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FT interview transcript: Lucas Papademos

82

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Financial Times interview with Lucas Papademos, Greek prime minister. Ralph Atkins, Frankfurt bureau chief, and Kerin Hope, Athens correspondent, spoke with Mr Papademos on Friday March 16 in Athens.

Financial Times: Restoring confidence in Greece is key – how are you going to achieve that?

Lucas Papademos: What has been accomplished recently – adoption of a new economic programme for 2012 to 2014, approval of a second financial package and the restructuring of public debt – should play an important role in gradually reducing uncertainty and boosting confidence among the Greek people and in the markets. The key element to restoring confidence will be to implement the new programme in a timely and effective manner. At the same time, it would be helpful to address the short-term negative side effects of the adjustment programme by complementing it with policy measures that can help support economic activity and employment over the short and medium term.

FT: Additional measures to what we have already?

LP: Yes, complementary measures. We all know that implementing some growth-enchancing reforms, as well as their effect on the economy, take time.

FT: Are you suggesting a Marshall plan?

LP: Well, different people use this term in different ways. What we are trying to pursue in co-operation with the European Commission and the European Investment Bank is a set of measures that can help address the shortage of liquidity in the banking system by utilising available [European Union] cohesion and structural funds as a guarantee that can allow the EIB to provide funding to the Greek banking system, which in turn can increase its lending to small and medium-sized firms. Similarly, we are exploring the use of a risk-sharing financial instrument that can improve the funding available for investment projects, including the large highway projects that have been stopped for more than one year. More generally, it will be necessary to improve further the rate of absorption and use of the available structural and cohesion funds. A.J.

FT: How much supplementary support might there be from the EIB?

LP: The magnitude that is being discussed regarding the financing of SMEs is about €1bn – so not huge but it could play an instrumental role in easing the liquidity constraints faced by banks and providing funds to SMEs, which have been severely affected by the credit crunch.

FT: Some economists and politicians believe a much larger-scale "Marshall plan"is needed, financed maybe by governments or private funds. Do you think that would help?

LP: Given the size of support received from European governments, I don't think there is scope for additional government funding.

FT: The fear of course is that you will have a downward spiral of fiscal austerity, economic contraction, more fiscal austerity, and you have to break that.

LP: Yes of course, absolutely. How can we break this? Over a period of time the positive effects of the programme on economic activity will gradually become visible. However, in the short term we are still experiencing negative side effects: the continuing recession and the rising unemployment to very high levels. So, if the programme is complemented with some additional policy measures, it should be sufficient – if implemented effectively – to break what you call a downward spiral and to start a virtuous circle of structural reform, increasing activity and faster fiscal consolidation.

I think it's important to highlight what the first programme has achieved so far because reality is much better than the image. First, with regard to fiscal consolidation, in two years the primary budget deficit was reduced by 8 percentage points of GDP. This is the largest average annual fiscal consolidation that has taken place not only in the EU but among OECD countries. Second, with regard to competitiveness gains, in two years 2010 and 2011 – and before the far-reaching labour market reforms that we are introducing now in the context of the second programme – the country gained competitiveness equal to about a half of the competitiveness lost vis-a-vis euro area partners in the nine years before. Third, according to the latest OECD Going for Growth report, Greece is listed as number one in terms of overall responsiveness to reforms.

Of course, a negative aspect of the first programme has been its short-term economic side effects. The weakening of economic activity and the increase in unemployment were greater than initially expected. I think this happened for three reasons. First, there have been implementation gaps, particularly with regard to the growth-enhancing reforms. Second, the external environment turned out worse than initially expected. Third, a major factor has been the reduced confidence and the increased uncertainty over the past year-and-a-half. That has not only affected consumption demand and investment activity, but it also had a major bearing on the banking system, because it encouraged outflows of deposits, therefore compounding the shortage of liquidity that the banking system faced.

If confidence is restored then we can move into a virtuous circle. I'm not saying this will happen in the next few months, but provided the policies are implemented fully then there is good reason to believe the economy will start gradually recovering in the second half of next year [2013].

FT: Why should we think implementation should be better now when the record has been so bad?

LP: There have been implementation delays and gaps – there is no question about this. Some steps have already been taken to improve implementation but their effects are not quite visible yet. Since last summer, Greece has asked for technical assistance from the European Commission. Recently, for example, important steps have been taken in order to improve public administration. There are other projects that aim to improve the effectiveness with which taxes are being collected and to streamline various processes that create obstacles to investment. The provision of technical assistance by the Commission and European Union member states should help improve implementation.

A significant factor that can help to this end is that now Greece's two major political parties are committed to the new programme. I think this political factor can play a role in improving the efficiency and speed with which policies are implemented.

FT: Germany says you should delay the elections ...

LP: There is no such issue. This government is now completing its mission and there is agreement with the political parties to proceed with elections by early May at the latest. When this government was formed in November 2011, there was an agreement among the parties that after a number of key objectives were achieved – adoption of a new economic programme, approval of a second financial package, the restructuring of public debt – elections would be held. The Greek people should now have the opportunity to express their preferences on key policy issues affecting the future of the country.

FT: Would you be prepared to carry on after the elections if you were chosen to be prime minister?

LP: It would not be appropriate before the election to disclose any such preference. I do not wish to be involved in the pre-election debate.

FT: What about in another capacity, as finance minister?

LP: The answer is the same.

FT: Was the lack of confidence in Greece exacerbated by the way the rest of the eurozone reacted to Greece – for instance the whole debate about "private sector involvement" in Greece's debt restructuring?

LP: Different factors contributed to the gradual deterioration of confidence over the past two years. One reason was that policies were not implemented in a timely manner. An earlier implementation of policy actions at national and European level – essentially the policies that were eventually adopted – would have contributed to containing the intensity and the scope of the crisis and would have helped contain the deterioration in confidence.

FT: You were on record in the Financial Times as opposing PSI. Was it a mistake?

LP: I don't think that PSI was a mistake. What I was saying in that article was that it was important to balance carefully the benefits and the risks associated with the private sector involvement. In the case of Greece, PSI was inevitable, given the size of the public debt and its expected dynamics. What was important was to understand the net benefits vis-a-vis the risks, and take steps to minimise the potential negative consequences.

FT: Do you think a further restructuring of Greece's debt might be needed at some point?

LP: The full and effective implementation of the new economic programme should eliminate such a possibility. We will do whatever is needed to ensure that this was the last restructuring of Greek sovereign debt.

FT: Does it help confidence when the German finance minister now talks about a possible third Greek bail-out and there is a discussion about Greece leaving the eurozone?

LP: Well, I think this simply reflects the fact that one cannot predict with precision the exact time when the country can regain access to the markets. It may happen in three years, it may happen over a longer period of time.

If by 2015 market access is not possible then it may be necessary to rely more on official funding. It has been explicitly stated that euro area governments will continue providing adequate support and beyond the life of the programme until Greece has regained market access, provided of course that Greece fulfils its obligations. So what [Germany's finance] minister Schäuble said is in line with what has already been stated and it is conditional on the access to markets. The intention of this government – and of future governments I am sure – is to implement the programme as effectively as possible so as to return to the markets as quickly as possible.

FT: In 2015?

LP: The timing cannot be predicted with precision. It is difficult to say now what the market expectations will be in three years. I am optimistic that, following what we have done, we are standing on more solid ground than a few months ago. I personally feel confident that the economic adjustment process and the efforts that are being made will be continued in the future. Why? Because this is the will of the majority of the Greek people. The will of the majority of the Greek people will be taken very carefully into account by the political parties that will form future governments.

Almost all opinion surveys have systematically indicated that a large majority of the people – I have seen figures ranging between 70 per cent and 80 per cent – very much support Greece's continuing participation in the euro area and this implies that, despite the sacrifices and the short-term adjustment costs, they are willing to do what has to be done in order for the country to remain in the euro area.

Why is this the case? The country is in the fifth year of recession, unemployment is about 20 per cent, youth unemployment is close to 50 per cent, isn't there an alternative way of achieving the adjustment? I believe that a large majority of the Greek people realises that the long-term benefits from Greece's continuing participation in the euro area are much greater than the short -term adjustment costs. They understand that securing fiscal sustainability and restoring competitiveness in a permanent manner can be achieved more effectively within the euro area than outside.

A large silent majority – and they are not the people demonstrating in the streets – understand that the price stability that the European monetary union entails and the fiscal discipline that it requires imply benefits for the country, and that the adjustment process is going to be more effective within the euro than outside.

FT: But do the Greeks really want to be run from Brussels and isn't there great resentment about pressure from Germany?

LP: Participation in a monetary union requires a certain loss of economic policy sovereignty, because fiscal policy in particular has to be compatible with the single monetary policy and therefore certain rules have to be applied and a degree of coordination has to be achieved. Otherwise there will be imbalances that will have adverse implications for the functioning of the economy. This is accepted by every country that has joined the monetary union.

A country like Greece, that is under a programme that receives financial support from its European partners, is subject to additional economic policy conditionality. But once the adjustment process has been completed this will end.

I believe, however, that one should make a distinction between loss of political sovereignty and a reduced degree of economic policy sovereignty.

In any event, the policies which are being implemented do not imply any fundamental loss of political or democratic sovereignty. Such a loss would be unacceptable and inappropriate. Both the first and second programmes were debated and approved by the Greek parliament – the latter one by a huge, two-thirds majority. On the basis of survey results, they have been supported by a majority of the Greek people.

The economic adjustment programme does not entail an external imposition on the political process. Democratic sovereignty has not been affected.

FT: When you were at the ECB, you argued that monetary union appeared to slow down structural adjustments in the eurozone. Does Greece not illustrate fundamental flaws in the eurozone?

LP: There is no doubt that the crisis demonstrated – let me put it positively – the need to strengthen the economic pillar of the economic and monetary union. It demonstrated that the fiscal policy framework was not sufficiently effective, particularly during a period of stress. In the light of the experience of the past two years, the euro area governments have taken a number of key steps in order to strengthen the economic pillar of EMU so as to enhance crisis prevention and crisis management and to ensure that the economic policies of countries in the monetary union are sufficiently coordinated given the constraints imposed by the monetary union and the integration of economic and financial markets.

FT: Otmar Issing [the ECB's former chief economist] described the monetary union as an experiment? Is it still an experiment?

LP: It is an experiment because the economic and monetary union we established has no historic precedent. It started by placing greater emphasis on the single monetary policy and less so on a strong economic union and it was established by sovereign member states. But why will it work? Despite delays, significant steps have been taken in the direction of completing EMU so as to secure its more efficient functioning – and its future.

Markets and policymakers outside the euro area have underestimated the commitment of euro area governments to move forward and secure the future of the monetary union – despite the market strains, the economic difficulties and the political concerns expressed within the euro area.

FT: Can Greece remain within the monetary union given the scale of its challenges?

LP: In my mind there is no doubt that the country will remain in the monetary union. The overwhelming majority of Greeks believe that restoring fiscal sustainability and competitiveness can be achieved in a more effective and permanent manner within the euro area rather than outside. What is key is policy implementation and not to repeat past mistakes. If this is done, I see no problem. In the middle of an adjustment process it is inevitable that there will be painful output and employment costs. But I am convinced that this will be a temporary situation.

It is difficult to predict the exact timing of the recovery and the pace at which unemployment will be absorbed. But on the basis of available projections, in about two years the economy should recover. The IMF is predicting that in 2014 and in 2015 growth rates of 2.5 per cent and above will be realised. The policies being implemented will eventually restore growth.

I am convinced that we are more than halfway along the path to economic recovery – although the fiscal consolidation process will last longer. Positive growth rates should be achieved within less than two years down the road.

FT: Do you believe the leaders of the Socialist and New Democracy parties are really committed to the reform programme?

LP: Yes. They have explicitly stated and given written assurances that they are committed to the objectives and policies of the programme.

FT: You have sat down with them privately, do you believe them?

LP: Until November, there were different and opposing views on the programme. But over time, and perhaps this has been one contribution of this coalition government, we have forged a higher degree of consensus on the new programme – both on its objectives and the means of achieving them.

In mid-February, 43 MPs from both parties who voted against the programme or elements of the programme were expelled. So among the two main parties there is now greater cohesion in supporting the programme. During the election campaign you may hear some nuances, but I believe that there is an understanding that the only way forward is to pursue the policies that are included in this programme.

FT: Is it right that you are strengthening the office of prime minister?

LP: We have started the process of reforming public administration and one objective is to improve coordination between ministries and the surveillance of their work. This is going to be done from the office of the prime minister. It will require increasing the number of staff and creating a unit that will focus on the more effective surveillance of the tasks carried out by the various ministries.

FT: You are creating a chancellery?

LP: It is not going to be as large as in Berlin (laughter).

FT: Is the aim to ensure that your successor has to stick to the same policies?

LP: The aim is to improve coordination and ensure continuity of policy implementation. Lack of continuity is part of the problem. Some of the staff, particularly those involved in surveillance of policies, should be permanent and not change every time a new government comes into power.

FT: You said there was the political will in Greece to do what ever is necessary to stay in the euro area. Is that consensus there elsewhere in the eurozone? You are familiar with the debate in Germany, the Netherlands....

LP: My answer would be positive, without underestimating the tensions that have surfaced over the past two years. The last two years have not been, let's say, "normal". But some of the institutional and treaty changes would have been totally inconceivable two years ago. And the policies adopted in Greece – structural and fiscal – would also have been inconceivable two years ago. The crisis created an opportunity. Greece is changing. What is important is to persevere, so the sacrifices of the Greek people are not lost. I'm aware of the scepticism, but in the light of the policies adopted, I think you can be confident that the future of Greece in the eurozone is secure.

FT: How did it feel moving from being an academic economist and central banker to becoming a politician, a prime minister?

LP: It was definitely a new experience, there is no doubt. At the ECB, we had to face many policy challenges that were evolving over time. But the challenges that I have confronted over the past four months have been wider in scope and greater in intensity. This country was on the brink of collapse in November, and ensuring that we would avoid a catastrophe and that a new financial package would be agreed upon was an extraordinary task.

FT: Were you tough enough?

LP: I think that the process I followed turned out to be appropriate in the end, although in the first few months there were some difficulties in reaching a consensus on policy matters and ensuring the effective functioning of the government. But over time I have seen that not only has a consensus been built but also a sense of trust between members of the cabinet – as well as greater understanding between the political parties on the need for the policies that we have agreed. In this country there is no tradition of coalition governments – so this was also an experiment.