economy is also crucial, either via spending on infrastructure in a kind of 'new Marshall plan' and/or via a slightly weaker Euro. On the other side of the coin, Greece must ensure that it returns to primary surpluses by the end of 2013, after which the surpluses will be used to buy out outstanding debt. It should promote privatisations on a realistic but swift timescale, on the basis of external advice to be independently carried out. As mentioned, privatisations are a subtle but hugely important issue. In the mind of this author, they should be designed such as to achieve three objectives, namely, and in this order, help the country towards development (a paramount criterion), maximise proceeds for budgetary purposes, and maintain employment. Reforms are moreover necessary in order for the lost competitiveness to be regained. Combatting tax-evasion is critical, both as a prerequisite for fiscal remedy and as a way to spread the costs of austerity in a just and socially acceptable way. A lot needs to be done to promote financial accountability and commitment to budgetary plan right across the public sector, including local government. The offices for budgetary planning and national audit under parliamentary auspices need to be established and (in the latter case) strengthened. Here, technical expertise from Europe may be helpful. The need for an overhaul of the public sector towards achieving the simultaneous goals of effective and efficient public services, combatting corruption, and sticking to the available resources, is well known. And, not least, European politicians and intellectuals should debate whether Europe should change its structures, particularly whether political integration should match economic integration.

ECONOMIC MODERNISATION AS THE NEXT STEP IN NATION-BUILDING

Greece has emerged from a deeply traumatic 20th century, often fighting bruising battles that showed the direction of things to come, as the historian Mark Mazower argued recently in the New York Times. It has made considerable political, social and economic progress over the last 40 years in particular. It has immensely benefitted from attaching itself to the great European project, and is grateful for the assistance and understanding that the European partners offer. The '3rd Greek Democracy' is steeped into the culture and agenda of 1974, the year of the demise of the military regime and its own inception. In that agenda, advancing mainly the demands for national self-determination and social emancipation, economic modernisation and rationalisation did not feature as high priorities. Since then, many of the gains on the social, political and economic fronts have been consolidated, but the country became increasingly complacent, not realising that the world is a dynamic place, where new problems and challenges appear all the time. Alongside political and social nation-building, the country ought to have pursued a thorough economic modernisation. Despite some commendable efforts, it is a fair assessment to say that an overall failure to modernise the economy has led to the current crisis. But all is not lost. As when it voiced its opposition to the colonels and supported Greece's political emancipation, Europe is now supporting the country in its hour of difficulty. Under its continuing support and modernising influence, Greece will rise to the challenge of economic reform as the next step in its nation-building programme.

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