

"The Need for Structural Reforms in Greece"

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"Greece's Structural Economic Reforms:

A Faster Pace towards Stabilization and Development"

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"The Need for Structural Reforms in Greece"

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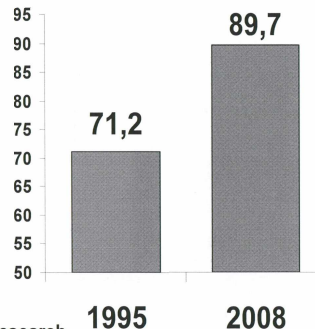
Part I

Why we desperately need reforms

I. Will Greece keep converging to the EU-15 average?



**GDP per capita
PPS, EU-15=100**

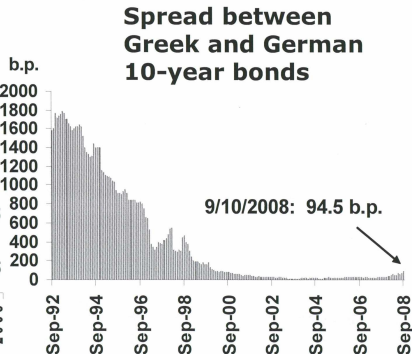
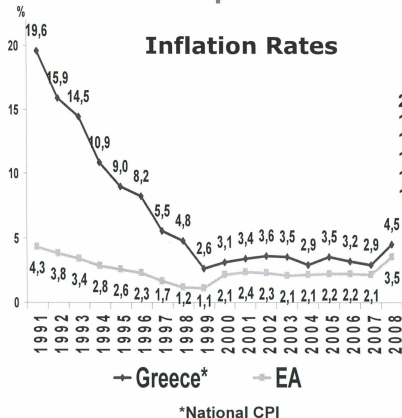


Source: European Commission, Ministry of Economy, Eurobank Research

- ✓ **Investment: the main driver of growth, with growth rates higher than those of consumption**
- ✓ **Until 2005, investment in equipment higher than investment in residential construction**
- ✓ **Is the party over now?**

I. As members of the EMU we enjoy ...

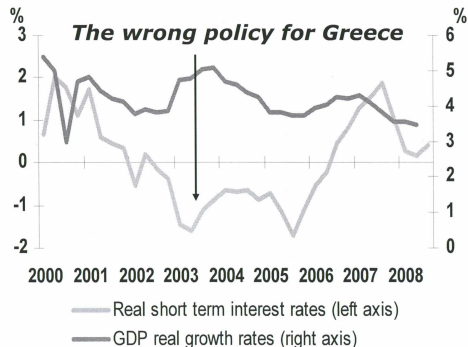
- ✓ Improved price stability
- ✓ Lower nominal interest rates
- ✓ FX stability
- ✓ Fiscal discipline



Source: Eurostat, ECB, Eurobank Research

I. Yet, EMU restricts our macro-policy choices ...

- ✓ Monetary policy set in Frankfurt, not Athens
- ✓ No FX policy, currency devaluation no longer an option
- ✓ Counter-cyclical fiscal policy only as an emergency tool, provided it abides by SGP and, with high debt/GDP, almost impossible
- ✓ Different economic cycles between Greece and Euro Area imply best policy for EMU would not necessarily be best policy for Greece, e.g., **real interest rates were negative** during the 2003-4 period of Olympic Games in Athens, a time of strong aggregate demand.



I. ... Making structural reforms a necessity

It is now necessary for the economy to be able to respond automatically and with increased flexibility to negative external shocks

Structural reforms →

- ✓ Increase competitiveness, exports, output and employment
- ✓ Make private sector more resilient to external shocks
- ✓ Increase potential output → output gap ↓ → inflation deceleration

The resilience of the domestic banking sector to the current international financial crisis is a direct result of the structural reforms in the sector from the early 90's.

IMF study on structural reforms, 6/2008, with data from 91 economies over the past three decades:

"Real and financial sector reforms have helped to boost economic growth in both developed and developing countries, with domestic financial sector liberalization, trade liberalization, and liberalization of the agricultural sector exerting particularly favorable effects.has also tended to enhance the assessment of the future profitability and solvency of domestic firms."

I. Yet, the existence of EMU hides the necessity of reforms

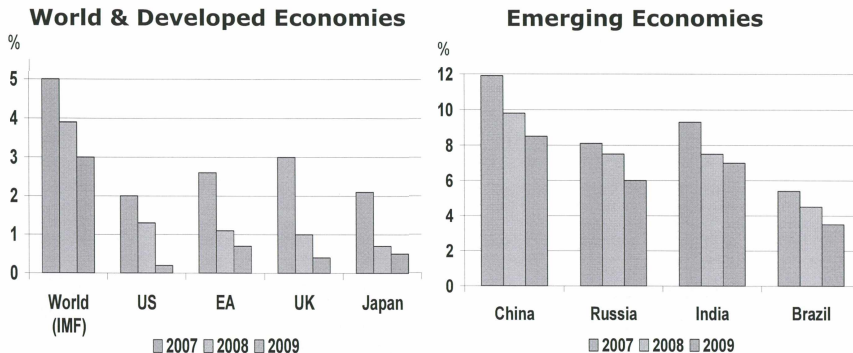
- ✓ For small countries of EMU, the **discipline of the market is lost**, as market variables reflect aggregate Euro Area conditions:
 - Traditional market alarms, such as a rise in interest rates or FX pressure, are now absent and cannot alert citizens and politicians for mistakes in domestic economic policy
 - Imbalances cumulate, creating a distorted growth path that is vulnerable to an abrupt correction
- ✓ If the economy goes into recession, it is likely to **stagnate** for a long time as it would be difficult to reverse the downward momentum: The tools are not many
- ✓ The present **global crisis** is likely to expose the **weaknesses** of the Greek economy and the **limitations** on policy responses
 - Later on, during calmer times, history will teach the necessity of structural reforms

Part II

Crisis and economic imbalances in Greece

- a) The global financial crisis as a stress test
- b) The three imbalances:
 - 1) Competitiveness
 - 2) Future fiscal pressures
 - 3) Inequalities

II.a A decrease of global output growth in 2009



Greece: 2007 → 4.0%

2008 → 3.3%

2009 → 2.0% (IMF), 3.0% (Government)

II.a How will Greece be affected by the crisis?

Channels of negative influence:

- 1) Lower economic activity abroad → less exports, lower tourist receipts, less foreign buying of property, lower shipping rates
- 2) Higher interest rates due to liquidity considerations → less credit expansion, lower consumption & investment

Greece will avoid:

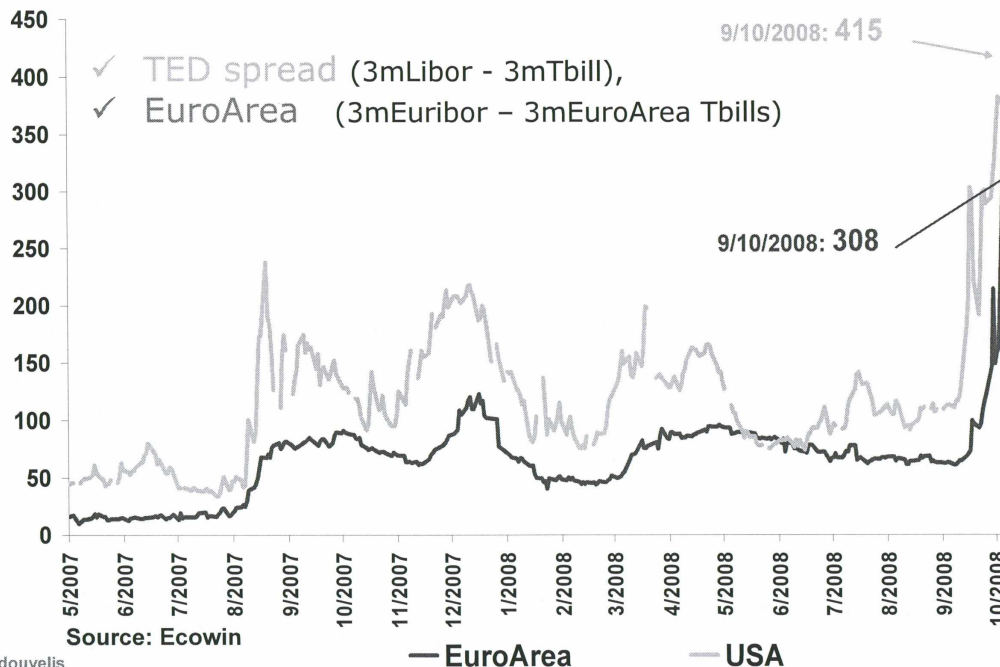
- ✓ Large bank failures and abrupt restriction of credit due to solvency reasons to the same degree observed abroad

II.a How large is the correction? The three problems of the global crisis

- ✓ The next 15 months will provide a stress test of the Greek economy
- ✓ Three problems underpin the global crisis:
 - 1) **Lack of liquidity**
 - 2) **Insolvency**
 - 3) **De-leveraging**
- ✓ Greek banks are affected only by the first factor
- ✓ Fortunately, structural reforms did occur in the Greek banking sector and Greek banks are very strong relative to their European peers
- ✓ If economy were to be affected more than European economies, one should search for other reasons than the behavior of banks

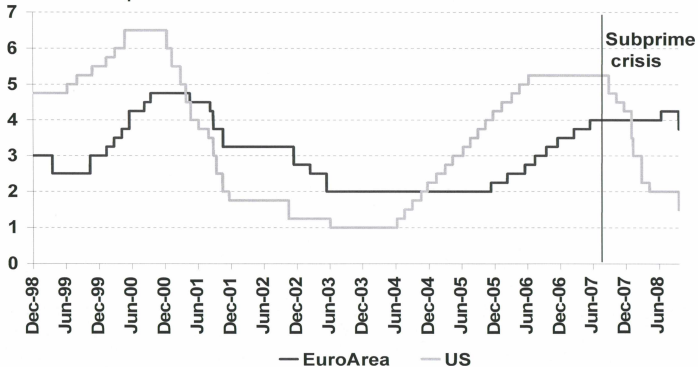
II.a Liquidity: US in worse shape than Euro Area

- ✓ Problem remains despite central bank interventions
- ✓ On Sept. 17, 3-month US T-bills reached 3 basis points!



II.a Monetary policy response

- ✓ Fed more aggressive than the ECB
- ✓ Lots of innovations in providing liquidity, yet the problem remains

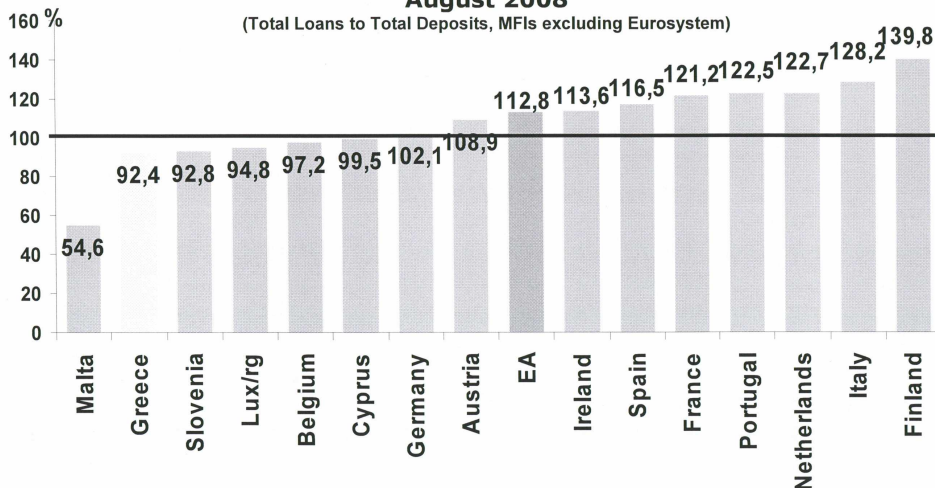


II.a Liquidity: Less of a problem in Greece relative to Euro Area

Loans to Deposits Ratio

August 2008

(Total Loans to Total Deposits, MFIs excluding Eurosystem)



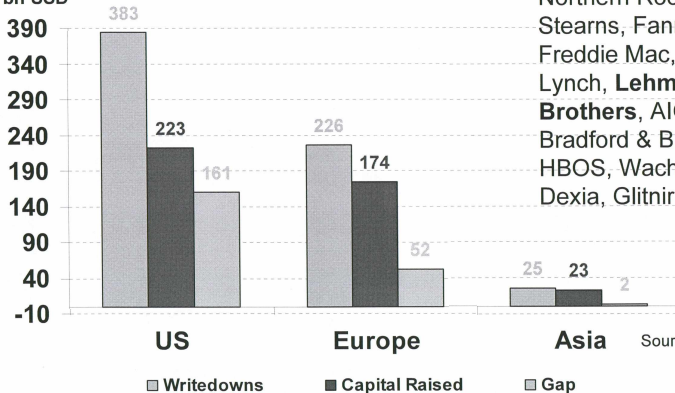
II. Insolvency

Total Write-downs: \$ 634.7
Total Capital Raised: \$ 419.3
Total Gap: \$ 215.4

Takeovers, mergers & capital infusions in US & Europe:

New Century Financial,
 Northern Rock, Bear-
 Stearns, Fannie Mae &
 Freddie Mac, Merrill
 Lynch, **Lehman**
Brothers, AIG, WaMu,
 Bradford & Bingley
 HBOS, Wachovia, Fortis,
 Dexia, Glitnir

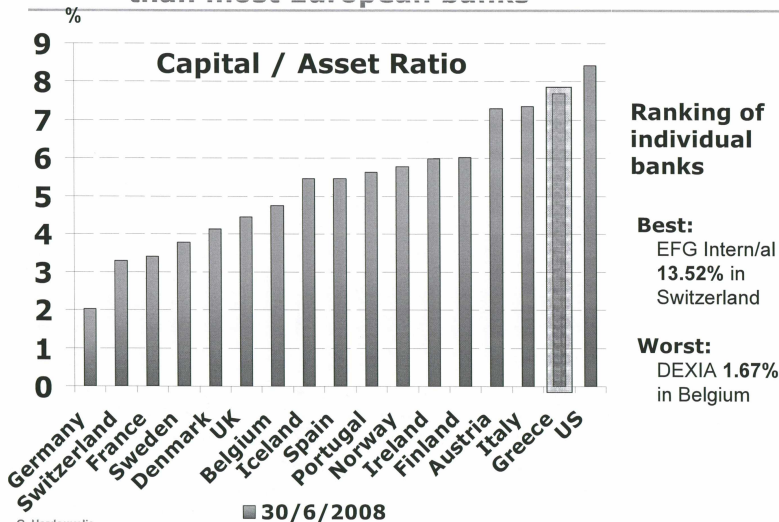
bn USD



Source: Bloomberg,
 Oct. 10, 2008

**IMF: Considers above numbers small.
 Estimates write-downs to reach \$1.4 trillion**

II.a Greek banks better capitalized than most European banks



II.a De-leveraging brings contraction

- ✓ Inability to raise capital to cover losses implies a multiple reduction in bank size (assets)
 - *GAP X Approximate factor of 12.5 in the US*
 - *GAP X Approximate factor of 20 in Europe*
- ✓ De-leveraging prolongs the crisis

Hence,

- ✓ **Further contraction in lending growth**
 - *1 year's worth of stagnation in lending in Europe*
 - *2 years' worth of stagnation in lending in USA*
- ✓ **Significant further downward pressure on asset prices**

II.b Greek imbalances

Long term imbalances:

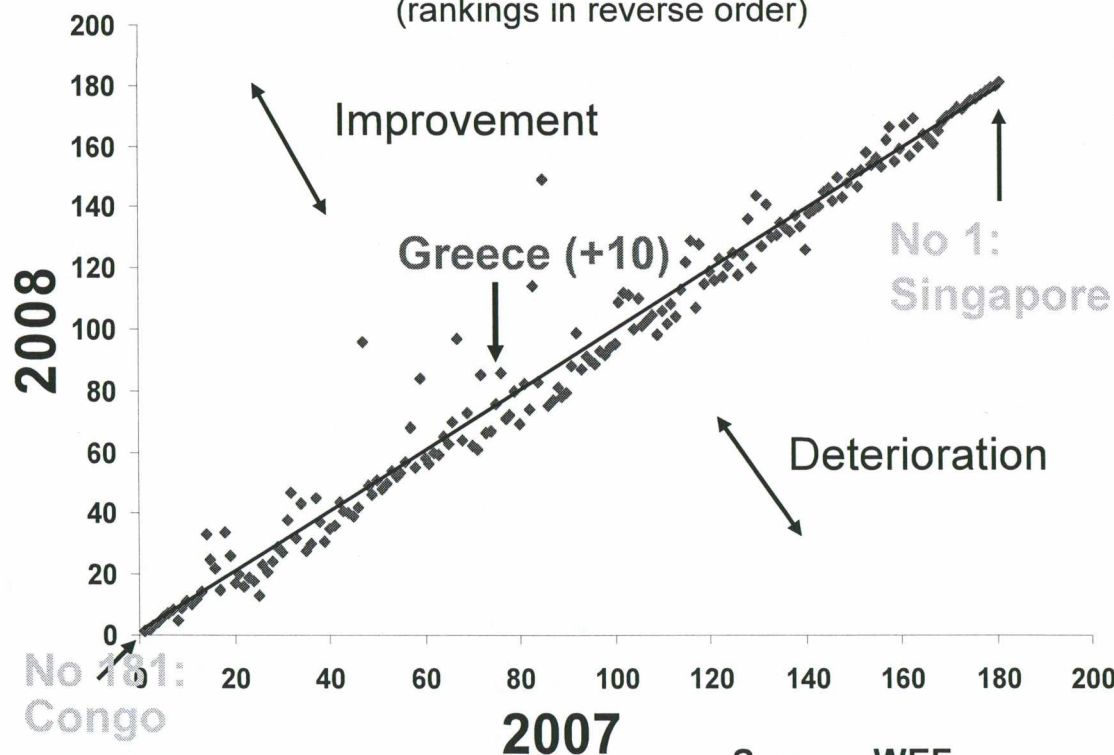
- ✓ Competitiveness at the micro and macro level
- ✓ Future budget pressures from aging population
- ✓ Income inequality

II.b Competitiveness and Ease of Doing Business

- Competitiveness is the deepest thorn in the Greek economy
- **World Bank - Doing Business 2009 report: Greece ranks 96th in 2008 among 181 economies in the ease of doing business, rising 10 places from the 106th in 2007.**
- Greece remains last among EU-27 countries

Ease of Doing Business Rankings 2007 – 2008

(rankings in reverse order)

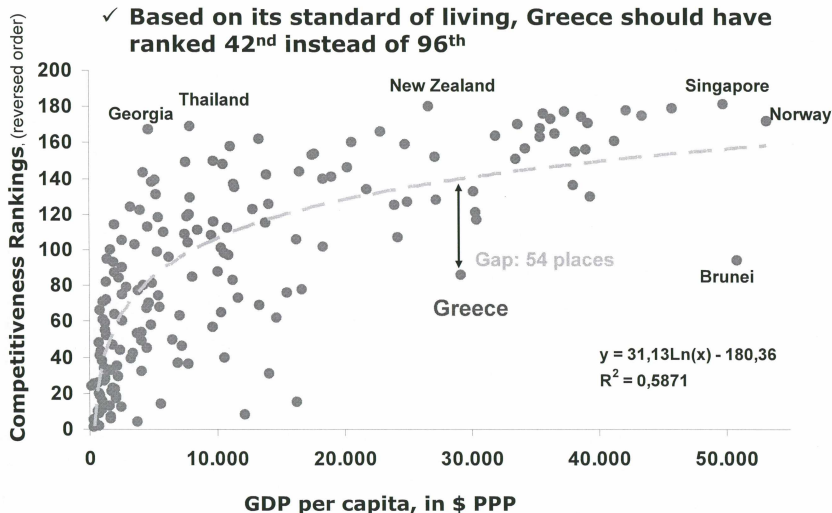


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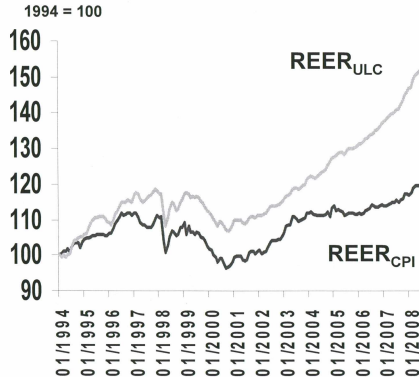
Source: WEF

Ease of...	Doing Business 2008 rank	Change in rank from 2007
Doing Business	96	+10
Starting a Business	133	+17
Dealing with Construction Permits	45	+1
Employing Workers	133	+10
Registering Property	101	-5
Getting Credit	109	-7
Protecting Investors	150	+11
Paying Taxes	62	+32
Trading Across Borders	70	-4
Enforcing Contracts	85	-1
Closing a Business	41	0

II.b Competitiveness way below Greece's level of development



II.b Greece is expensive relative to its trading partners ...

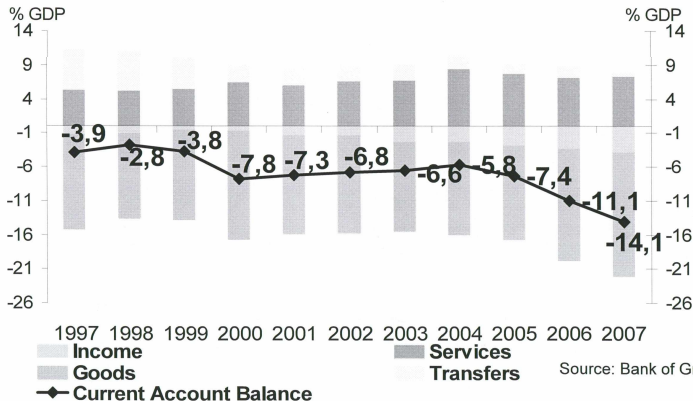


Source: IMF

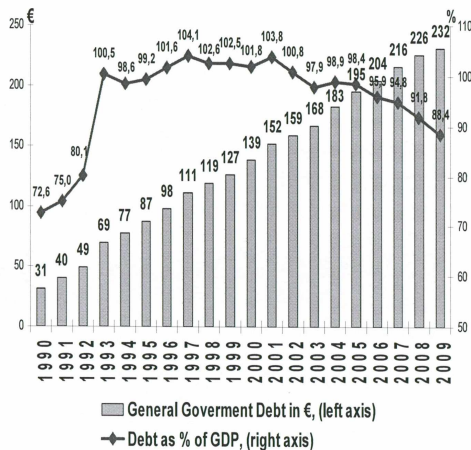
- ✓ Real Effective Exchange Rates have worsened since 2000
- ✓ The higher CPI inflation in Greece points to lack of competition in product & service markets.
- ✓ Unit labor costs are increasing faster in Greece

II.b ... hence, Greece's current account is getting worse

- ✓ CA deficit has tripled relative to the pre-EMU period
- ✓ CA deficit can lead to an abrupt future recession



II.b Fiscal pressures from aging population



	2005	2010	2050
Health Expenditures (% GDP)	5.1	5.4	6.8
Education Expenditures (% AEP)	3.4	3.1	3.1
% of older employees (55 – 64)	10.9	12.0	17.4
Old-age Dependency Ratio	26.8	28.0	60.4
Number of pupils&students (thousands)	1888	1768	1444

II.b Inequalities

	Unemployment (2007)		Employment (2007)	
	Greece	EU-15	Greece	EU-15
Total	8.3%	7.0%	61.4%	66.9%
Male	5.2%	6.4%	74.9%	74.2%
Female	12.8%	7.8%	47.9%	59.7%
Young	22.9%	14.7%	24.0%	40.8%

At risk of poverty rate

% of working population (2006)

	Greece	EU-15
Total	14.0%	7.0%
Male	15.0%	8.0%
Female	12.0%	7.0%

At risk of poverty rate

% of population (2006)

	Greece	EU-15
After Social Transfers	21.0%	16.0%
Before Social Transfers	40.0%	43.0%

Source: Eurostat

Part III

Structural Reforms

III. The difficulty of structural reforms

Difficulties in structural reforms arise from:

- ✓ Uncertainty regarding their positive influence
- ✓ Delayed effects, becoming evident mainly in the long run
- ✓ Ability of a well-organized opposing minority coalition to dominate public debate
- ✓ Theory of “second best” does not work always, e.g. unemployment benefits have come under attack without due respect to issues of aggregate demand or inequality
- ✓ A crisis may be necessary in order to make the need for reforms evident and the resistance weak

Structural reforms in Greece are needed in:

- Business environment
- product and services markets,
- labor market,
- the public sector

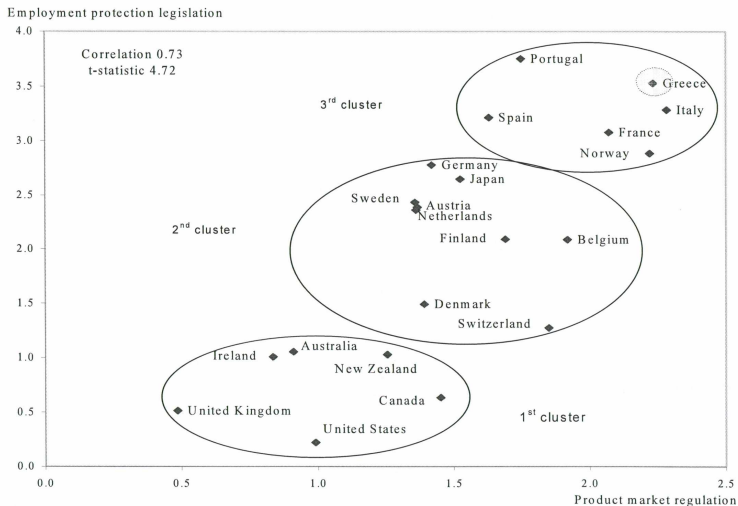
IMF on Greece:

“Important initiatives are underway to improve the business environment. However, enhancing competition and reducing labor market rigidities remain challenges”.

Staff report for the 2007 Article IV Consultation, March 2008

III. Greece is a country full of restrictions

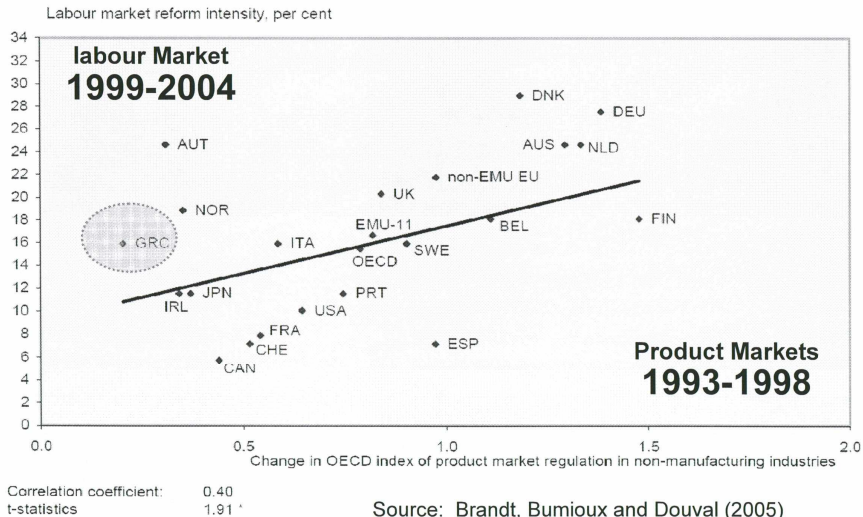
Simultaneous restrictions in many markets



Source: Nicoletti (OECD), Scarpetta (WB)

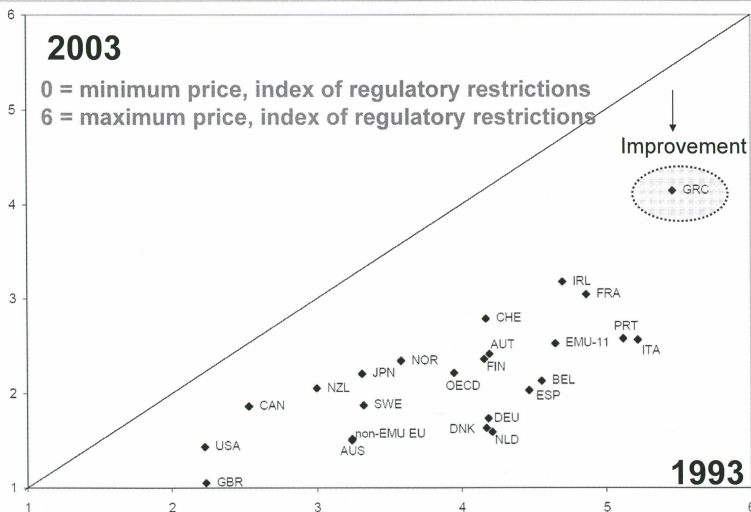
III. Priorities

- ✓ First do the reforms in business environment, product markets & government sector, then in labor markets to maximize impact
- ✓ Blanchard-Giavazzi (QJE, 2003): Competition in product markets makes easier the implementation of structural reforms in the labor market



Source: Brandt, Bunioux and Douval (2005)

III. Restrictions in product and service markets are declining in Europe



Source: OECD, ECB working paper 596, March 2006, p. 27

III. Reforms in product and service markets

IMF on Greece:

“Enhancing competition, particularly in the network industries and in the transport sector, remains a challenge”

Staff report for the 2007 Article IV Consultation, March 2008

- ✓ The target is to increase competition (e.g. privatizations are useless if they simply replace a state monopoly with a private one)
- ✓ It is obvious that competition in services should be a priority, e.g. retail trade, closed professions, since international trade has already intensified the competition in product markets.
- ✓ Study by Nickell (JPE, 1996) with data from U.K. companies: Increased competitiveness (monopoly rents, concentration, import penetration, number of competitors) → increased productivity (level, growth)

III. Reforms in product and service markets: Projects under way

- PPPs
- Liberalizing markets:
 - ✓ New laws for the electric energy and natural gas markets.
- Closed professions: Lots of talk
- Enhancement of competition
 - ✓ Strengthening of the Hellenic Competition Commission
 - ✓ Oil products market – the measures proposed by HCC in 8/2008 are in public consultation.
 - ✓ Insurance companies: new supervisory law – solvency controls – gradual consolidation
 - ✓ Restructuring of state controlled companies: new laws (2005, 2008) – introduction of IFRS – long term operational planning – “private sector” rules for new recruits.
 - ✓ Privatizations: revenues of € 6.7 bill. in 2004 – 2008 – Deutsche Telecom’s entry into OTE the most important development – further plans for the introduction of “sales and leaseback” schemes – the Athens International Airport entry into the ASE – sale of Tourism Development Co. assets – DEPA

III. Reforms in the labor market: The European experience

Reform intensity indicator 1994-2004

(% percentage of maximum possible score)

	Denmark	EuroArea	Ireland	Portugal	Greece	Spain
Total Score	29.3	18.5	17.4	15.9	13.8	10.5
Active Labour Market Policies	56	36,9	46	23	42	8
Taxes & social security contributions	13	32,8	88	25	13	19
Employment protection legislation	10	9,4	-10	17	7	17
Unemployment benefit systems	42	11,5	15	8	12	8
Wage formation & industrial relations	27	2,3	-14	5	5	7
Working time flexibility – part time work	17	22,2	0	33	17	0
Pension reform	25	25,7	0	17	-8	8

Source: Brandt, Bumiaux and Duval (2005) & ECB working paper 596

III. Reforms in the labor market

IMF on Greece: "Sustaining strong economic growth with domestic stability will require broader labour market reforms. Wage moderation and enhancing wage flexibility are important challenges."

Staff report for the 2007 Article IV Consultation, March 2008.

- ✓ The most difficult reforms to implement: Most of the time they either being postponed or avoided altogether
- ✓ **Flexicurity:** flexibility of labour markets for employers & security of employment for employees. → substantially enhances competitiveness and creates higher levels of employment.

"A one-size-fits-all approach across Europe to flexicurity will not work – each labor market has its own characteristics to take into consideration"

Study of European Foundation for the Improvement of Living and Working Conditions, 10/2008

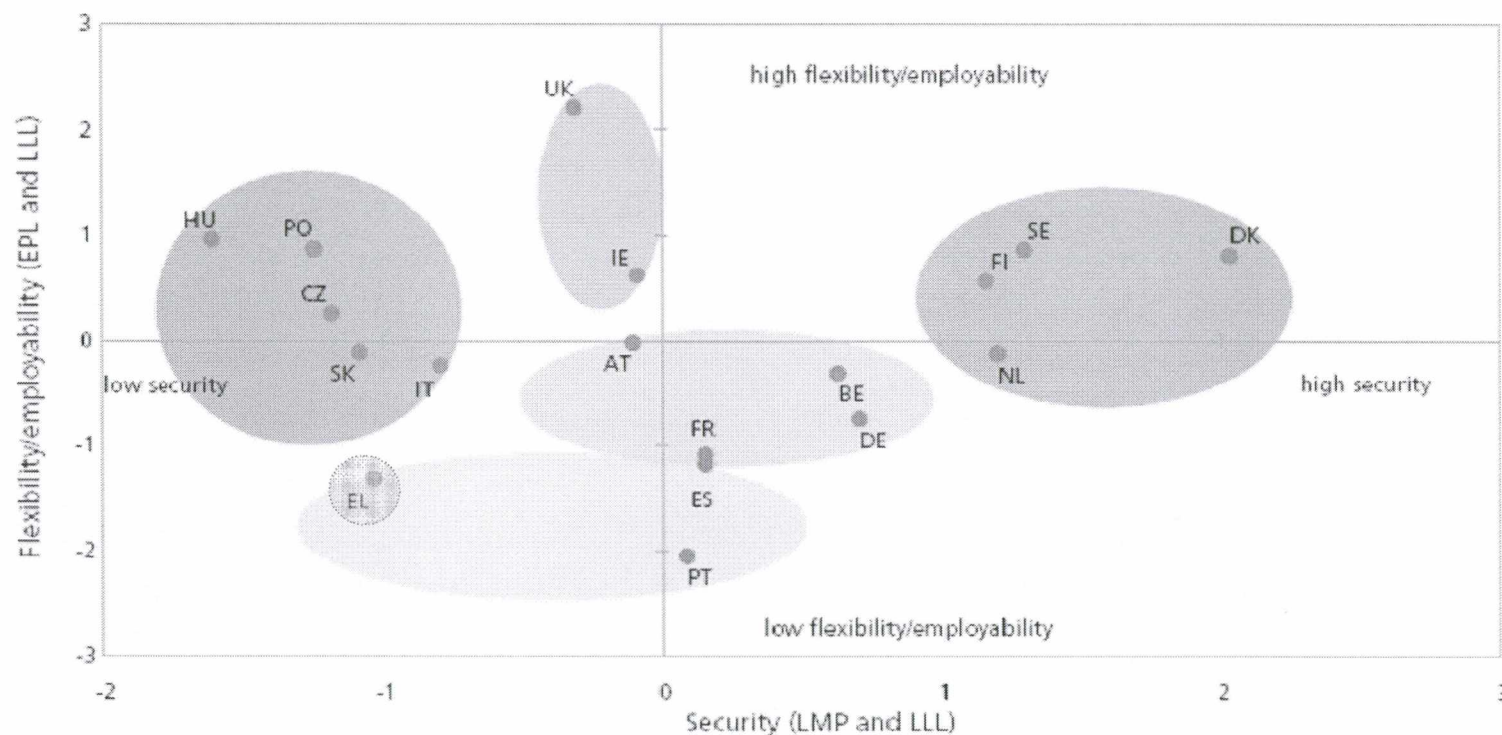
For flexicurity to go from buzz-word to reality:

- ✓ **Employment security, not job security**, and containing a mix of rights and tools.
- ✓ Provide flexible and reliable contractual arrangements
- ✓ Comprehensive lifelong learning programs
- ✓ Effective active labour market policies
- ✓ Modern social security systems
- ✓ The most vulnerable workers need specific attention so as avoid the risk of falling into in-work poverty

III. Flexicurity

Low security plus low flexibility in Greece

National flexicurity patterns and country clusters (principal component analysis)



National flexicurity patterns and country clusters

Note: EPL = Employment protection legislation; LLL = Lifelong learning; and LMP = Labour market policies. For a full list of country codes, see Table A4 in the Annex to this report.

Source: European Commission, 2006, p. 106

III. Flexicurity in Greece: Projects under way

- ✓ ***Contractual arrangements*** - Restrictions were introduced regarding the use of successive fixed-term employment contracts
- ✓ ***Lifelong learning*** - A National Scheme for the Certification of Job Qualifications is being discussed. The scheme aims to recognise all qualifications held by employees, irrespective of how they were acquired. This effort seeks to boost mobility in the labour market
- ✓ ***Active labour market policies*** - Economic incentives for recruitment
- ✓ ***Social security*** - No specific policies were reported

III. Public sector reforms

	Public expenditure (% GDP)			
	1960	1980	1998	2006
Belgium	33.2	56.1	51.2	49.2
Germany	31.8	47.1	48.7	45.7
Greece	20.6	29	49.5	46.1
Spain	20.3	31.5	41	38.5
France	33.4	45.7	53.5	53.8
Ireland	26	46.1	34.8	34.1
Italy	28.1	43	49.6	50.1
Luxembourg	25.4	48.4	42.1	40.4
Netherlands	29.3	53.3	46	46.7
Austria	34.1	46.8	53.9	49.2
Portugal	14.7	34.8	42.3	46.1
Finland	26.3	39.1	52.8	48.6
EuroArea	30.4	45	49	47.5
United Kingdom	36.1	43.2	40	45.0
Japan	16.6	31.5	42.5	39.6
USA	28.2	33.8	33	34.5

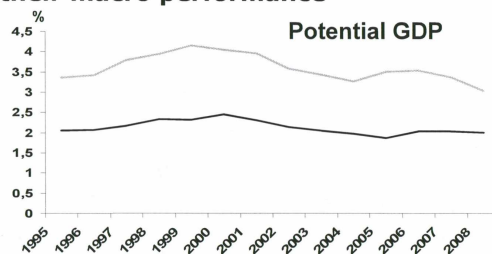
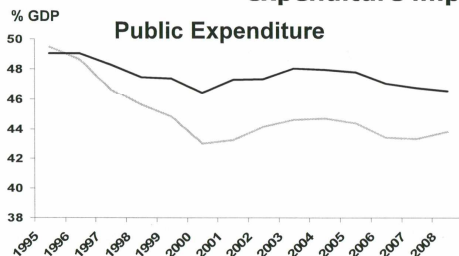
ECB Monthly Bulletin April 2006, p.61

The importance of public expenditure reform for economic growth and stability
G. Hardouvelis

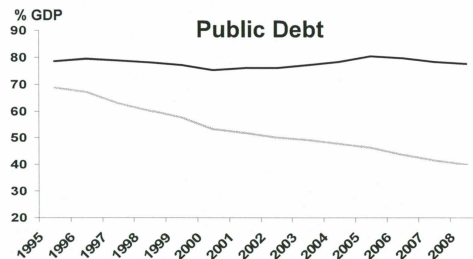
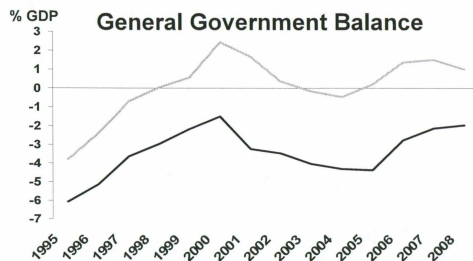
- **Belgium, Ireland, Luxembourg, Netherlands:** Structural reforms in public expenditure in early 80's → reduction 1980-1998 from 5% of GDP (Belgium) up to 11% of GDP (Ireland). In the same time, public expenditure in Greece increased by 21%.
- **Spain, Austria, Finland:** Structural reforms in public expenditure in the 90's.
- Recent measures in **Greece** include
 - the inclusion of a multiplicity of Ministry "Special Accounts" into the budget process
 - the anticipated future restructuring of the budget on a project cost basis.

III. Public sector reforms & better macro performance

The 7 countries that undertook reforms in public expenditure improved their macro performance



— Countries (7) undergone structural reforms
 — Countries (5) not undergone structural reforms



IV. Conclusions

- ✓ Greece is a laggard in structural reforms
- ✓ Structural reforms are required in an EMU country that lacks policy tools, as they bring increased flexibility in sustaining adverse shocks and they help reduce the country's imbalances
- ✓ Product market reforms should be the first in line, as they are easier to implement and can pave the way for the more difficult ones
- ✓ The current crisis has not yet affected Greece, exactly because it started in the financial sector, an area where reforms took place long time ago
- ✓ Yet the crisis may hit Greece the moment it spreads away from the financial sector into the real economy, as it may bring forward in time an anticipated correction stemming from one of the country's sharp imbalances: The huge current account deficit
- ✓ In a future environment of low growth, it may be more difficult to carry on with those reforms needed to improve competitiveness, make the pension system financially stable and reduce inequalities.

THANK YOU FOR YOUR ATTENTION!!

**My thanks to the Research department of Eurobank EFG
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For more info, please consult the Eurobank website:

<http://www.eurobank.gr/research>



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