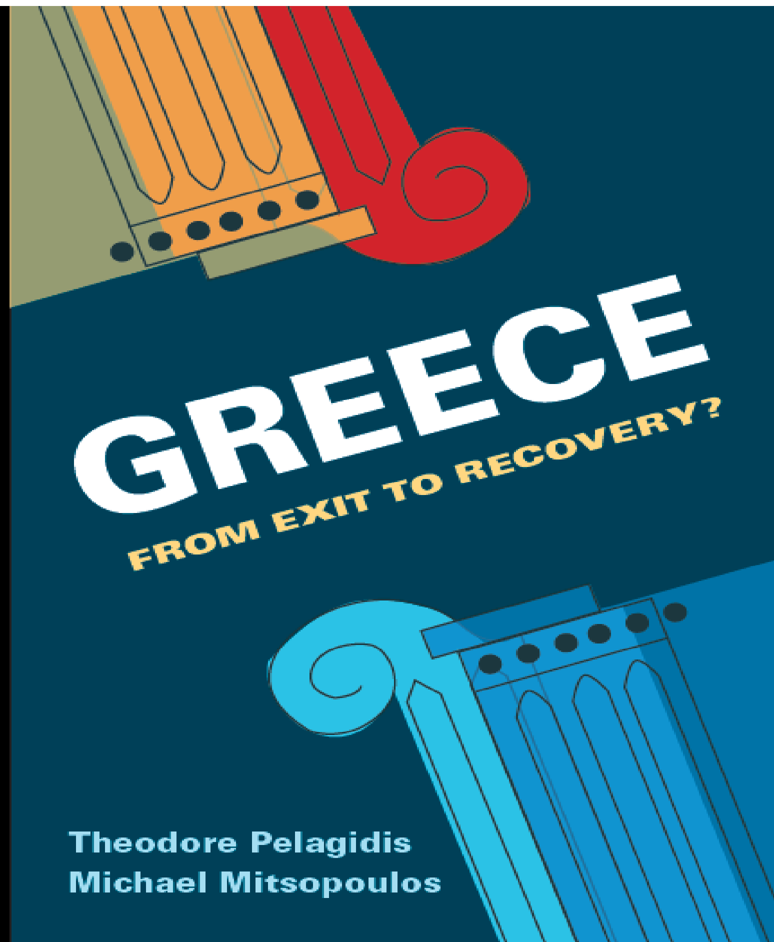
BROOKINGS INSTITUTION
EUROPE GROWTH PROJECT
GREECE



Chapter 1 – key questions

- What did the IMF, E.U. and ECB say about the euro accession of Greece and its performance in the euro area? A failure before the program?
- Could 2010 have been foreseen?
- Were Greek politicians aware of costs for Greece to join the single currency and the reforms that should be done?

Vikings in Greece

Kleptocratic Interest groups in a rent seeking economy, *The Cato Journal* N.3, 2009

Chapter 2 - Key questions.

- Did the MOU solve problems;
- Did the MOU create new problems;
- Did the Troika worry about the new problems;
- What now;

To keep in mind

- Not a perfect - & undecided- monetary union and the antidotes are not there
- Euro is a hard currency for Greece
- Surplus countries deny to reflate in EZ -& have gathered a large part of available liquidity in EZ!
- Overreliance on foreign funding –that flow massively after joining the euro- makes Greece extremely vulnerable to changes in lending conditions…

The two faces of Janus: High Growth & Low Competitiveness 1995-2008

- Persisting inflation differential with the euro zone 1.5-2.0%) (in goods' sector, not a B-S effect!)
- Persistent current account deficit (12-14% of GDP)
- High Budget deficits = -CA & inflation
- Red tape and growth stifling regulation keeping employment less than 50% of total population
- FDI = practically zero
- Public sector debt steadily excessive above 100%
- Consistently low competitiveness ranking, relatively to per capita GDP !

EVERY BUBBLE HAS ITS BURST!

A huge “Domestic Income – Expenditure” (competitiveness) disparity reflecting a huge, 15% of GDP, twin deficits (2009-10)

‘The Depression of the century’ begins…

Failure 1

"Business as usual" for the rent-seeking system, "dead end" for the productive economy. 2010-2012

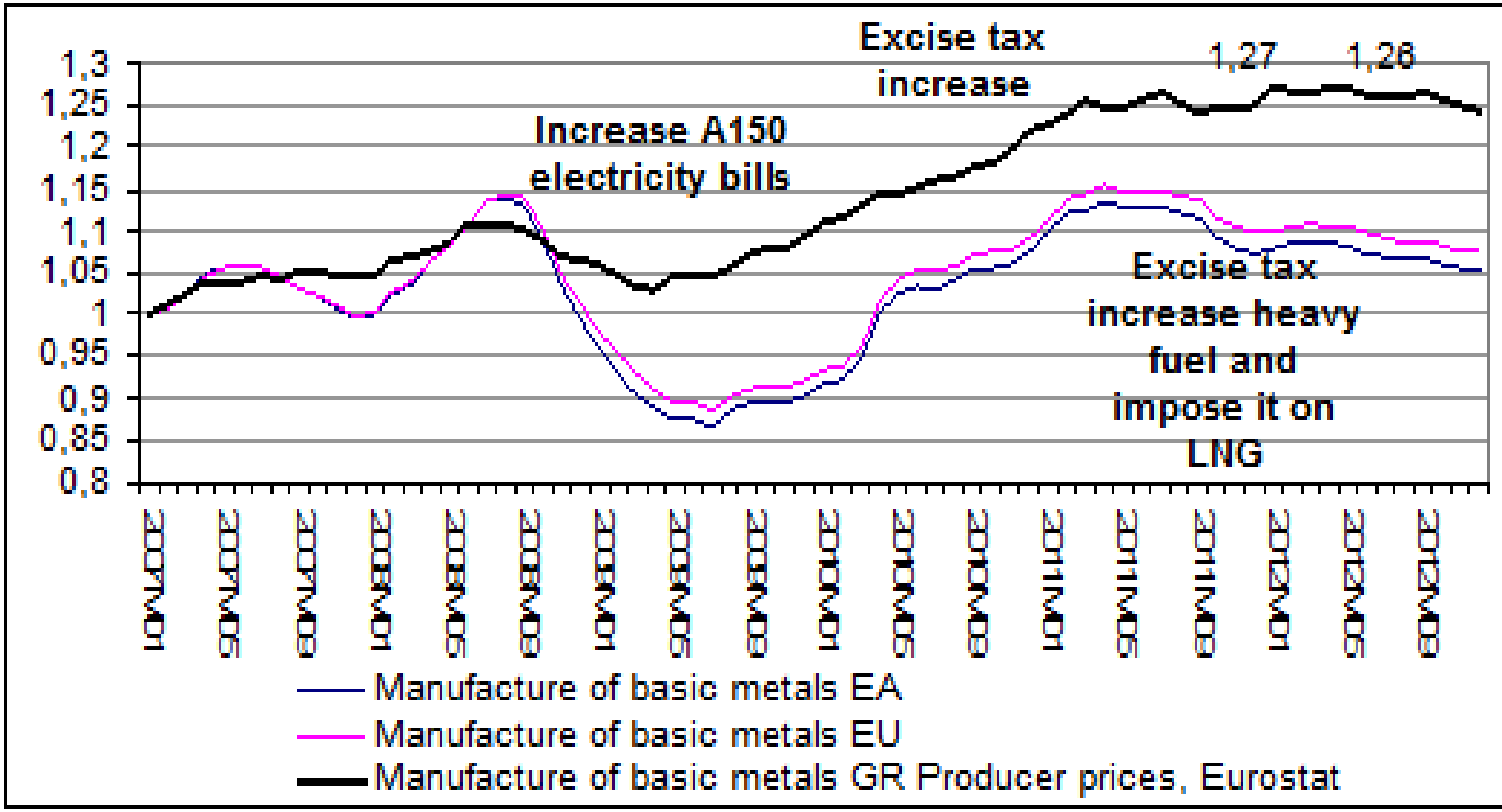
Indicative list of new taxes

- Multiple abolition of tax exemptions
- Increased of annual estate tax, up to 2% of administratively set value, and then additional estate tax through electricity bills
- Multiple VAT increases
- New personal income taxation law with higher rates, lower tax free income
- 3 tax increases on tobacco, alcoholic beverages and VAT increase on non-alcoholic beverages
- Further increase of tax on mobile communications – highest in EU
- 3 gas/petrol tax increases
- Multiple increases of taxes on electricity, especially for businesses – now probably highest energy prices in EU for industry!
- Introduction and increase of luxury tax
- Recurrent extraordinary tax on profitable companies and increased tax on dividends
- Introduction and increase of recurrent extraordinary tax on high personal incomes
- Tax on banks and increase of tax advancement
- Tax on tv advertisements
- Tax on violations of building permits
- Green tax
- Income tax on leased cars and private sector company cars (but not government official cars!!!)
- Introduction and then increase of tax on assumed income
- Increase in train, bus tickets
- Tax to avoid anti-smoking ban
- Fee to access hospitals
- Highest recurrent real estate taxes in the OECD, and probably the world!
- Taxes on yachts (now all foreigners took their yachts to Turkey and Montenegro!!!)

Taxes on production: Not a smart deal!

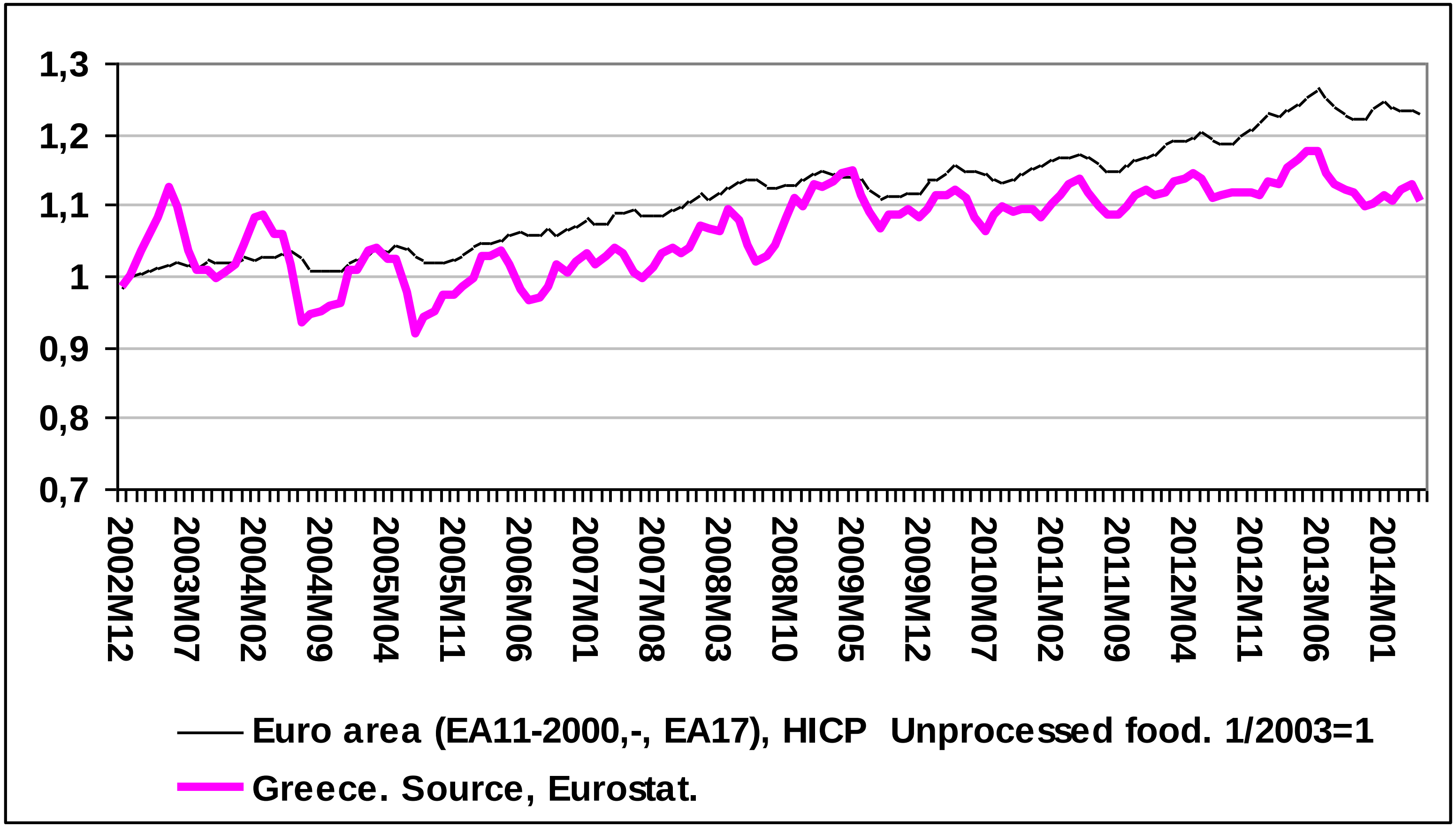
An example of excise tax increase. Producers' cost divergence between Greece and EU.

And you expect Greece to export?



With constant indirect taxes…

internal devaluation might have been successful…



Failure 2
Textbook 101 Economics
'Internal devaluation fighting itself!'

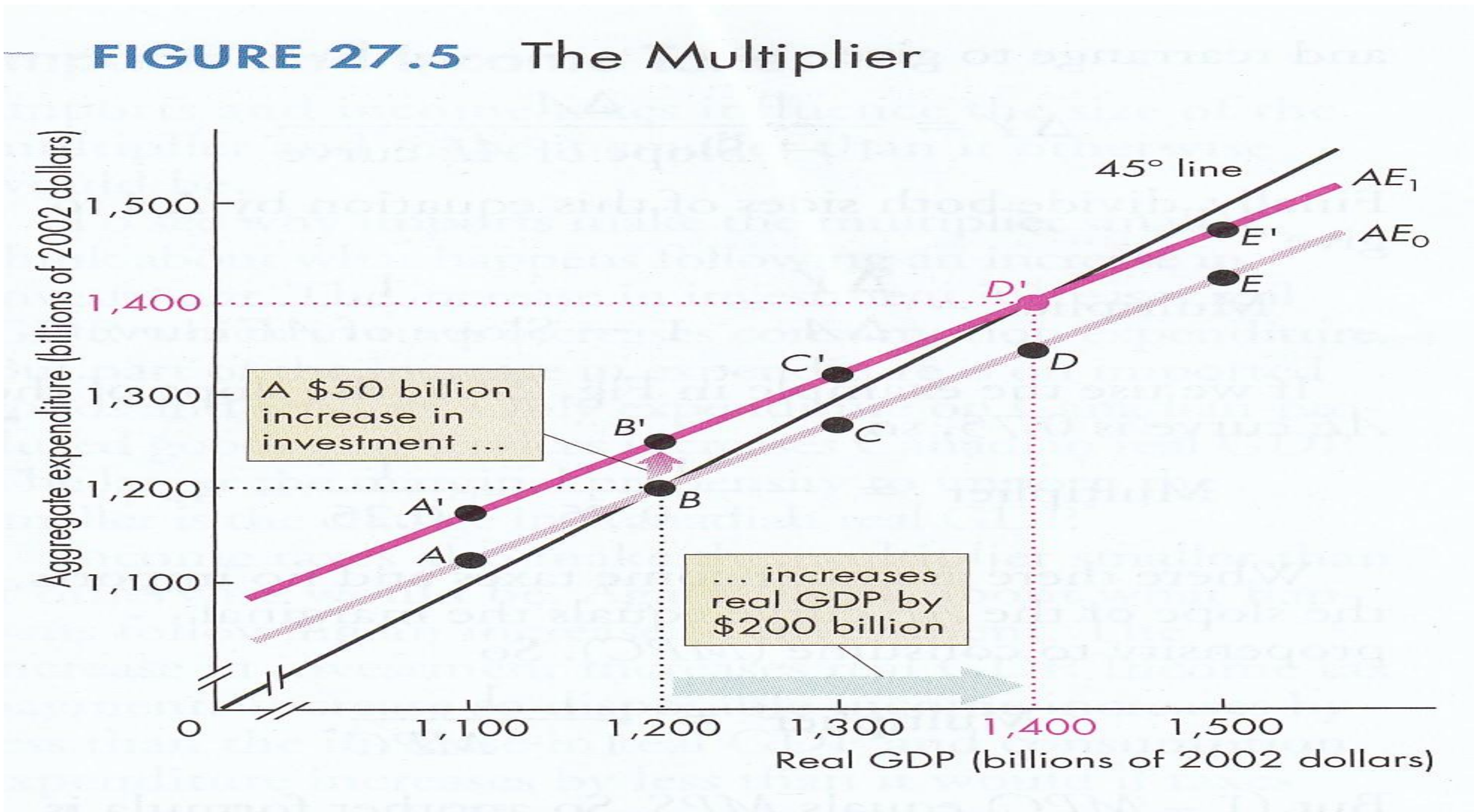
Implementing Internal devaluation but at the same time allowing the government to tax heavily the productive sector of the economy

Collateral damage:

How a country with a 'depression of the century' can, at the same time- pay back a storm of maturing bonds?

The $1mil. Question…

It is not the 'multiplier, stupid!

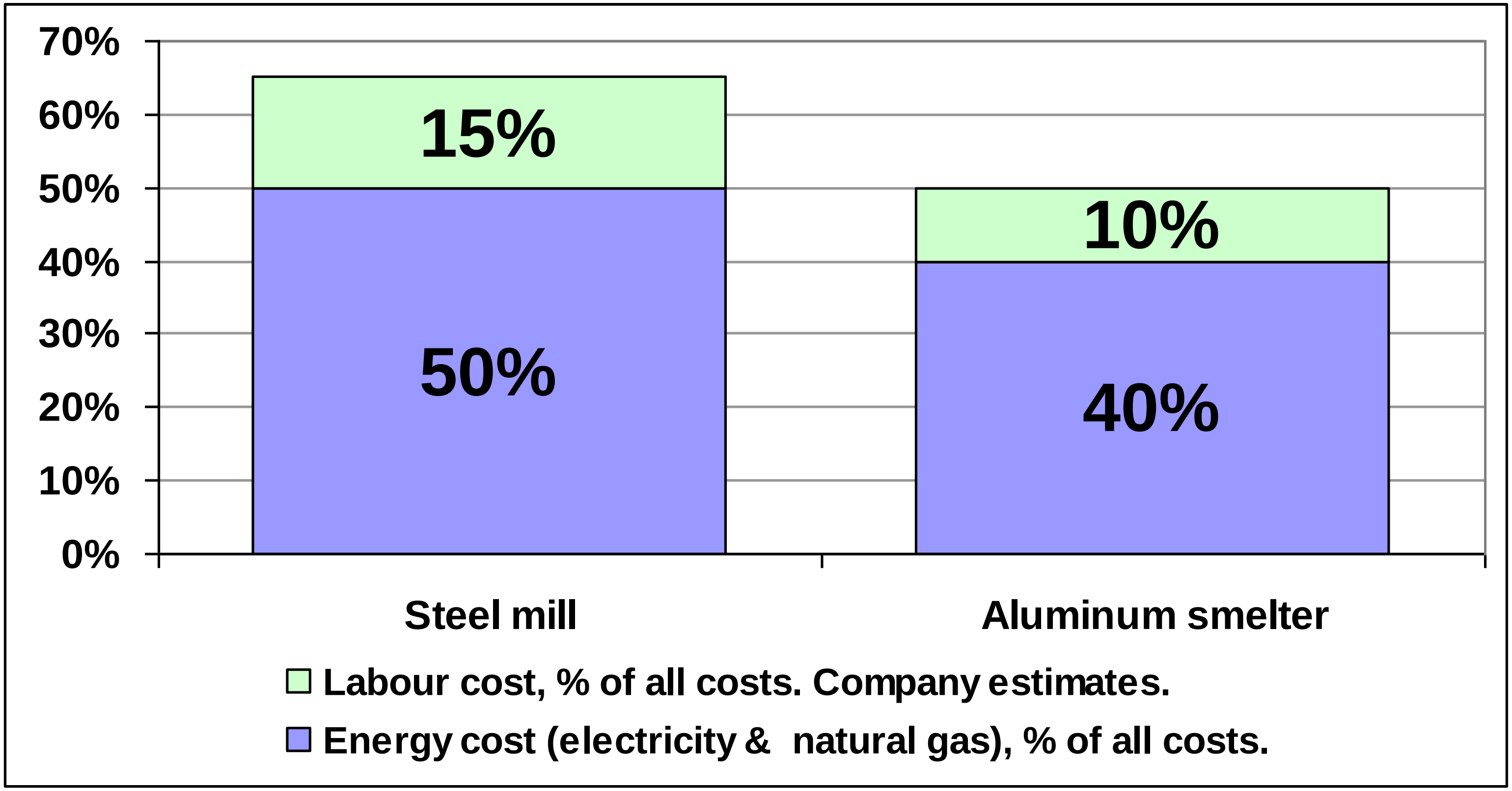


A great idea!

Suffice to cut sharply wages to restore competitiveness!

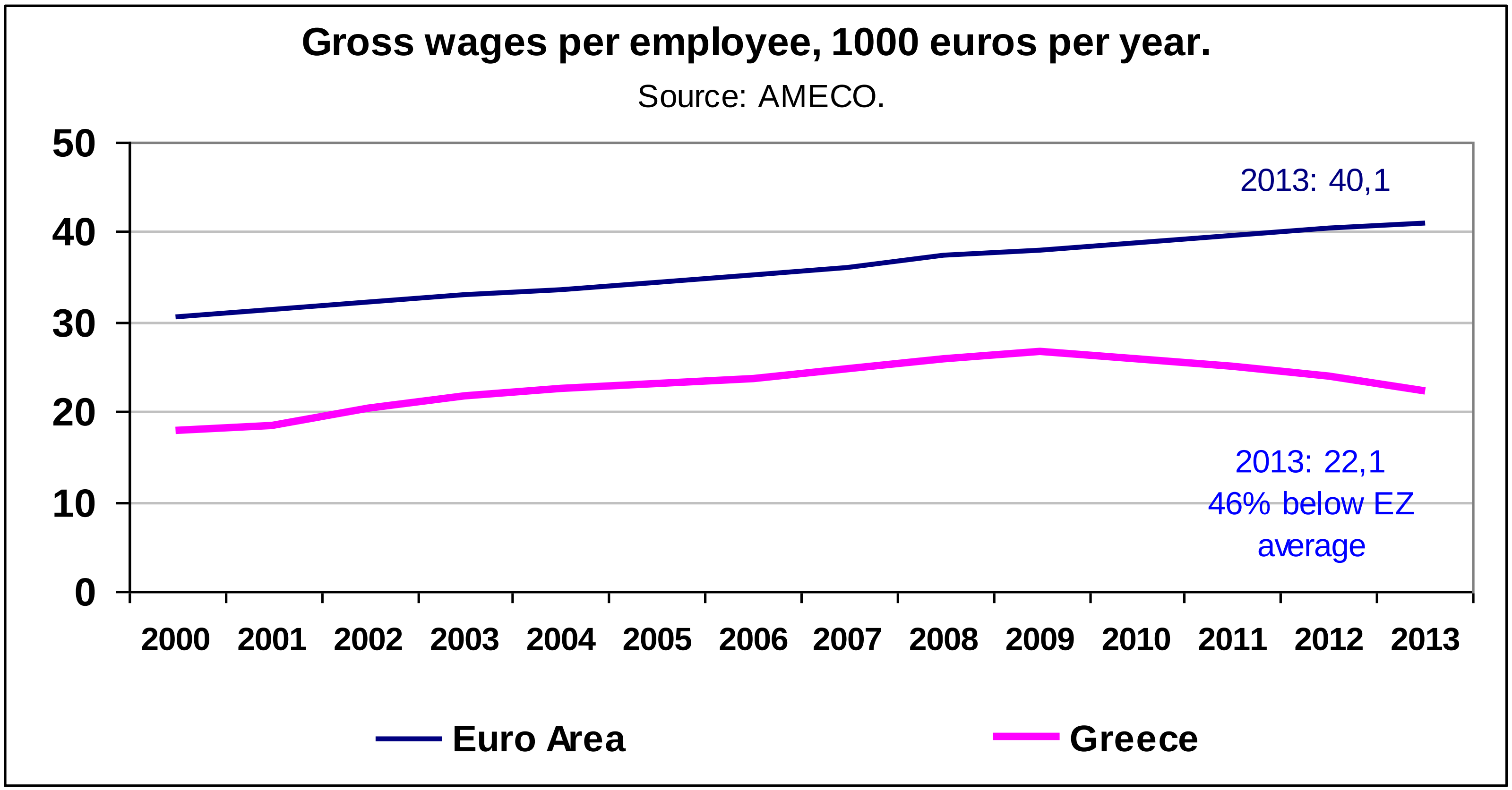
What? It doesn't work?

Need to cut more and more….and more…

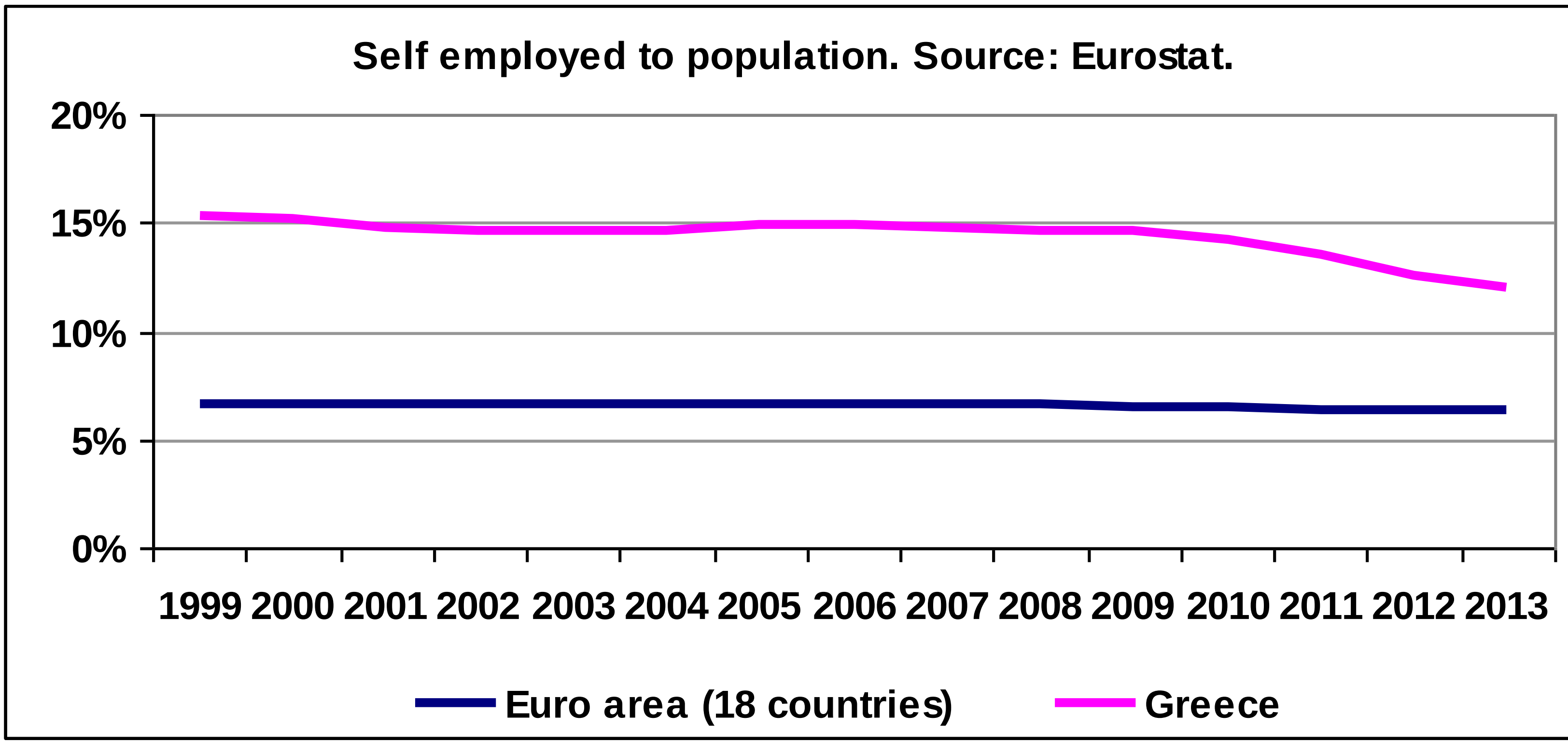


Failure 3

Attacking first and foremost (already low private sector) wages (that is…attacking GDP).



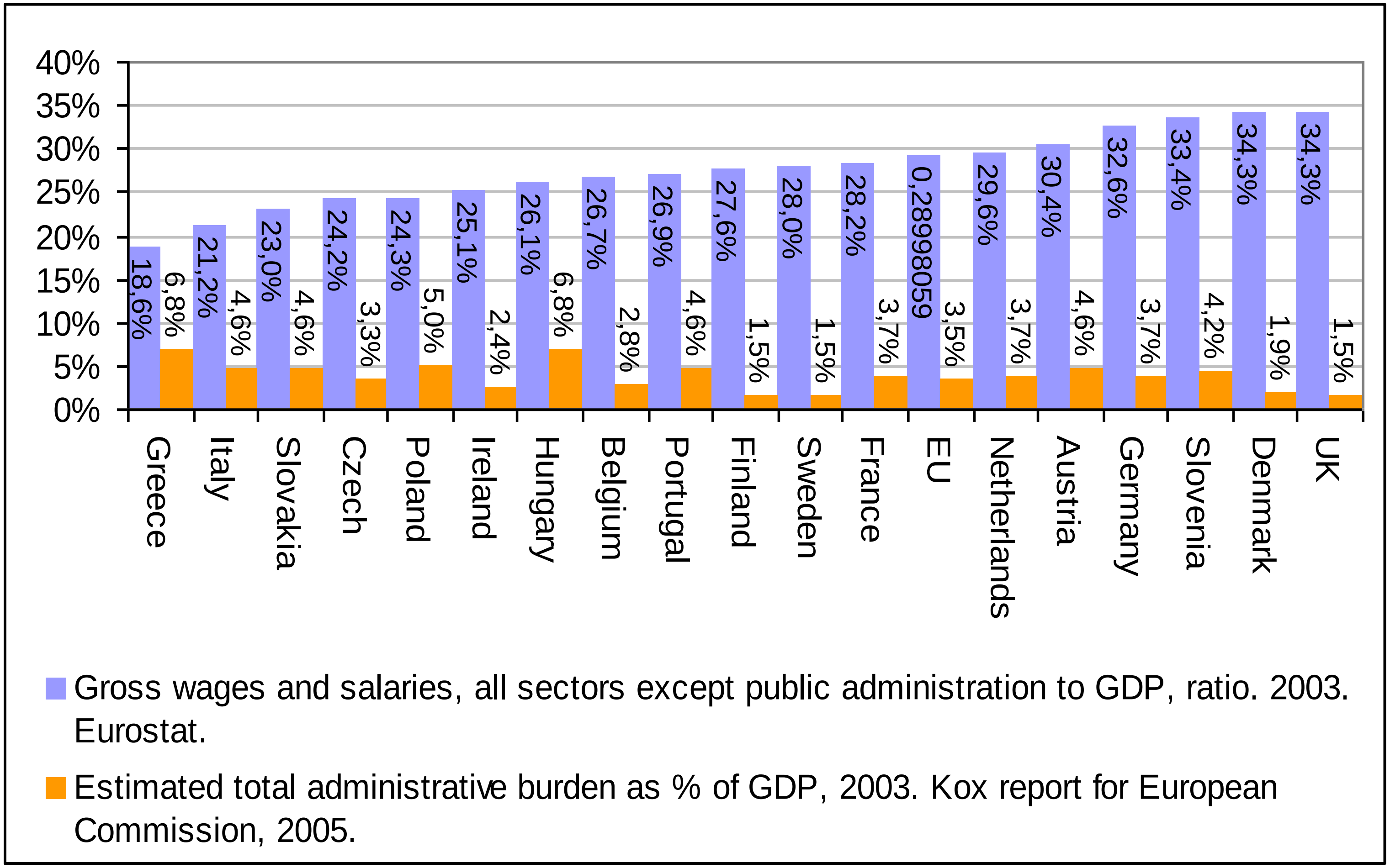
How effective is to cut wages when there are so many self-employed?



And how did they miss this?

Administrative cost = 6.8%/gdp (sky-high)

Private sector wage bill = 18%/gdp, lowest in EU!



Failure 4
Never put labour market deregulation ahead of product market liberalization

(ask OECD for evidence)

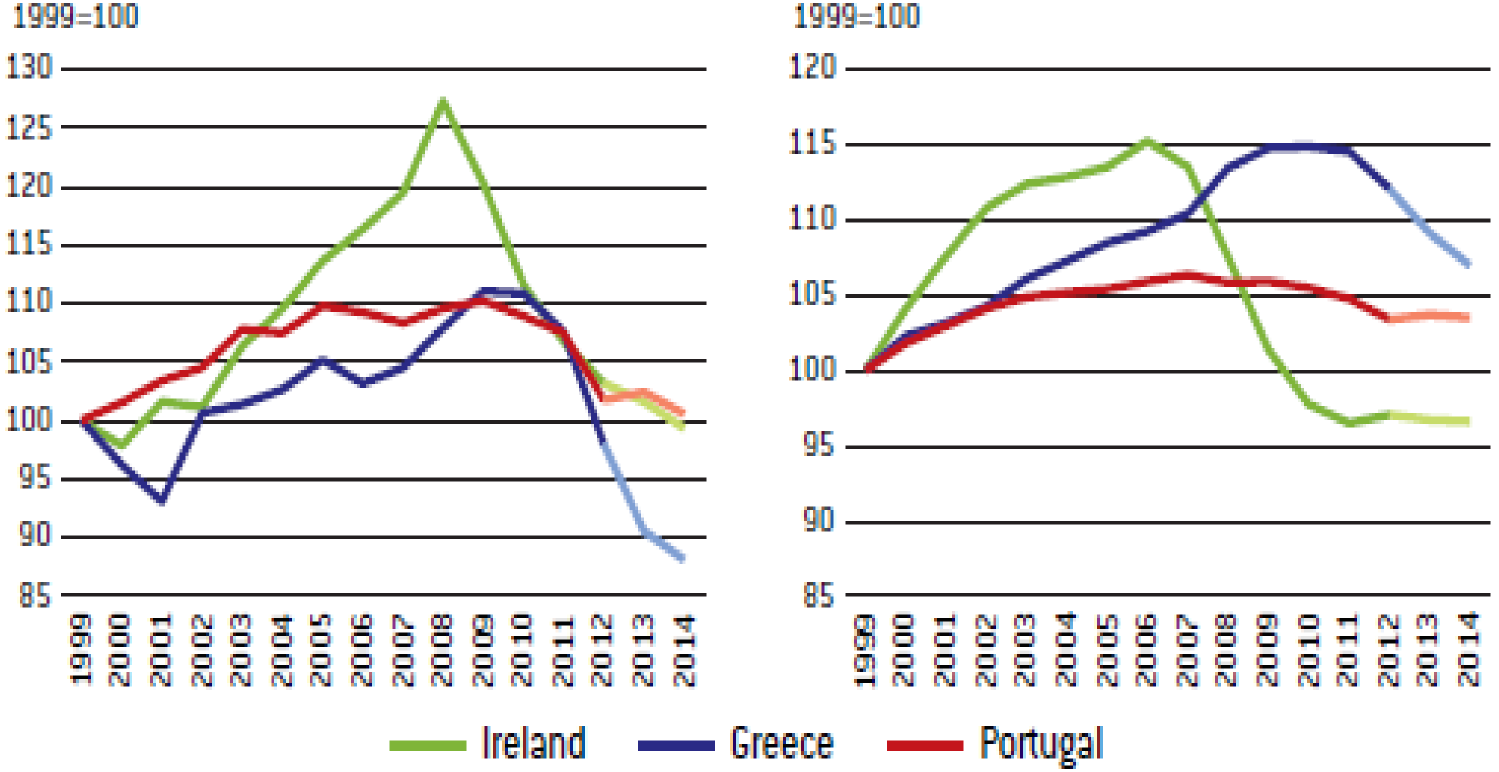
One needs to understand the role and persistence of rents in protecting sectors!

(The Vikings style “massive free riding”..)

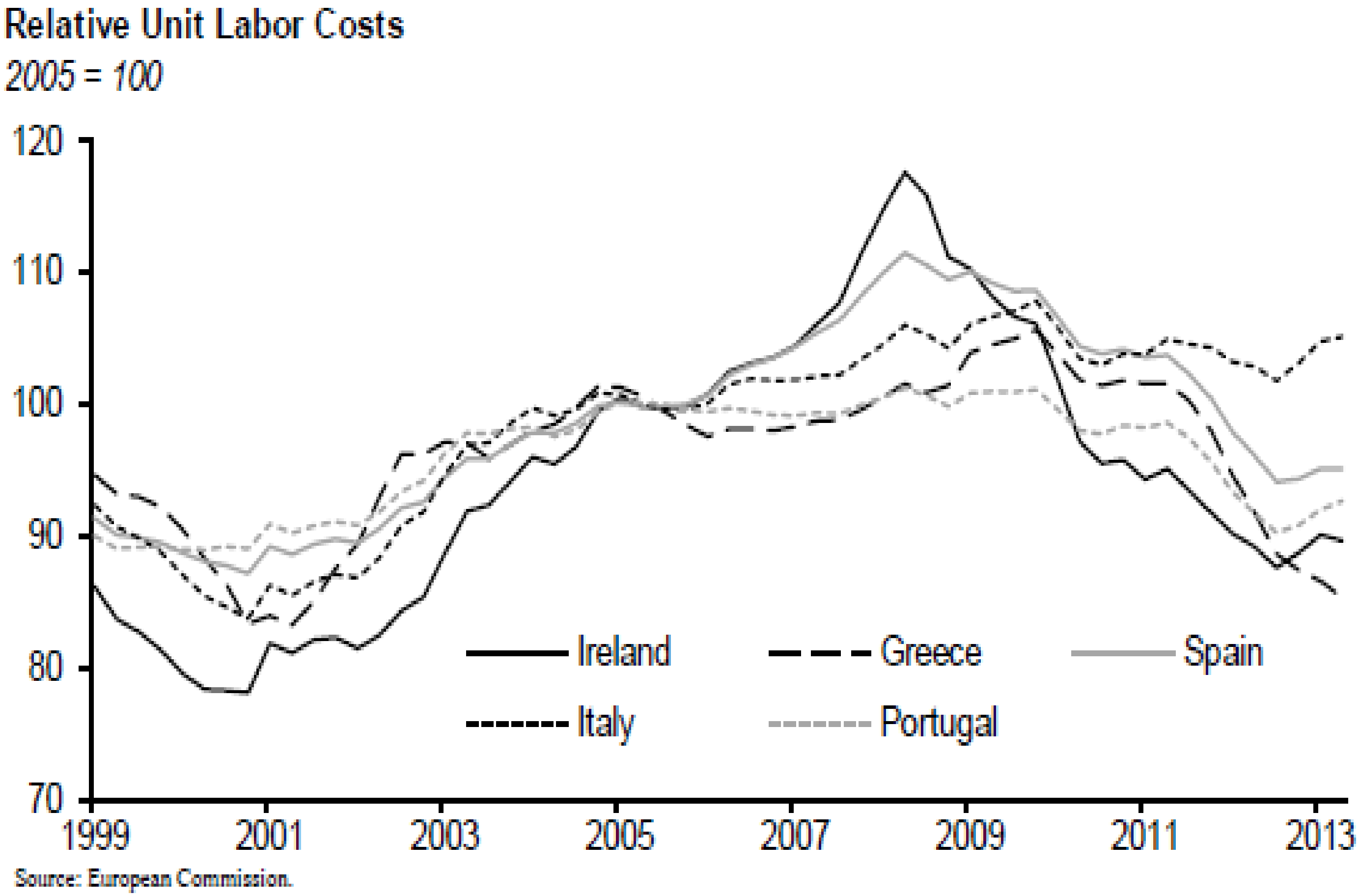
The political economy of reform is not a theoretical nuisance to ignore, here it is a make or break practical issue.

Wage costs and Prices

Figure 23: Real effective exchange rates, based on unit labour costs (left panel), and GDP deflators (right panel), performance relative to the rest of the former EU15: double export weights



More evidence on labor cost. Myth- busting.



Chapter 2 – Answering key questions

- No, the MOU initially did not set out to solve the main problems (business environment, privatization, product markets and professional services, bad laws etc).
- It focused initially only on tax increases and falling wages in the private sector.
- It ignored for too long non-wage costs in spite of the hard evidence that they were the main problem for the productive economy, not average wages.
- Especially the IMF seems not to have had “structural reforms” as a priority in its 1990-2009 reports and after 2009.

Yes, the MOU (as implemented) created some new problems:

- Increases in taxes and prices of state-monopoly run energy brought lately stagnating exports
- Unbelievable complication of all the new tax laws
- Grexit talk context just before PSI2 destroyed a large part of a healthy private sector, that is the tax base.
- Overall the productive sector was left to die but what about the powerful network of the, broadly speaking, political system???
- Now the balance of power in the political system is even worse than it was in 2010!

What now?

Still dealing with a depression as if it still were a sovereign debt crisis! It is not!

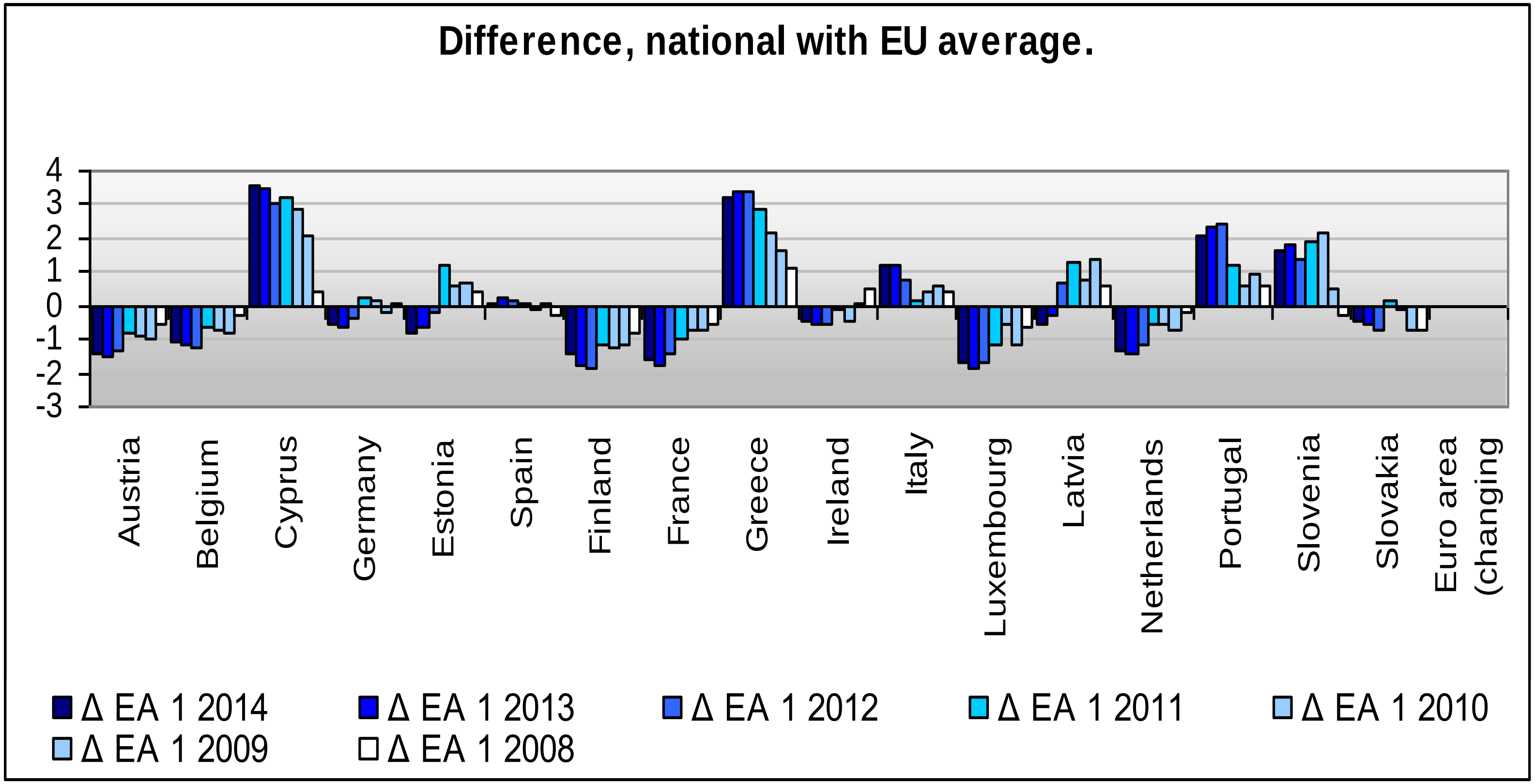
The irony: The new problems cancelled the positive effect of –at last- many structural reforms of 2013…

- Did you take a van from your hotel here or to the beach? Reforms you can see!
- Now you can actually board now a home-ported cruise: Reforms you can enjoy!
- Want to move? Rent a U-Haul or bargain with the mover: Reforms you can live with.
- Have a manufacturing unit in Attica? You can now renovate it, for the first time after 30 years! Reforms to produce.
- Are you an academic with a good business idea? There is now an (indirect) way to work for the start-up.
- Do you want to export? Many procedures now on-line and the port of Piraeus actually works!
- A new hiring can be made on line (not 3 papers to 3 agencies any more!)
- **…etc, etc…**

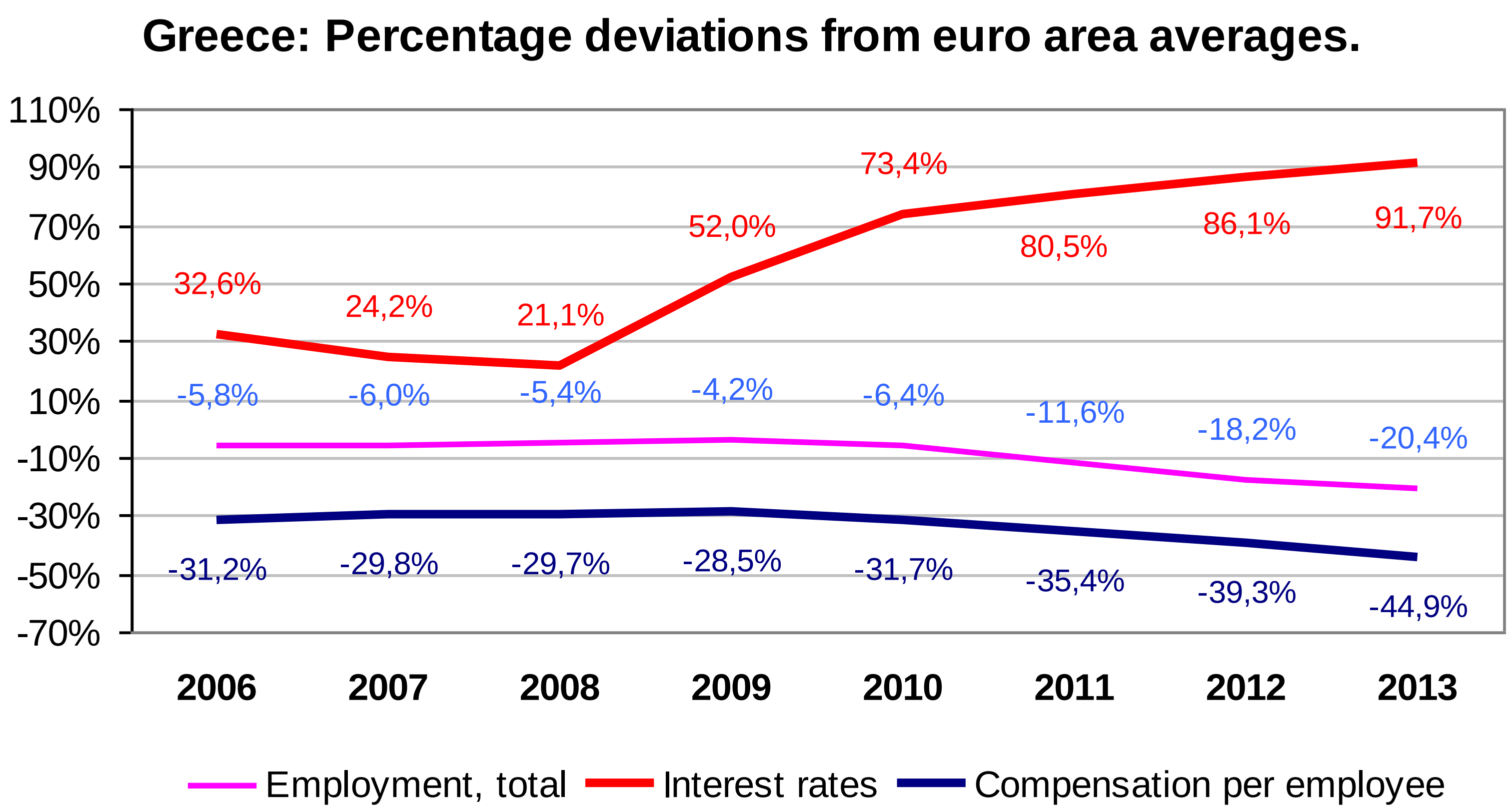
BUT…

Just a hint of why exports are not making the difference today (as in Portugal ….)

Greek enterprises: Facing high energy costs, lack of liquidity, and last but not least, <u>sky high Interest rates</u>



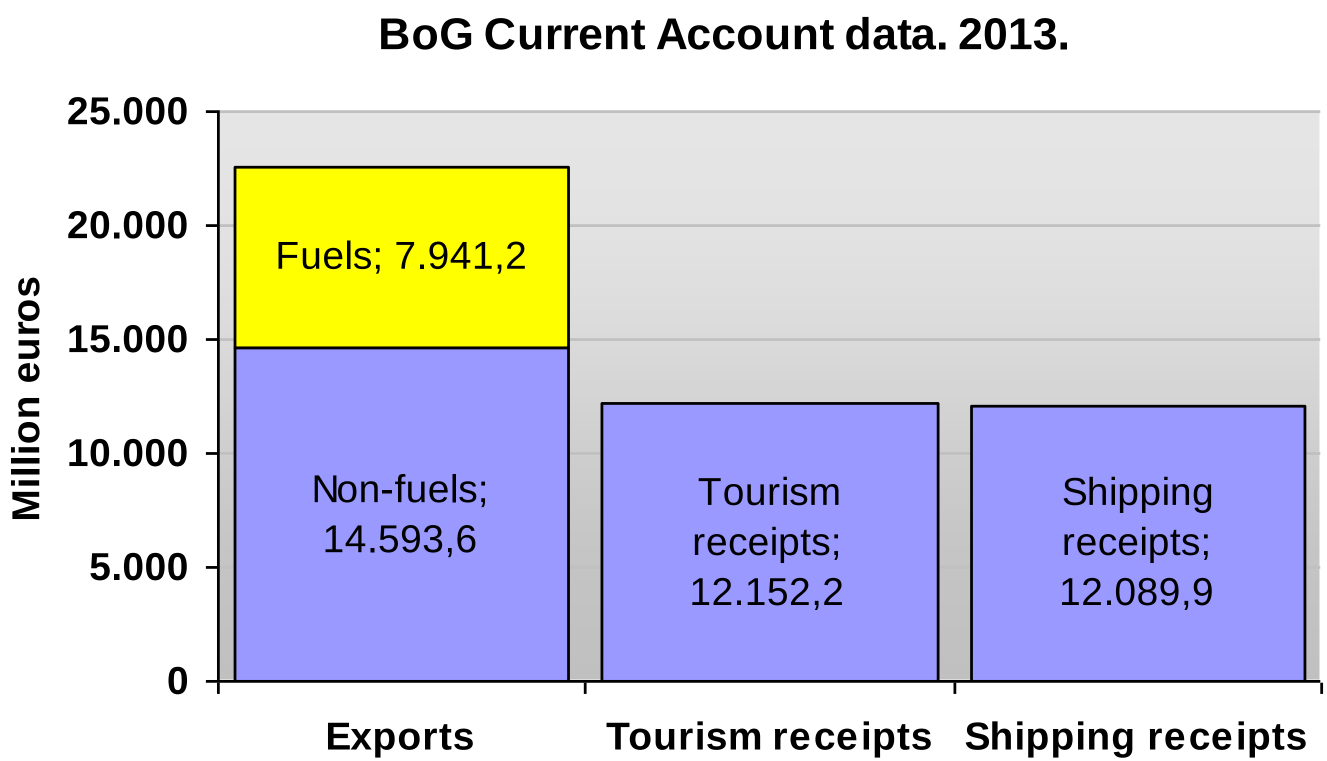
Private sector cost of money (and energy cost and taxes…) crowds out fall in wages!



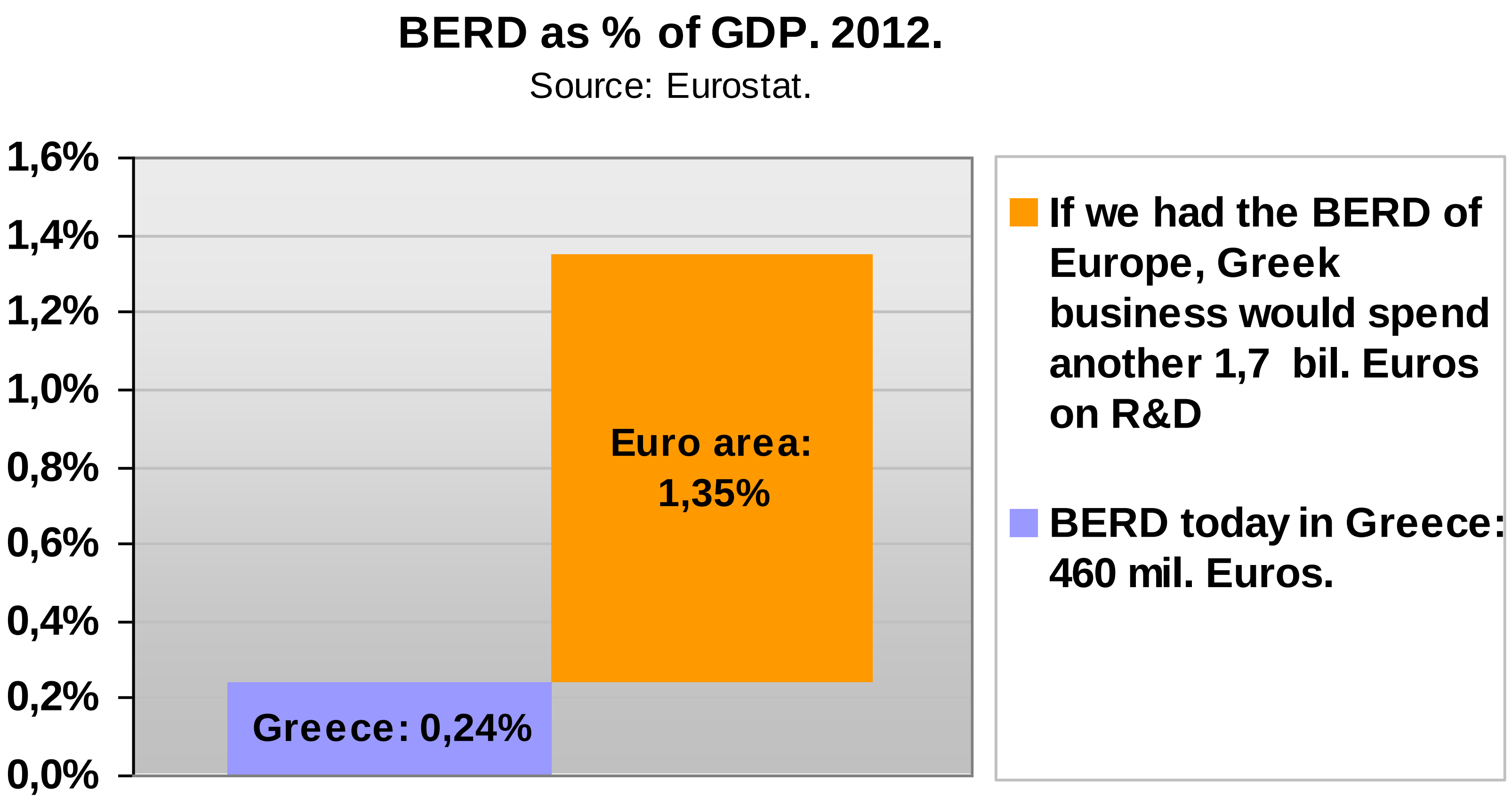
Section III

- Something new about the future.
- GO BEYOND THE COMPARATIVE ADVANTAGE STEREOTYPES (TOURISM, SHIPPING, SOME AGRICULTURAL PRODUCTS, ETC.)
- Does not mean what others say does not apply.

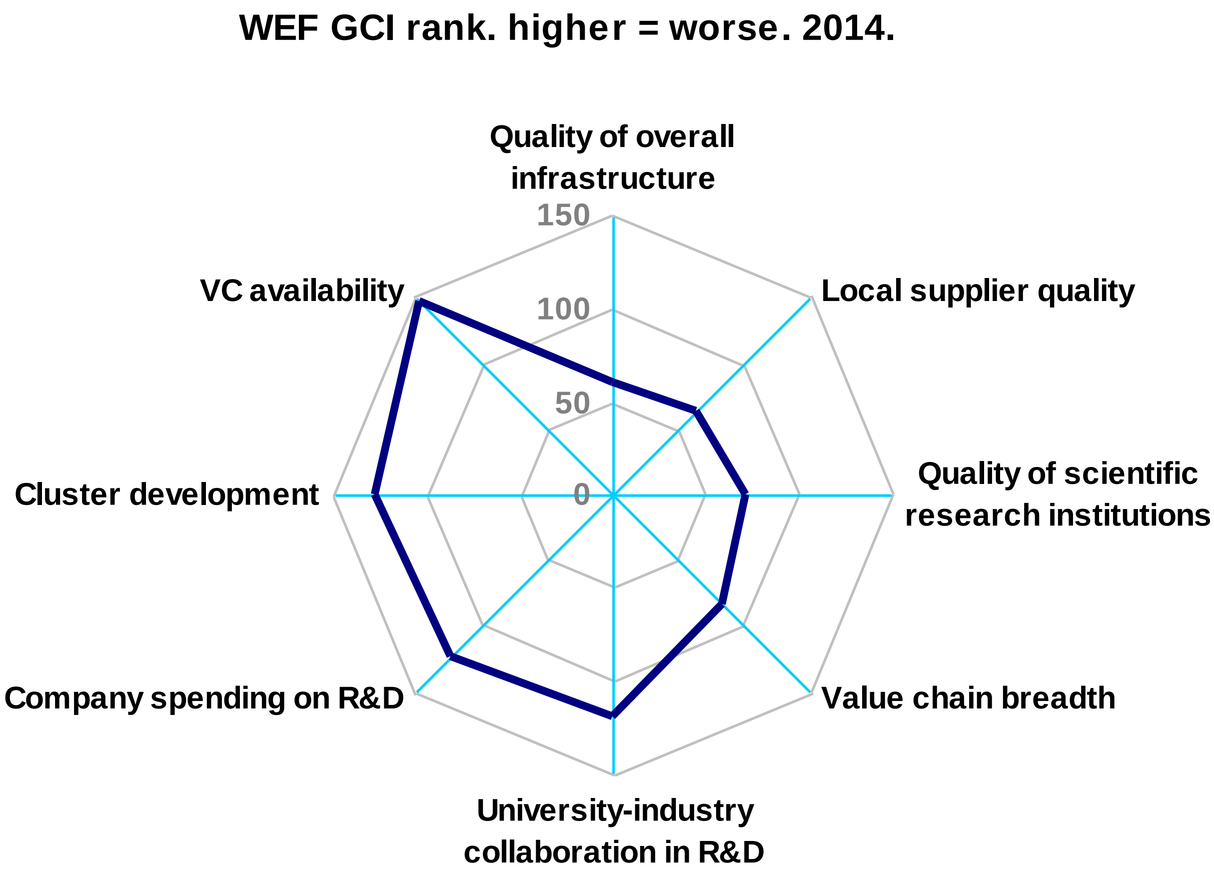
Exports of goods: 14.5 bil. (nobody mentions, except Ricardo Hausmann & friends) + fuels $8 bil.
Receipts from tourism/travel: 12.1 bil. (everybody talks about)
Receipts from transport services: 12.1 bil. (everybody talks about)
:



Business expenditure on R&D (BERD): Like with production, there is quite a gap!



Worse in VC, Clustering, R&D



What we have done

Candidate independent variables (WEF, WB data)

Property rights
Intellectual property protection
Burden of government regulation
Quality of overall infrastructure
Quality of the educational system
Intensity of local competition
Burden of customs procedures
Flexibility of wage determination
Venture capital availability
Domestic market size index
Value chain breadth
Quality of scientific research institutions
Control of Corruption
Government Effectiveness
Regulatory Quality
Rule of Law
Voice and Accountability

Significant and positive effects of business R&D:

- **Availability of venture capital funds**
- **Value chain breadth**
- **Quality of research institutions**
- **Quality of the educational system**
- **Burden of government regulation**
- **Intensity of local competition**

What the data tells us:

- The literature that documents the need to have flexible financing (eg VC), research capacity (eg. quality of research institutions), production capacity (value chain breadth) and incentives to use these (competition) is in line with the findings.
- Interestingly, wage flexibility seems here to matter little.

These significant variables have strong correlations with the eliminated multicollinear variables:

- Protection of property and intellectual property
- Quality of infrastructure
- Control of corruption
- Effectiveness of government
- Regulatory quality
- Rule of law

A tangible opportunity for Greece

- **Existing research capacity and significant physical infrastructure**.
- **Poor performance in innovation and competitiveness especially with respect to government regulations and practices that curtail competition.**
- **The breadth of the value chain is important**.
- **Financing is a problem and needs to be fixed comprehensively**.
- **Respect for property and intellectual property is an issue.**
- Appropriate **governance of research institutions and higher education institutions**
- These are complementary actions, all growth enablers, are needed now! Details in the book!

THANK YOU!