European Policy Response and Regional Development: The Case of Greece

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Levy Economics Institute

Macroeconomic Management and Financial Regulation in Core Countries and the Periphery

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CAFRAL- Levy - IDEAs Workshop

GREEK SOVEREIGN DEBT CRISIS

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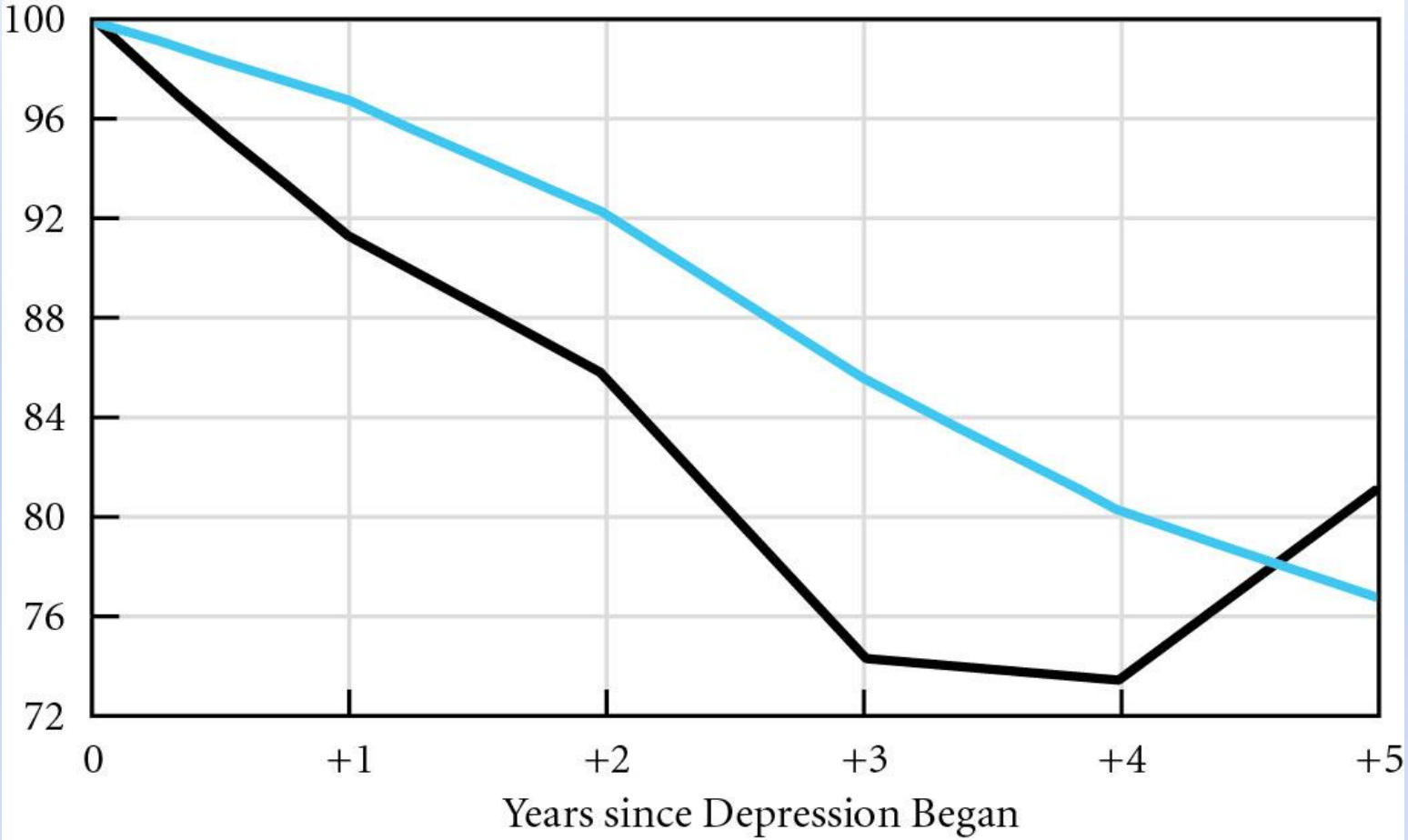
Inability of Greece to roll over maturing debt in 2009 because of much higher government deficits (15.8%) and accumulated debt of over 125% to GDP than originally estimated.

Fear of contagion involving other Eurozone countries, i.e., Portugal, Spain and even Italy.

Greece turned to EU and IMF. The result was two rescue programs totaling about 240 billion euros with harsh austerity measures that are still continuing and causing devastating effects.

Greece is, for the sixth year, in continuing deep recession, and the cumulative economic effects are much worse than those experienced by the U.S. during the Great Depression.

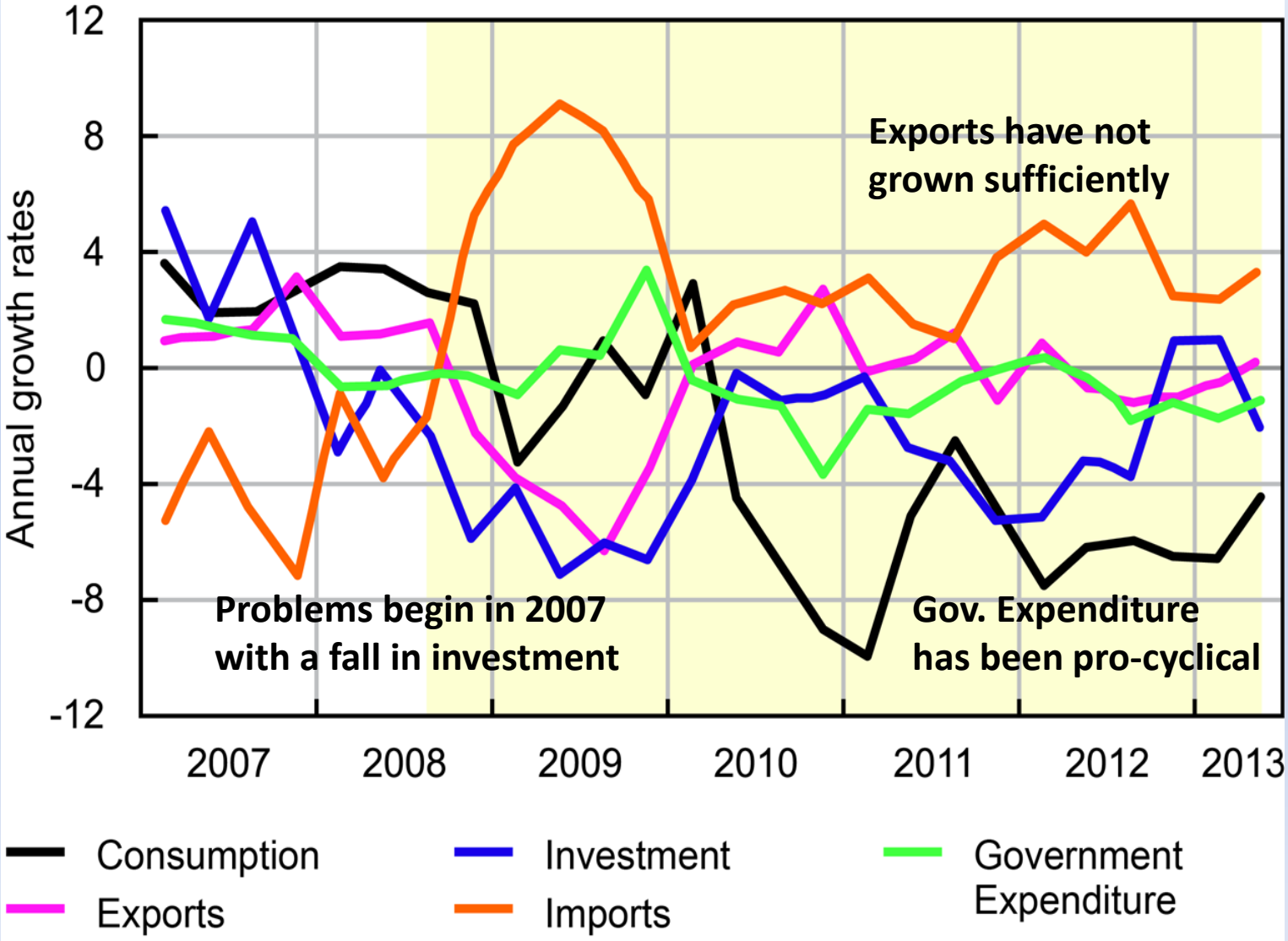
Figure 1 Greece and the United States: Two Great Depressions—Real GDP Indices



Sources: BEA; ElStat

Figure 2

Greece. Contributions to real GDP growth



Source: ElStat

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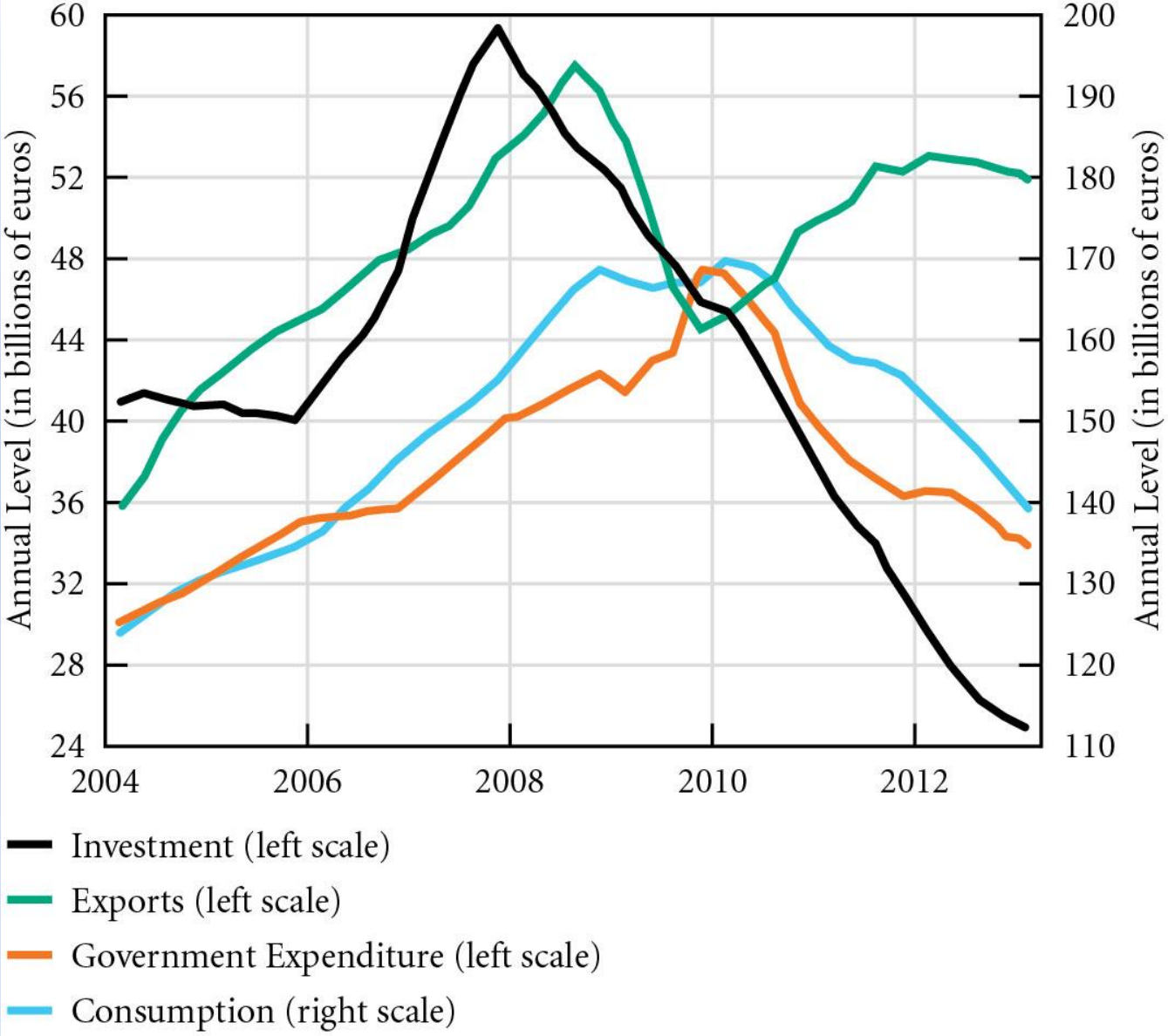
Figure 3 Greece: GDP Components



Source: ElStat

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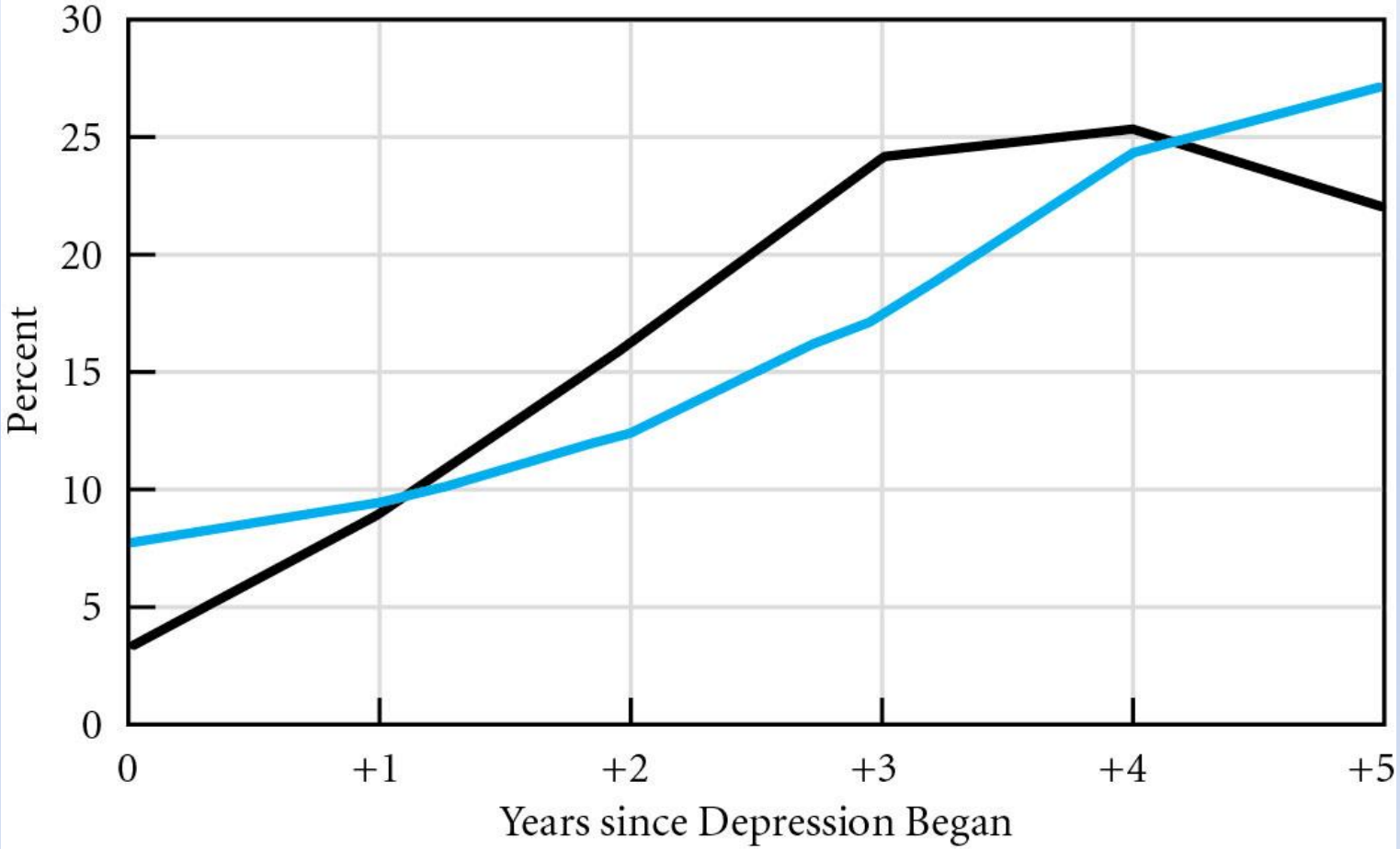
Figure 4 Greece and the United States: Two Great Depressions—Unemployment Rates



Sources: BEA; ElStat

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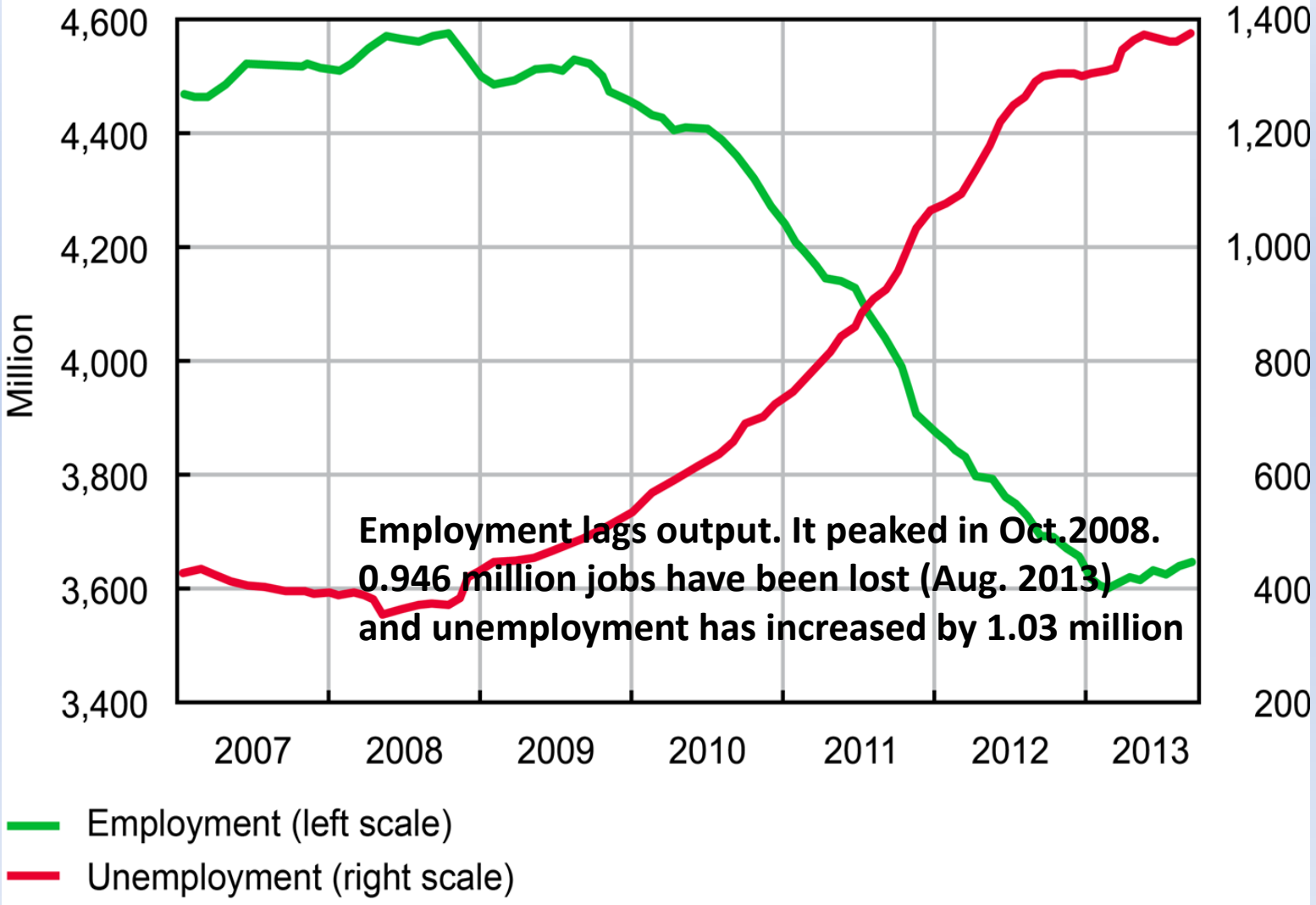
Figure 5
Greece. Employment and unemployment



Source: ElStat

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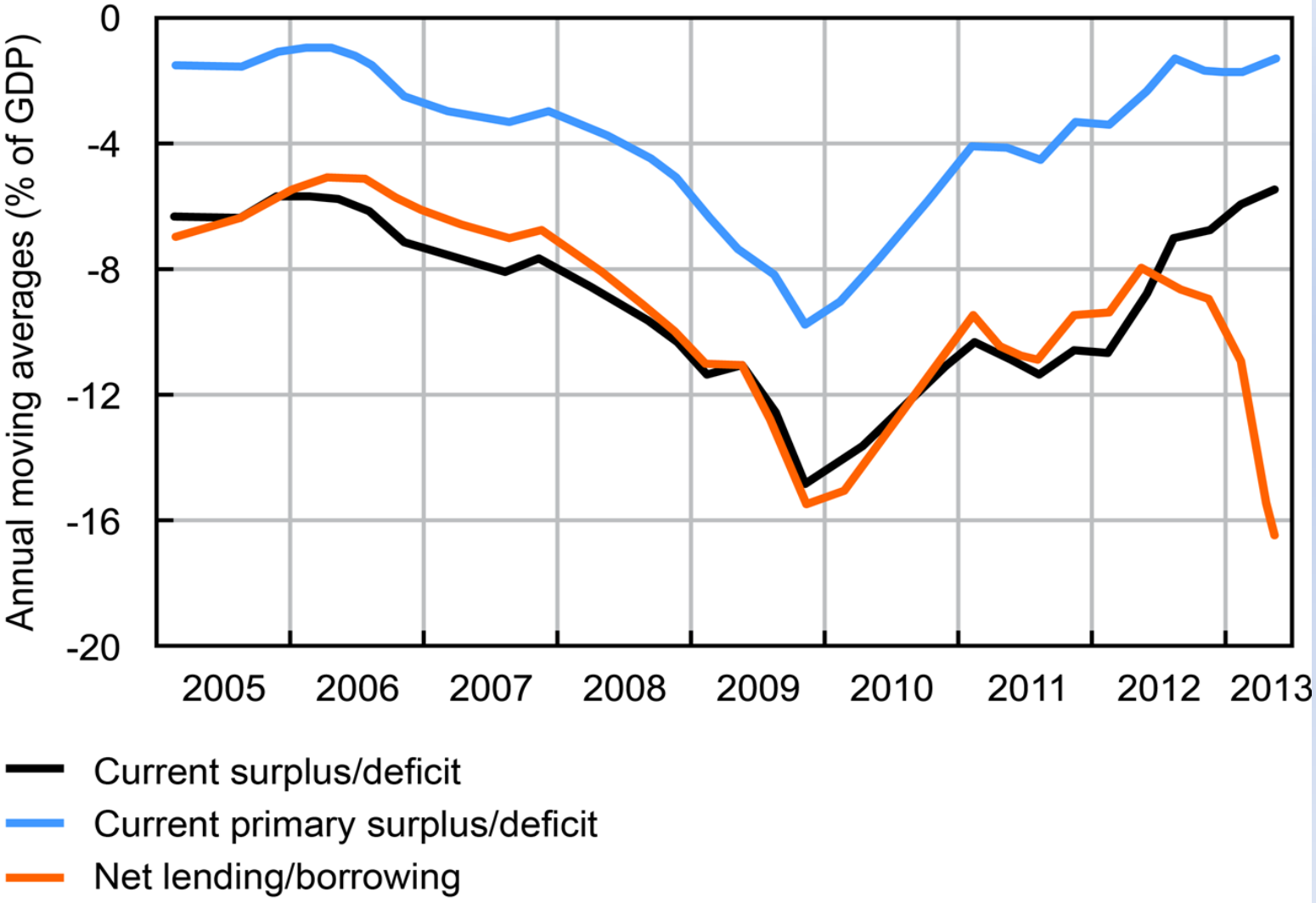
Figure 6

Greece. General government surplus/deficit



Source: ElStat

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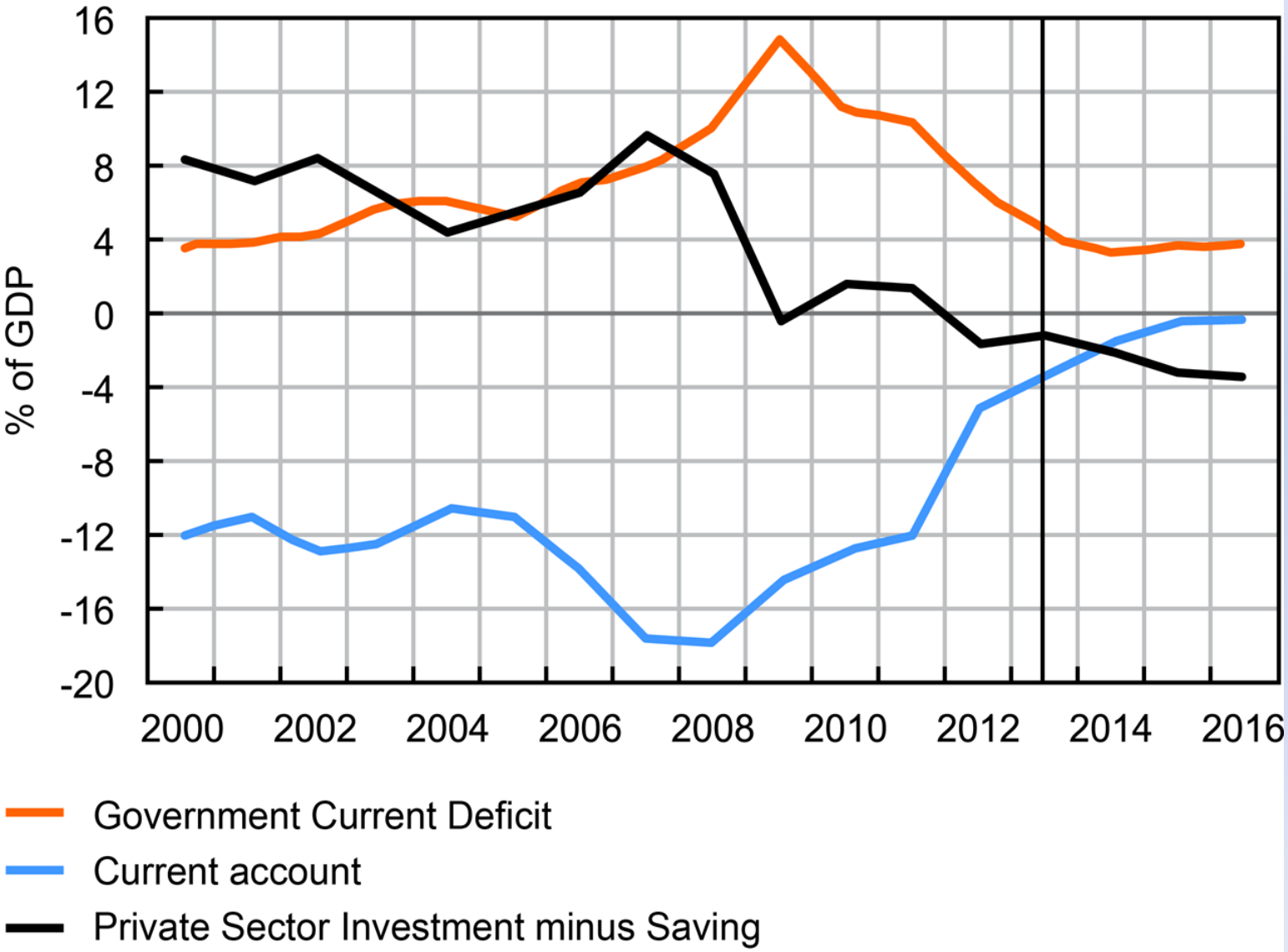
Figure 7

Greece. Baseline. Main Sector Balances



THE TROIKA PLAN

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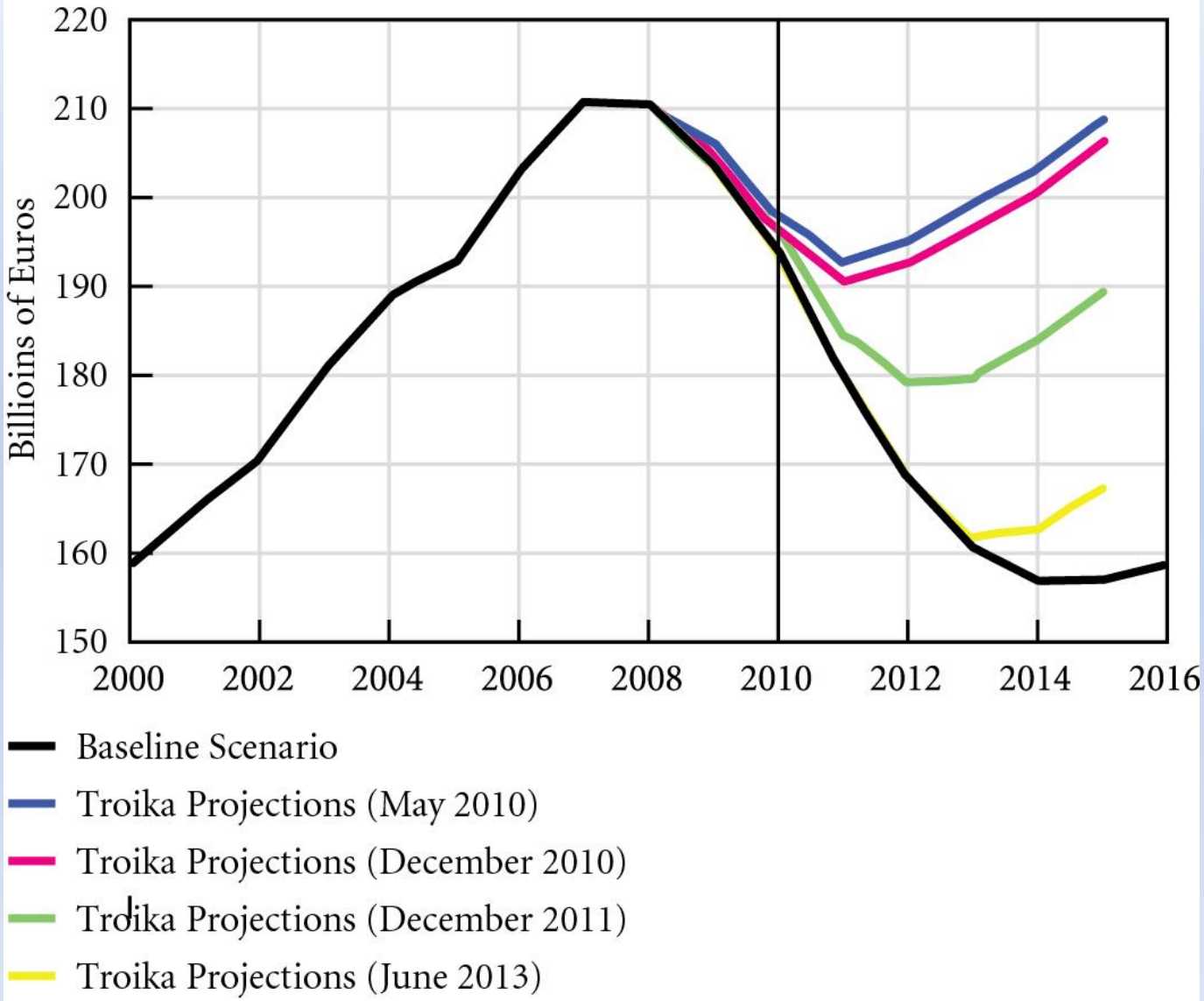
The Troika (IMF; EU; ECB) plan aimed at solving the problems trough

- **Fiscal austerity: reducing public employment; increasing taxes; privatizing public enterprises**
- **Internal devaluation: target 15% decrease in nominal wages; actual devaluation is 30%, double the target**
- **Public debt has been restructured (haircut) and gradually transformed. Now most of Greek public debt is a credit of EFSF and other Eurozone institutions**

Figure 8 Greece: Real GDP (2005=100)



Sources: IMF; EC; authors' calculations

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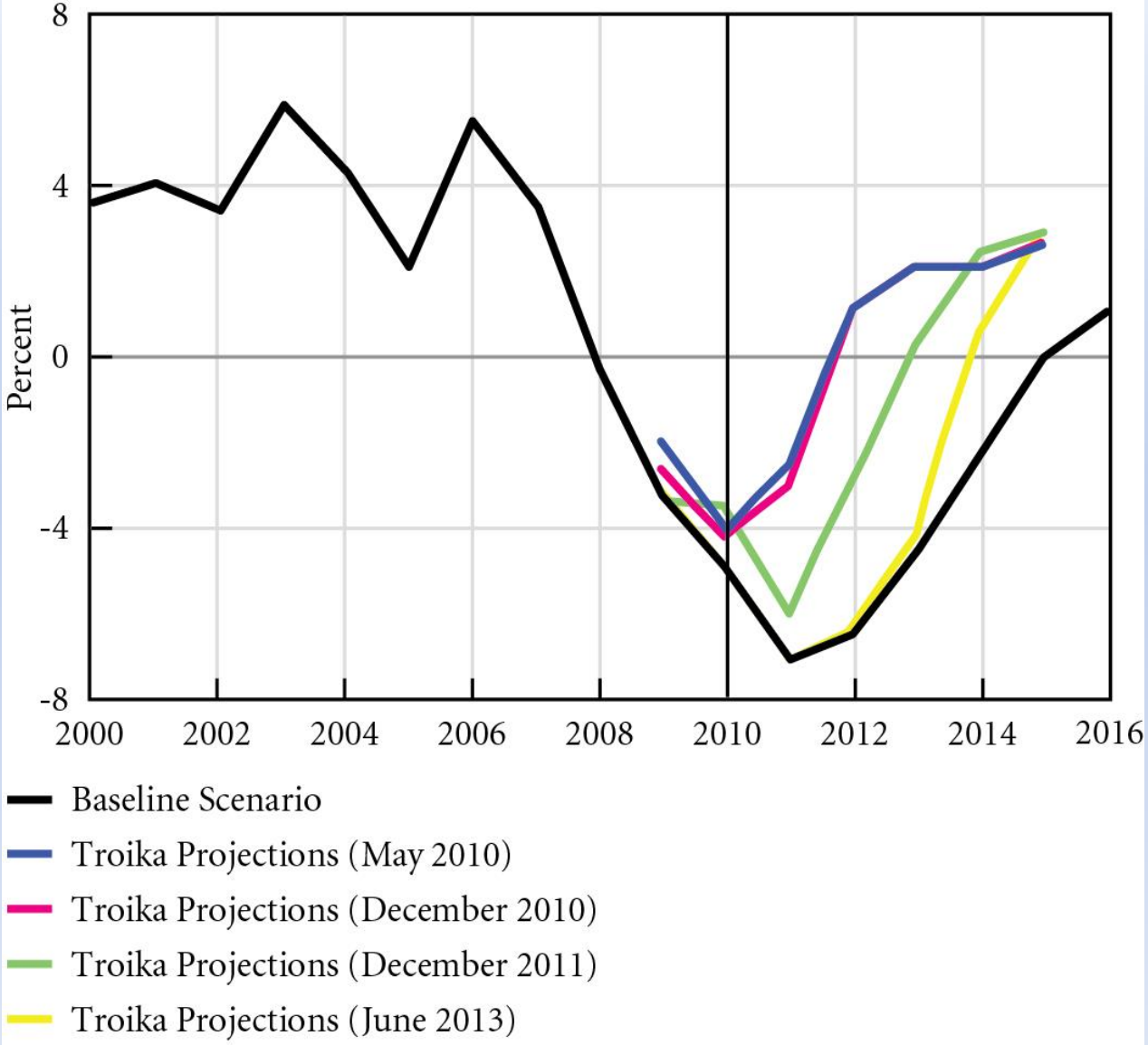
Figure 9 Greece: Real GDP Growth Rate



Sources: IMF; EC; authors' calculations

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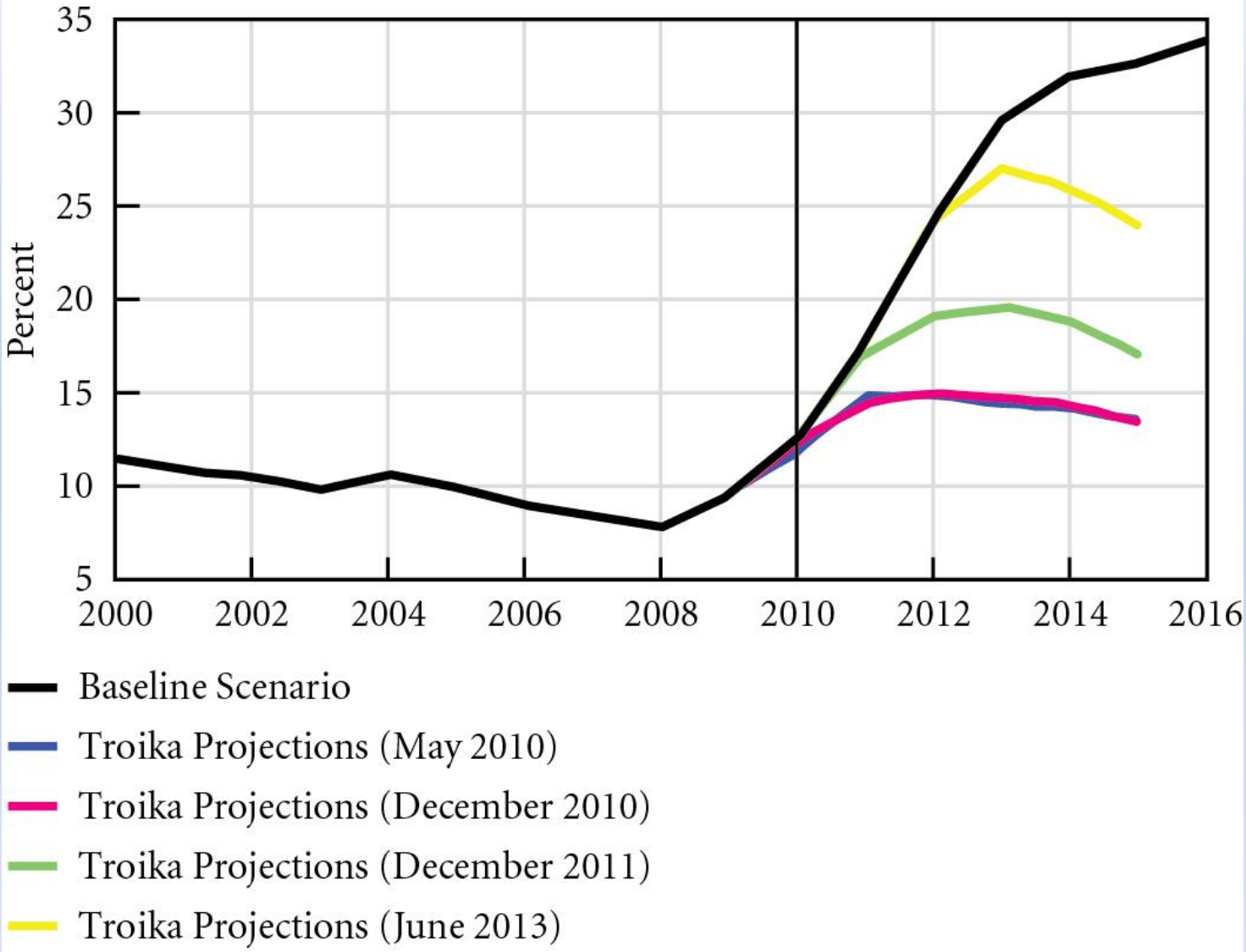
Figure 10 Greece: Unemployment Rate



Sources: IMF; EC; authors' calculations

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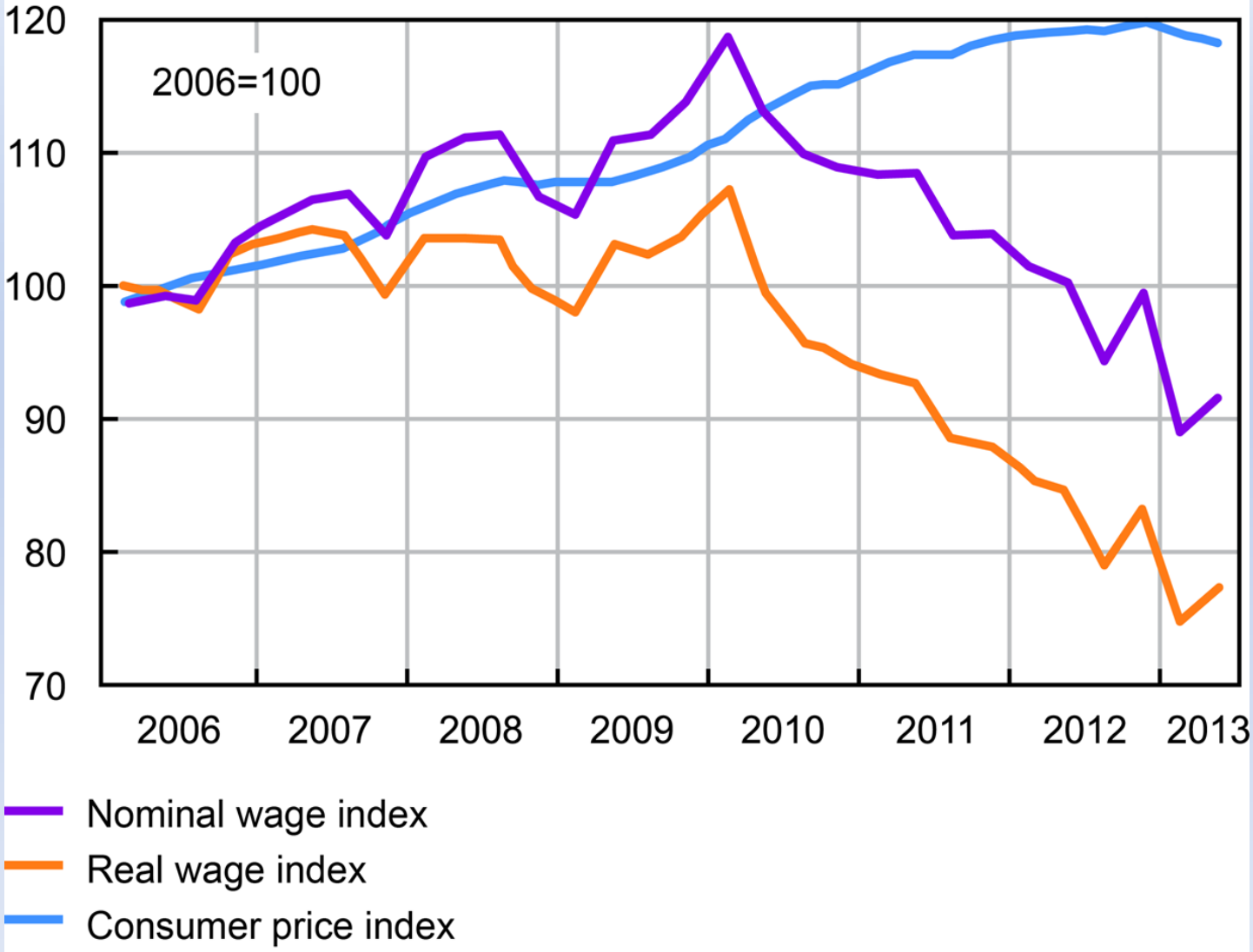
Figure 11

Greece. Wage and price indexes



Source: ElStat

Figure 12

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Euro area. Competitiveness indexes

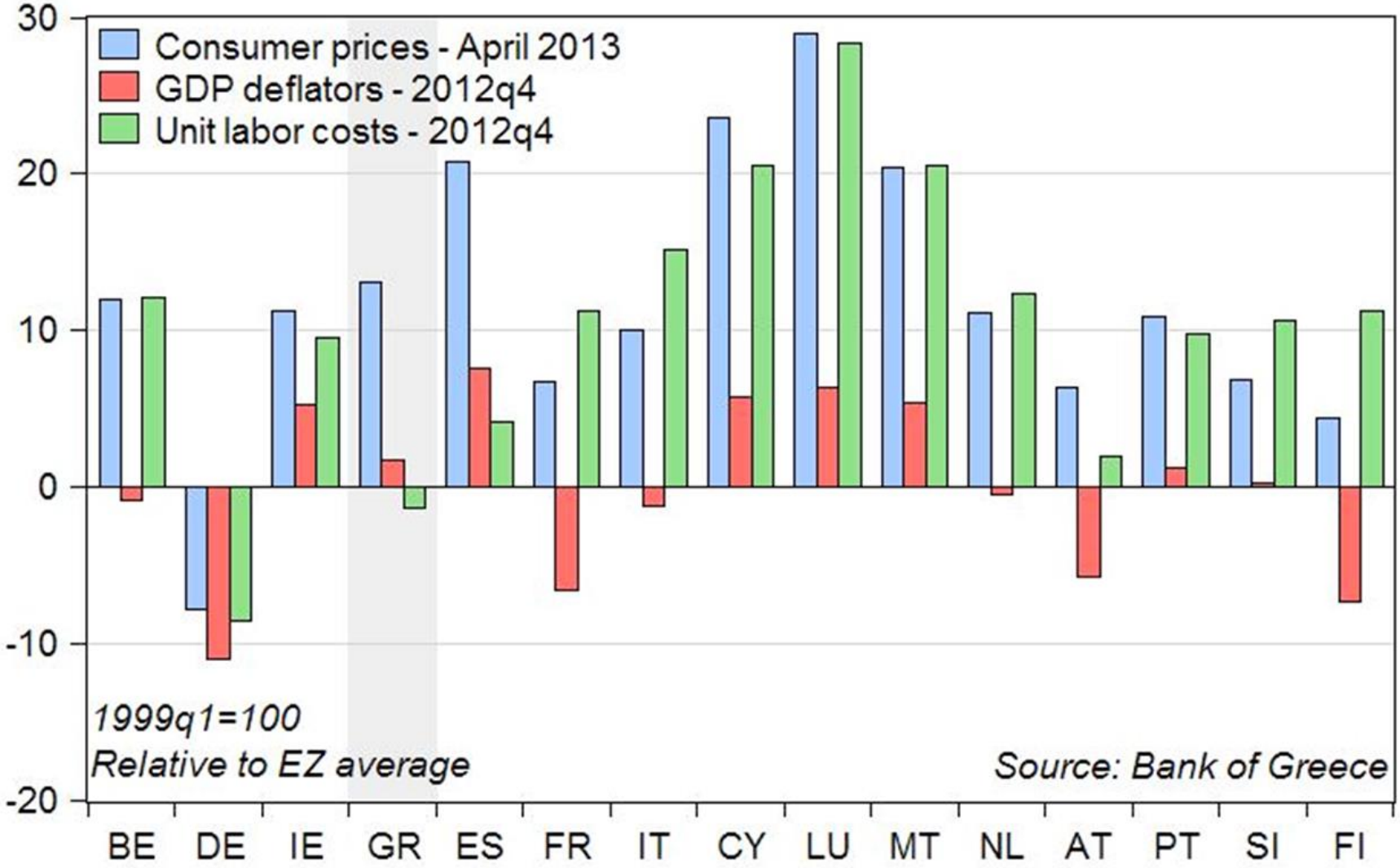

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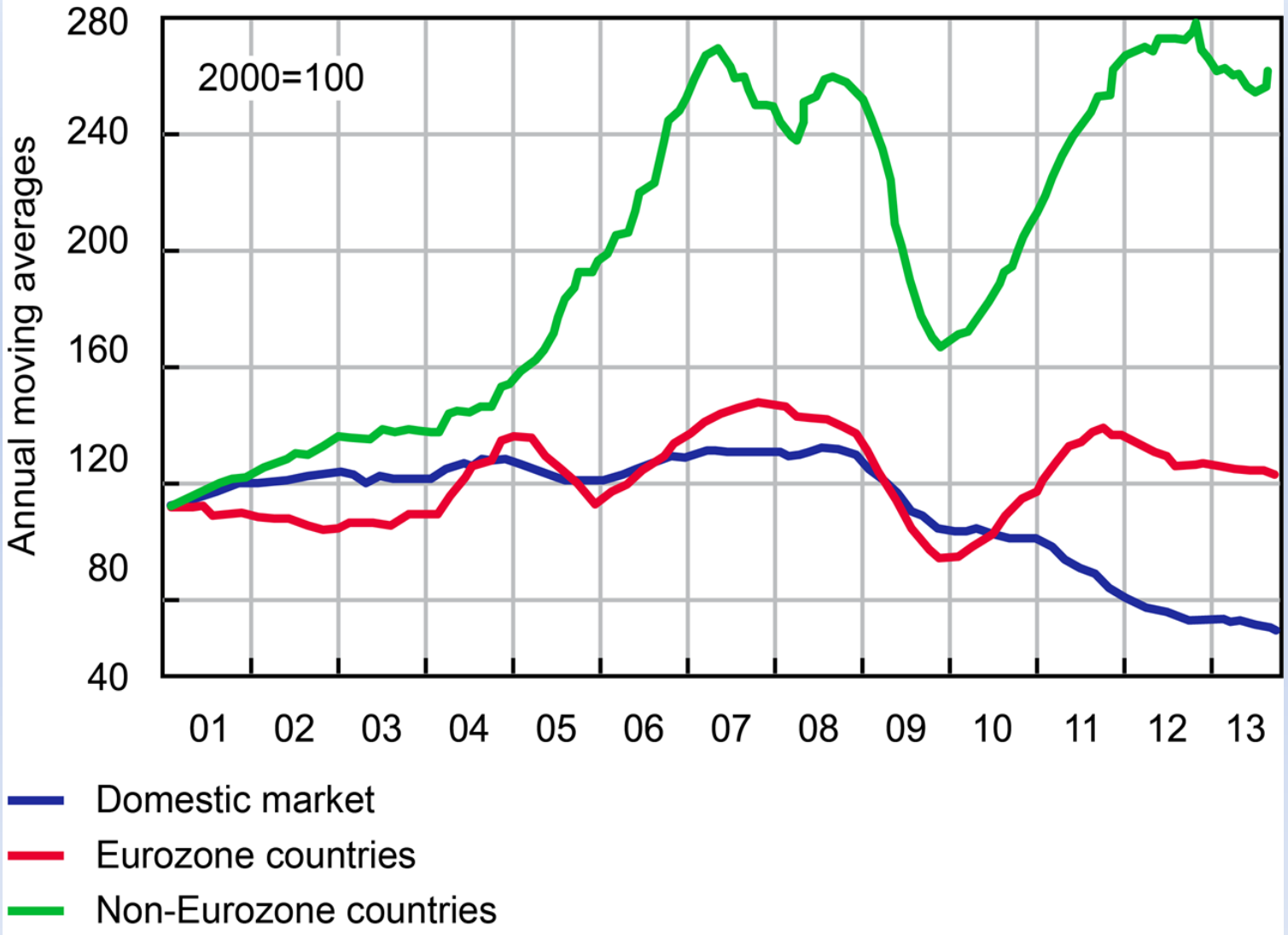
Figure 13
Greece. New orders indices in industry



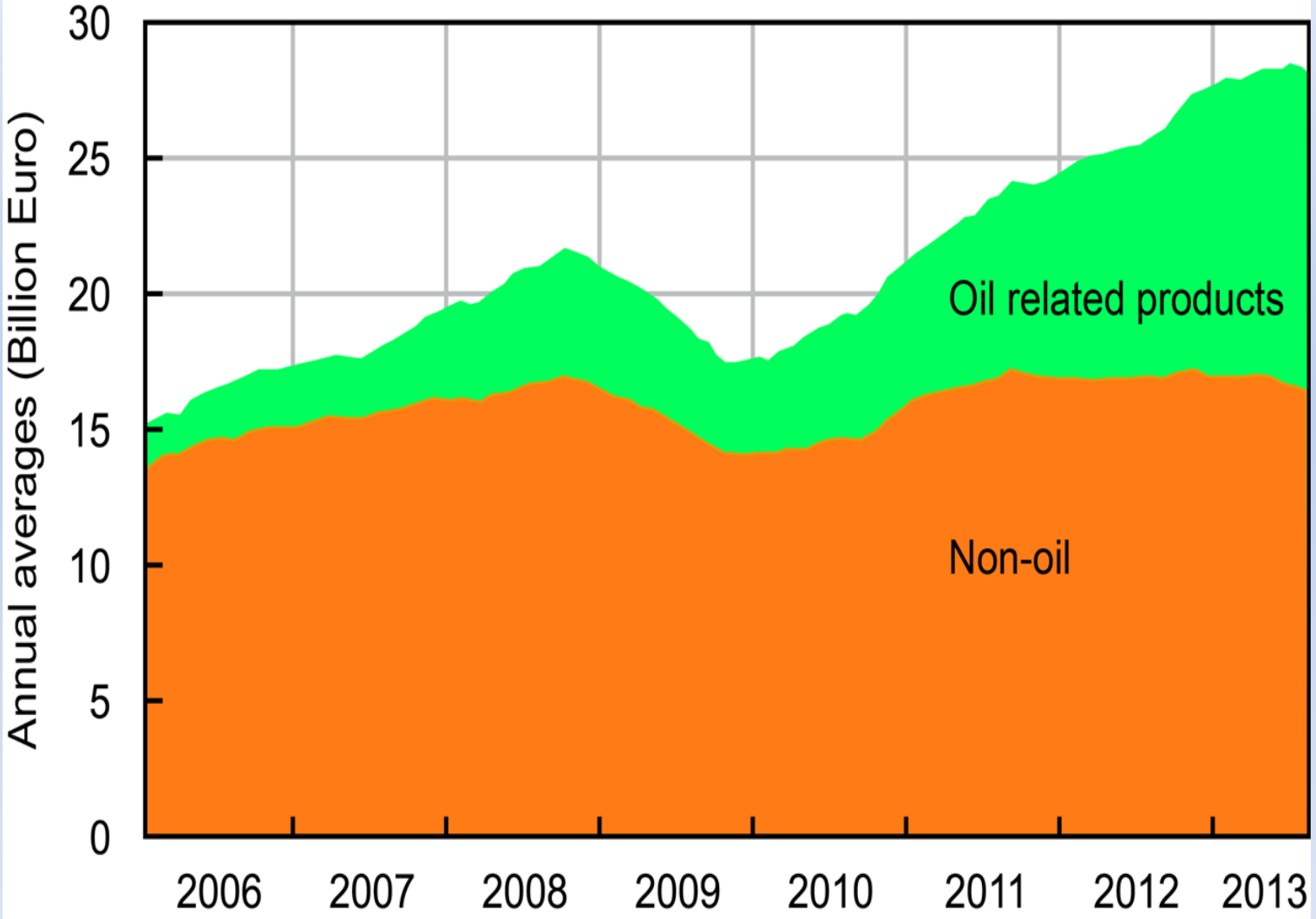
Source: ElStat

Table 1
Greece – Exports by destination (2011)

	Million euro	*Percent*	*Cumulated*
Italy	2,955	9.32	9.32
Turkey	2,485	7.84	18.64
Germany	2,454	7.74	26.47
Cyprus	1,903	6.00	34.21
Bulgaria	1,724	5.44	40.21
United States	1,712	5.40	45.65
United Kingdom	1,239	3.91	51.05
France	906	2.86	54.96
Romania	830	2.62	57.81
Singapore	818	2.58	60.43
Macedonia	794	2.50	63.01
Spain	640	2.02	65.51
Netherlands	637	2.01	67.53

Figure 14

Greece. Exports of goods



Source: ElStat

Table 2. Greece. Exports of goods by SITC category and destination
(percent of total exports)

	To EU27			To other countries			TOTAL		
	2000	**2007**	**2012**	**2000**	**2007**	**2012**	**2000**	**2007**	**2012**
Food and live animals	11.3	11.2	9.6	3.6	3.2	3.5	14.9	14.4	13.1
Beverages and tobacco	2.1	1.3	1.3	2.6	1.4	1.0	4.7	2.7	2.3
Crude materials, inedible, except fuels	2.9	2.5	1.5	2.6	1.7	3.1	5.6	4.2	4.6
Mineral fuels, lubricants and related m.	3.7	4.5	6.1	10.0	12.4	32.5	13.8	16.9	38.5
Animal and veg. oils, fats and waxes	2.1	1.8	1.2	0.3	0.3	0.2	2.4	2.1	1.4
Chemicals and related products, n.e.s.	5.2	9.5	6.4	2.9	3.3	2.6	8.1	12.8	9.0
Manufactured goods	13.5	14.3	8.2	6.7	6.5	6.0	20.2	20.8	14.2
Machinery and transport equipment	7.4	7.9	4.6	5.1	4.1	3.9	12.5	11.9	8.5
Miscellaneous manufactured articles	13.7	8.0	4.1	4.2	2.7	2.1	17.9	10.7	6.2
Other n.e.c.	0.0	2.4	1.2	0.0	1.0	1.0	0.0	3.4	2.2
TOTAL	62.0	63.4	44.1	38.0	36.6	55.9	100.0	100.0	100.0

Source: Eurostat

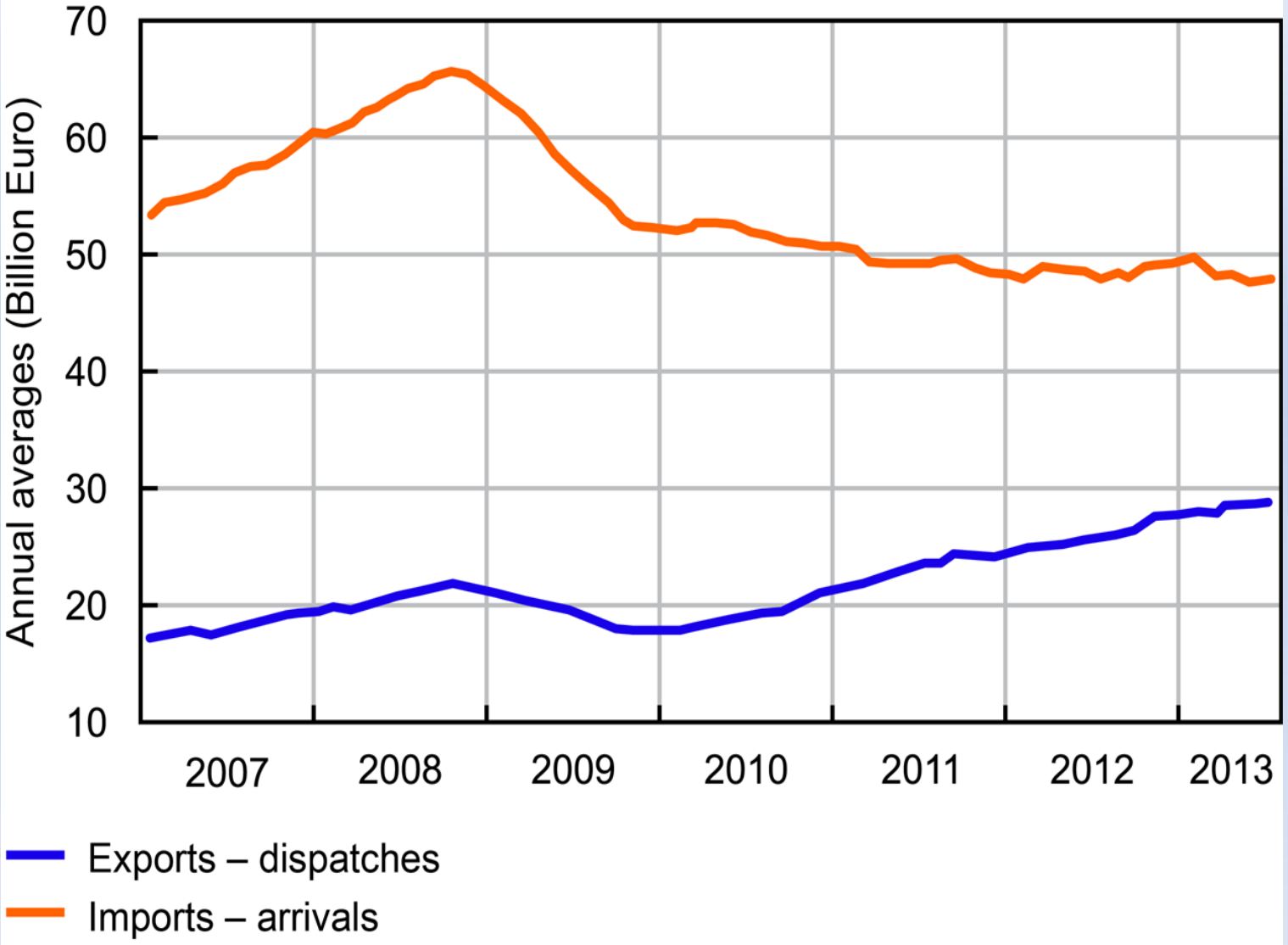
Table 3. Projections for Greek export markets (growth rates)

	Real GDP of major trading partners	*GDP deflator index*	*Deflator of domestic demand*
2012	0.14	2.73	3.49
2013	1.97	1.78	2.05
2014	1.67	2.54	2.53
2015	2.23	2.68	2.67
2016	2.46	2.73	2.76

Source: Authors' calculations on data from Eurostat and IMF (WEO October 2013). Major trading partners based on 2011 exports are: Bulgaria; Cyprus; France; Germany; Italy; Macedonia; Netherlands; Romania; Singapore; Spain; Turkey; United Kingdom; United States

Figure 15

Greece. Trade in goods



Source: ElStat

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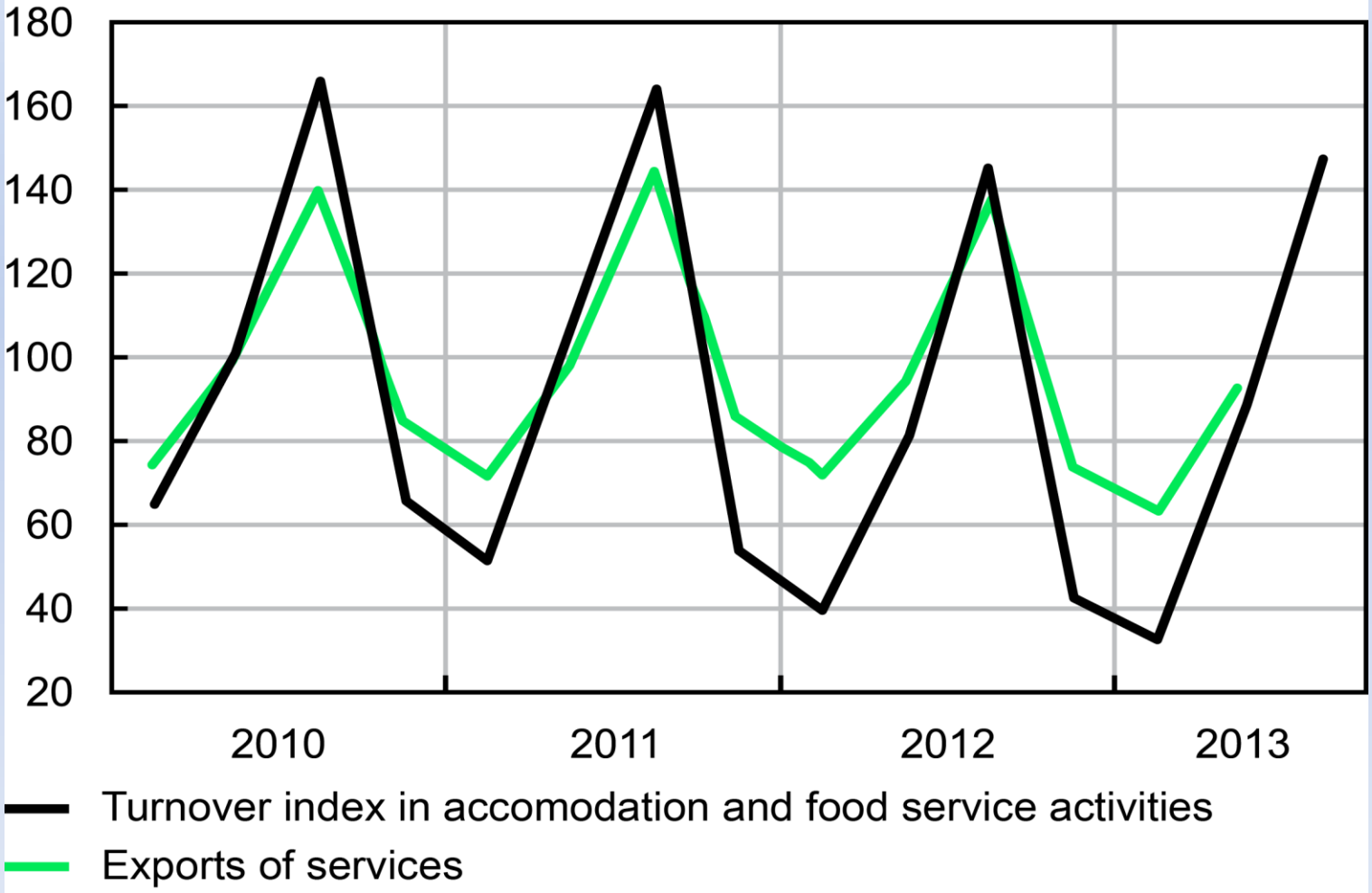
Figure 16

Greece. Exports of services and turnover index in tourism

2010=100



Source: ElStat

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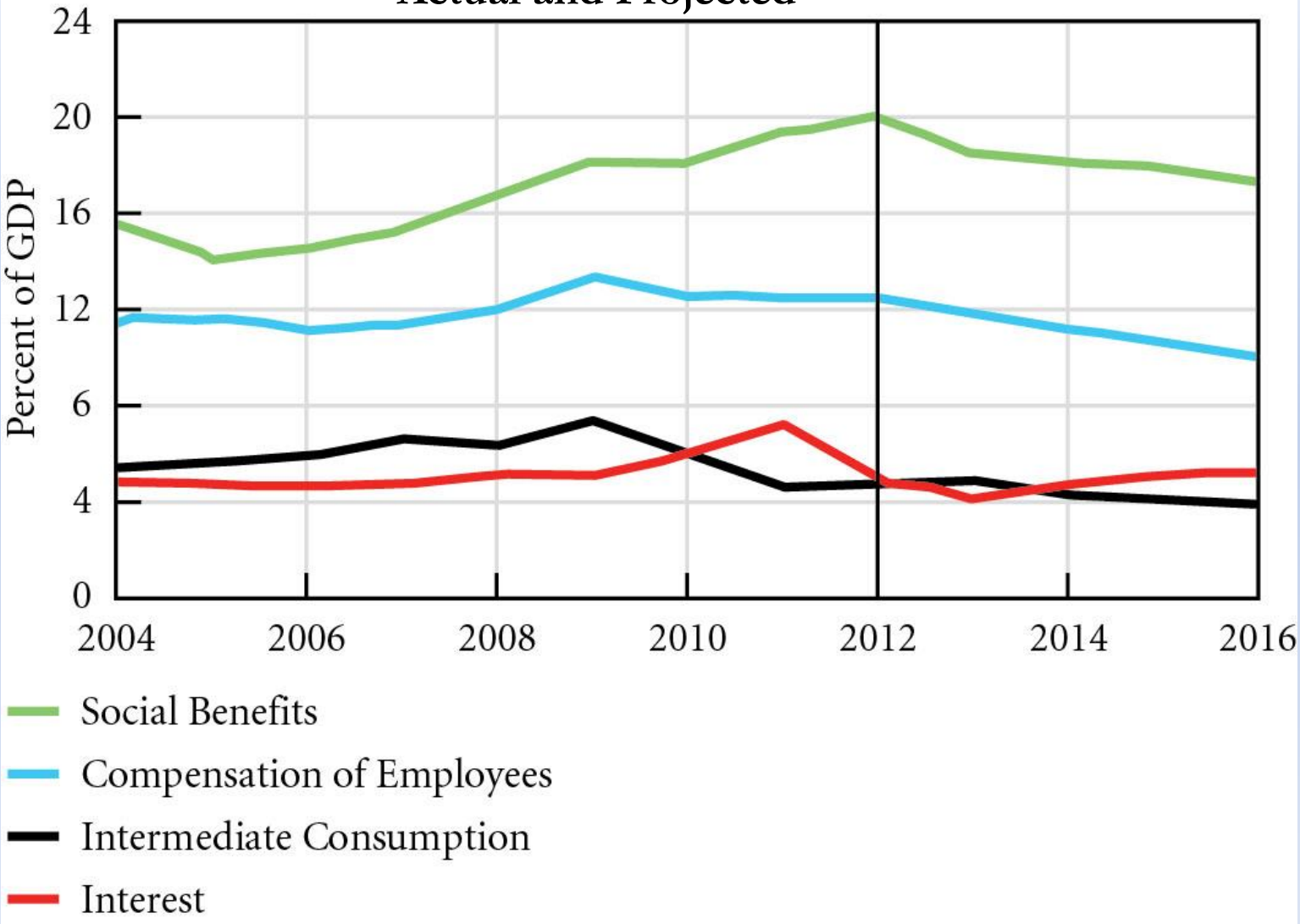
Figure 17 Greece: Government Current Expenditure

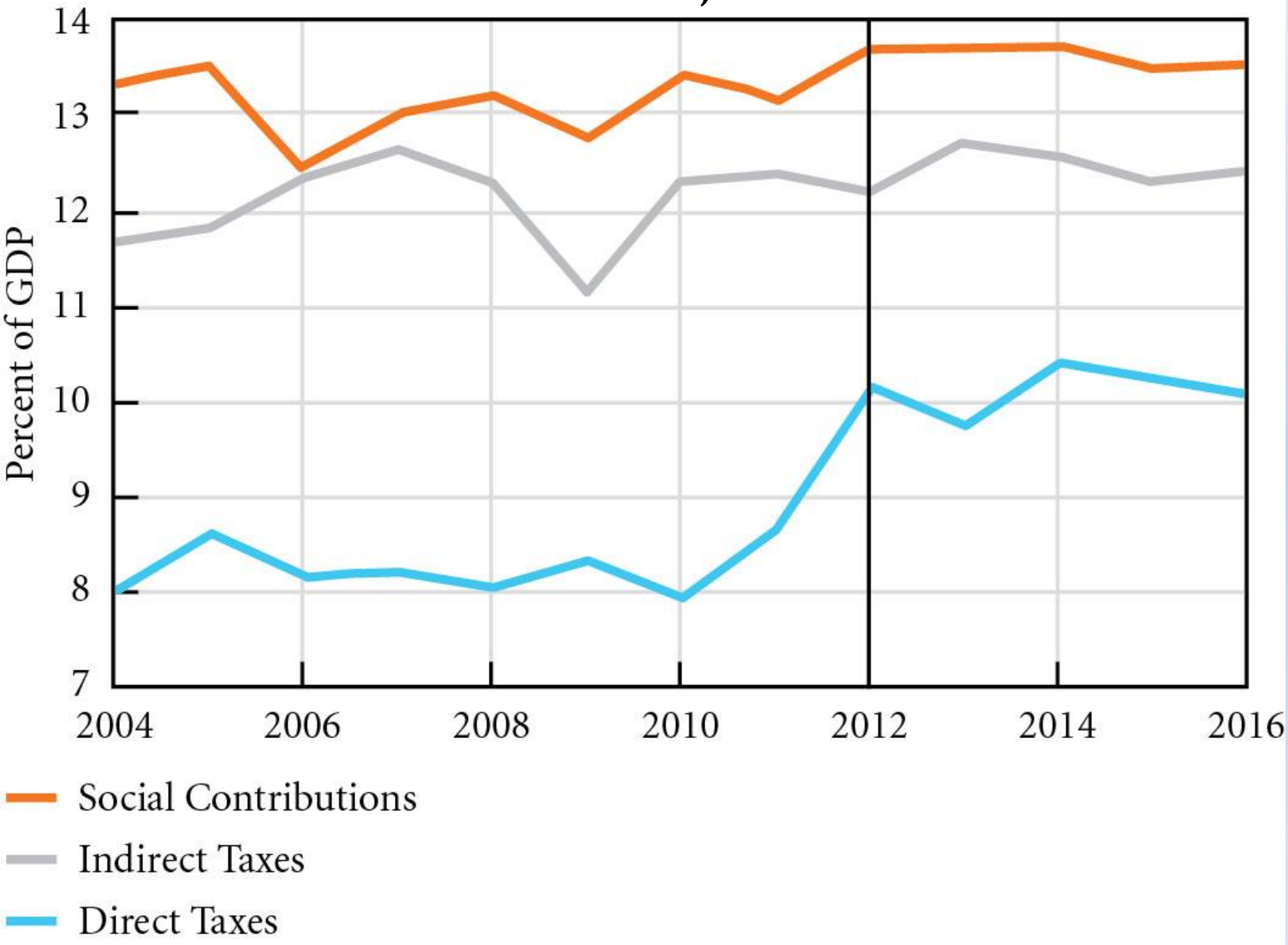
Actual and Projected



Sources: ElStat; EC; IMF

Figure 18 Greece: Government Current Revenue

Actual and Projected



Sources: ElStat; EC; IMF

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THE FAULTY STRUCTURE OF THE EURO PROJECT

- If the European leaders had good knowledge of Eurozone countries' balance sheets, they would know that, for example, Germany's trade surpluses are matched with the south member countries' trade deficits.
- Member states with surpluses need to behave in a cooperative manner toward the trade deficit member states.
- An expansionary policy in Germany and other north European member states, together with increases in private sector wages, would help reduce Eurozone internal imbalances.
- Eurobonds, a Euro Treasury and/or a recycling of trade surpluses are the solutions to rehabilitate and complete the Euro project.
- But, since all of the above appear politically infeasible, other national options must be considered.

AN ALTERNATE POLICY OPTION: A MARSHALL PLAN

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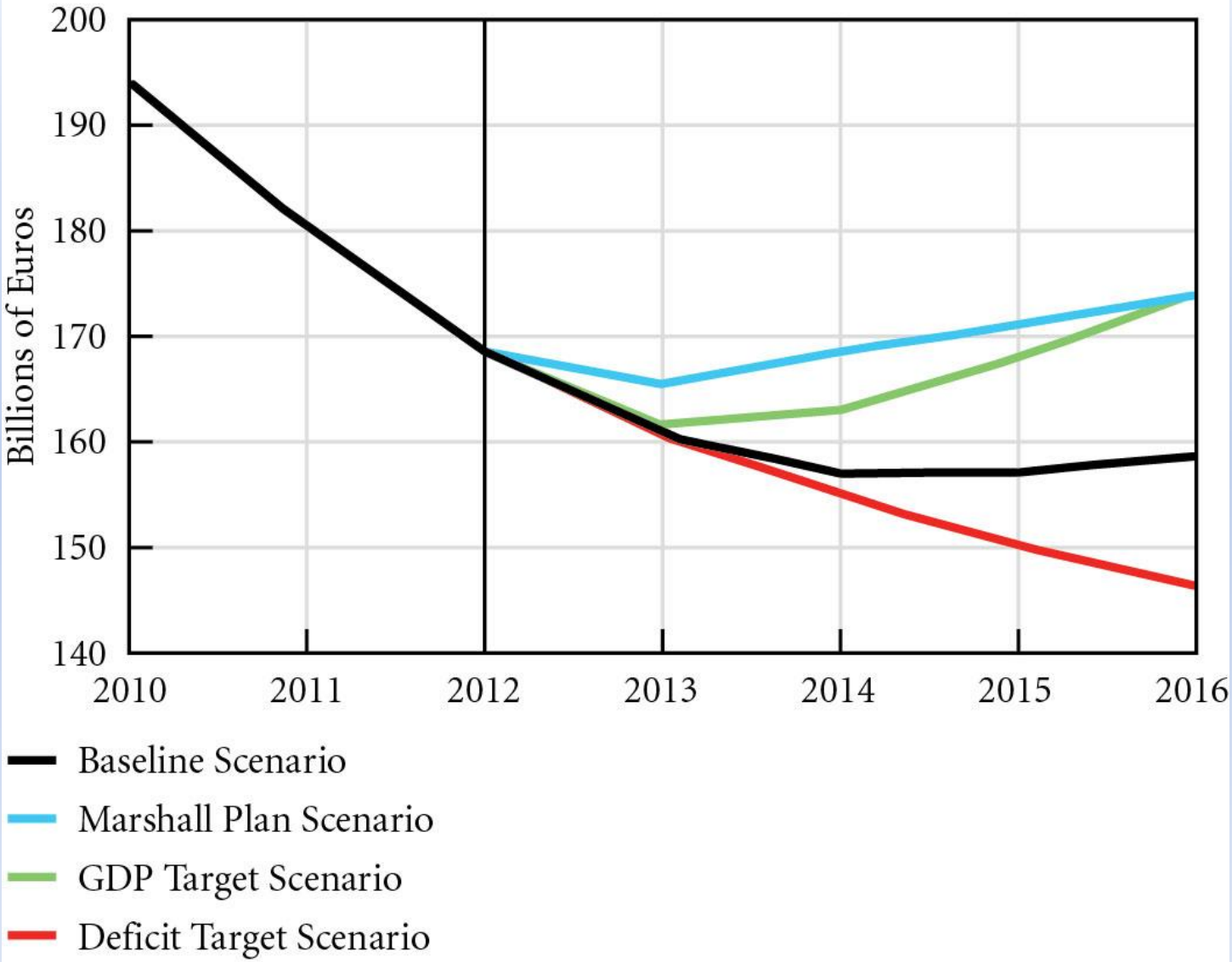
- **Externally funded and overseen by the European Investment Bank or other EU institution, for a total amount of 30 billion Euros at the rate of 2 billion each quarter beginning now.**

- **Funds would be spent for public consumption and targeted investment to foster growth in key production of goods and services.**

- **Funds could be used to finance a direct job creation program along the lines discussed.**

Figure 19 Greece: Alternative Scenarios for Real GDP



Source: Authors' calculations

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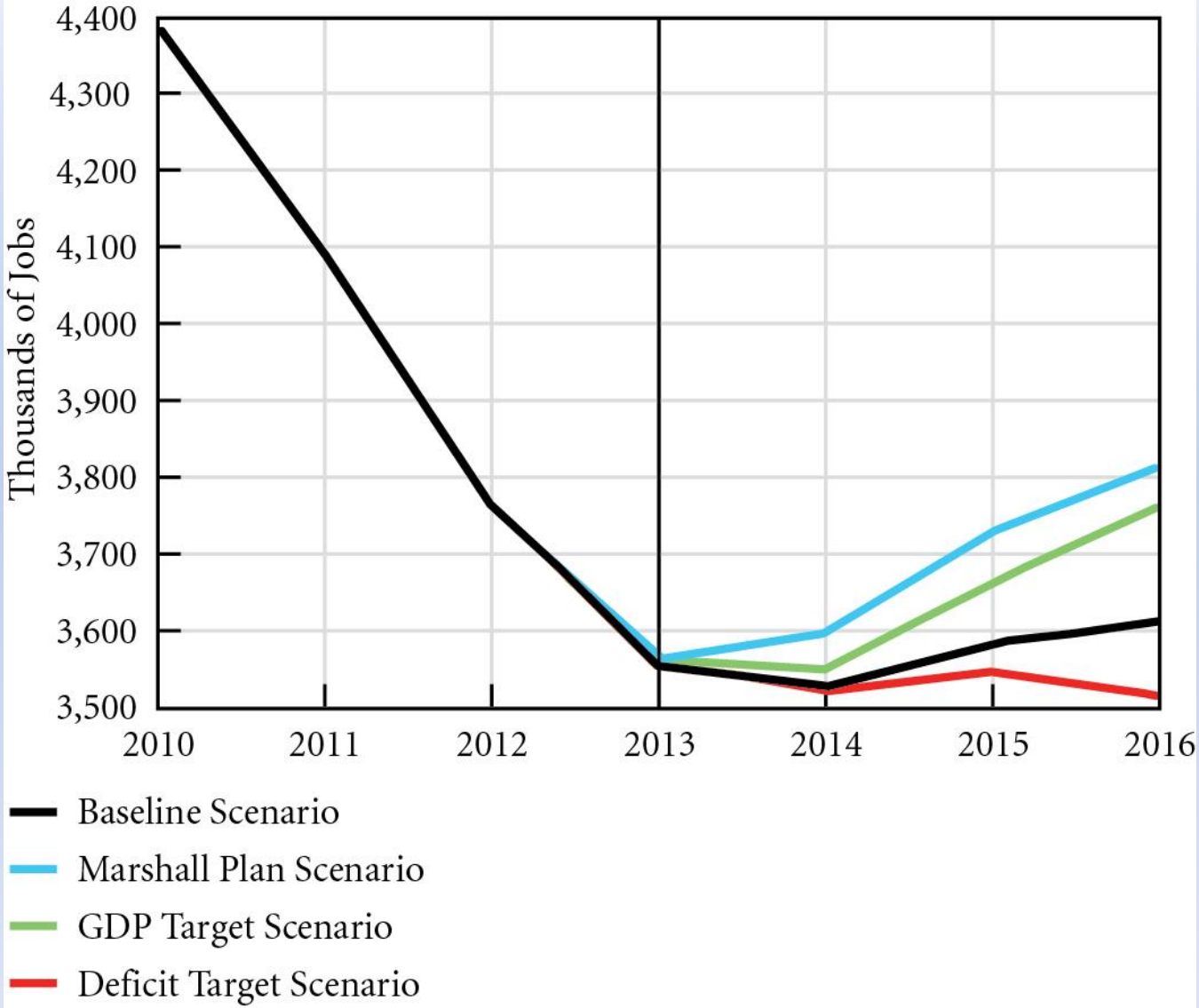
Figure 20 Greece: Alternative Scenarios for Employment



Source: Authors' calculations

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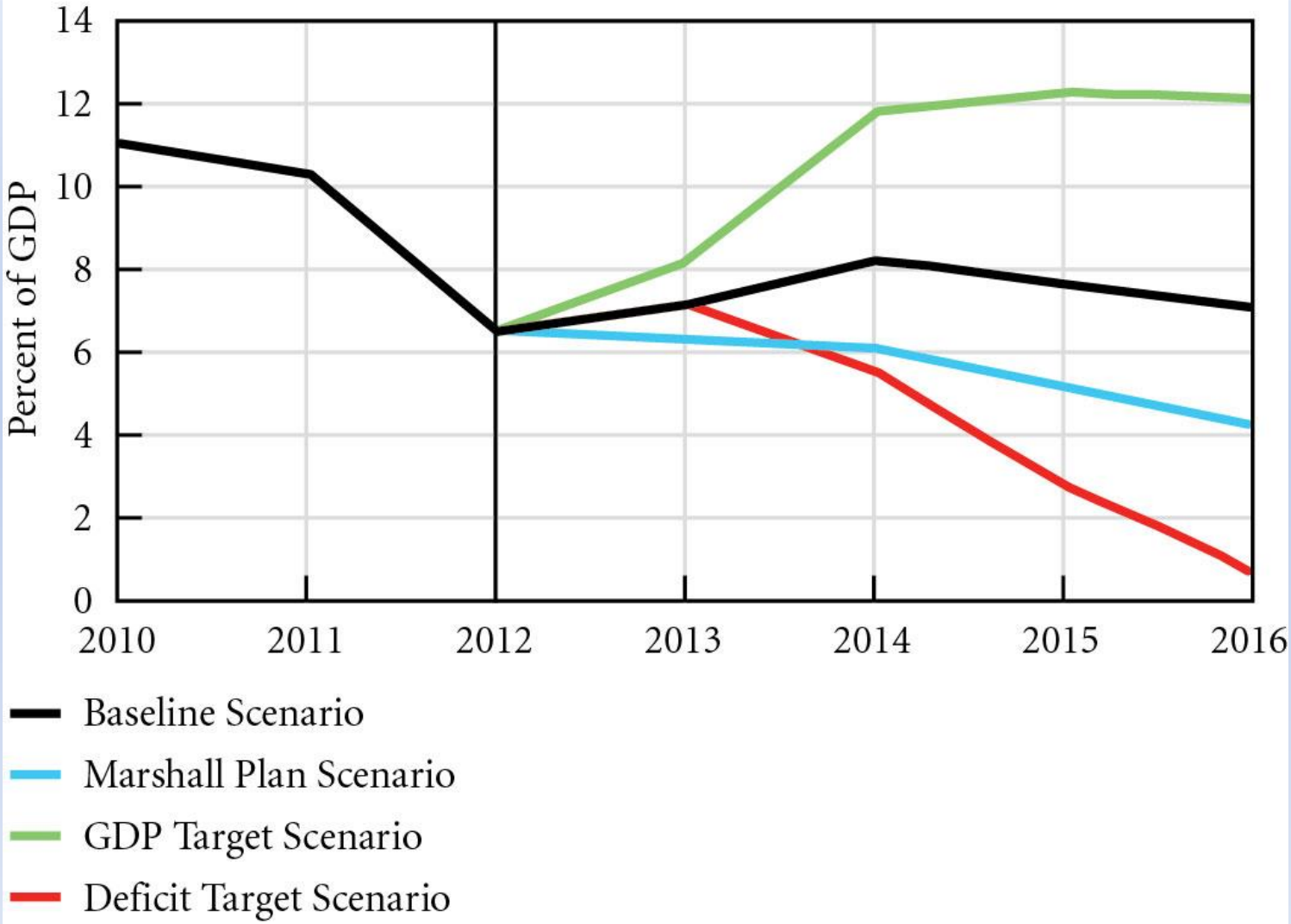
Figure 21 Greece: Alternative Scenarios for the Government Current Deficit



Source: Authors' calculations

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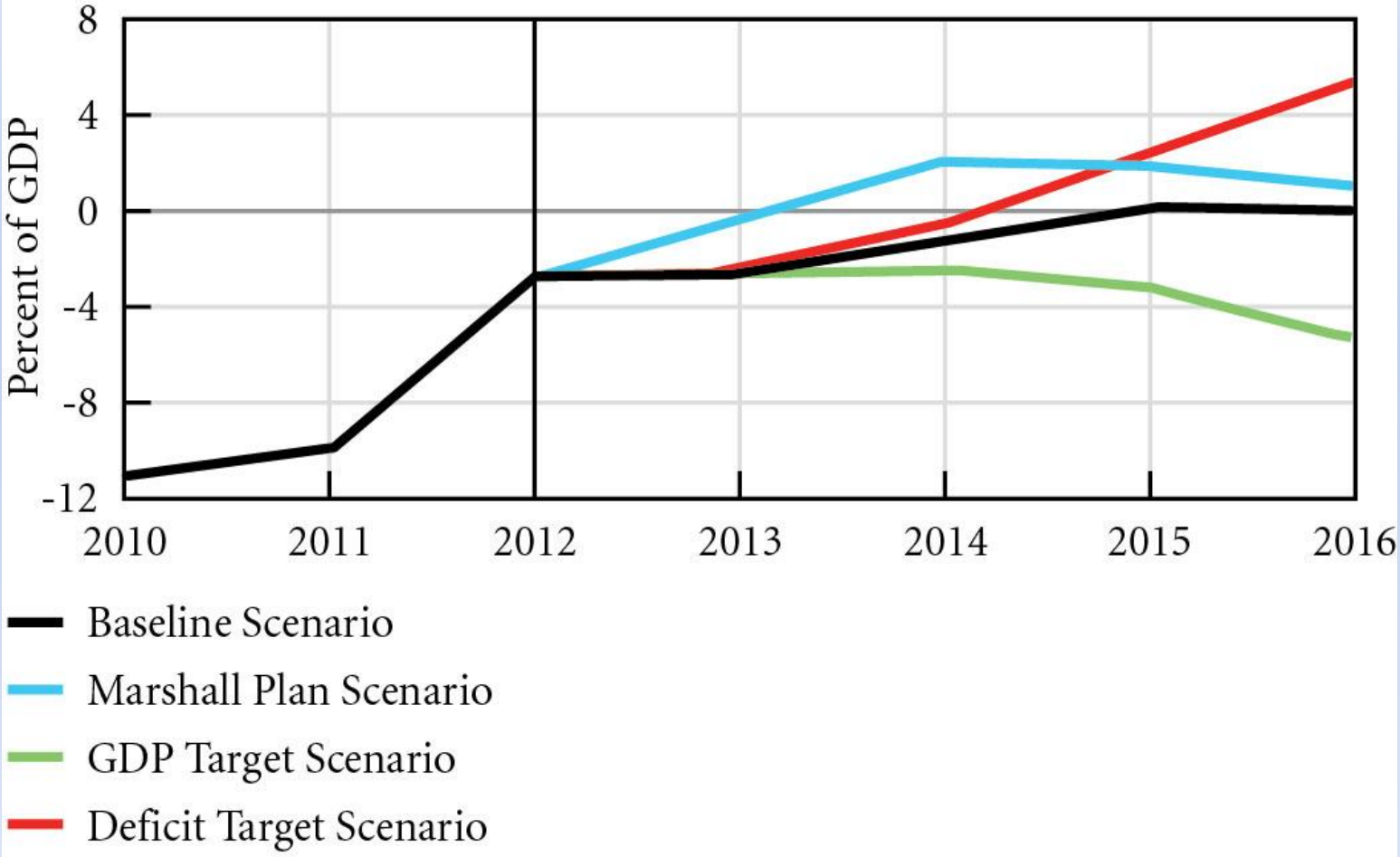
Figure 22 Greece: Alternative Scenarios for the External Account



Source: Authors' calculations

A SECOND ALTERNATIVE POLICY OPTION: SUSPENDING ALL INTEREST PAYMENTS AND FREEZING PUBLIC DEBT

- Public sector debt is frozen with no interest payments made until GDP levels are restored to 2010 levels.
- Creditors agree to roll over maturing debt for as many years, until 2010 GDP levels are restored.
- Interest payment is conservatively estimated at about 7.5 billion Euro per year.
- The amount of 7.5 billion Euro per year could be used, instead, for public consumption and targeted investments or to finance a direct job creation program.

Figure 23

Greece. Alternative scenarios. Real GDP

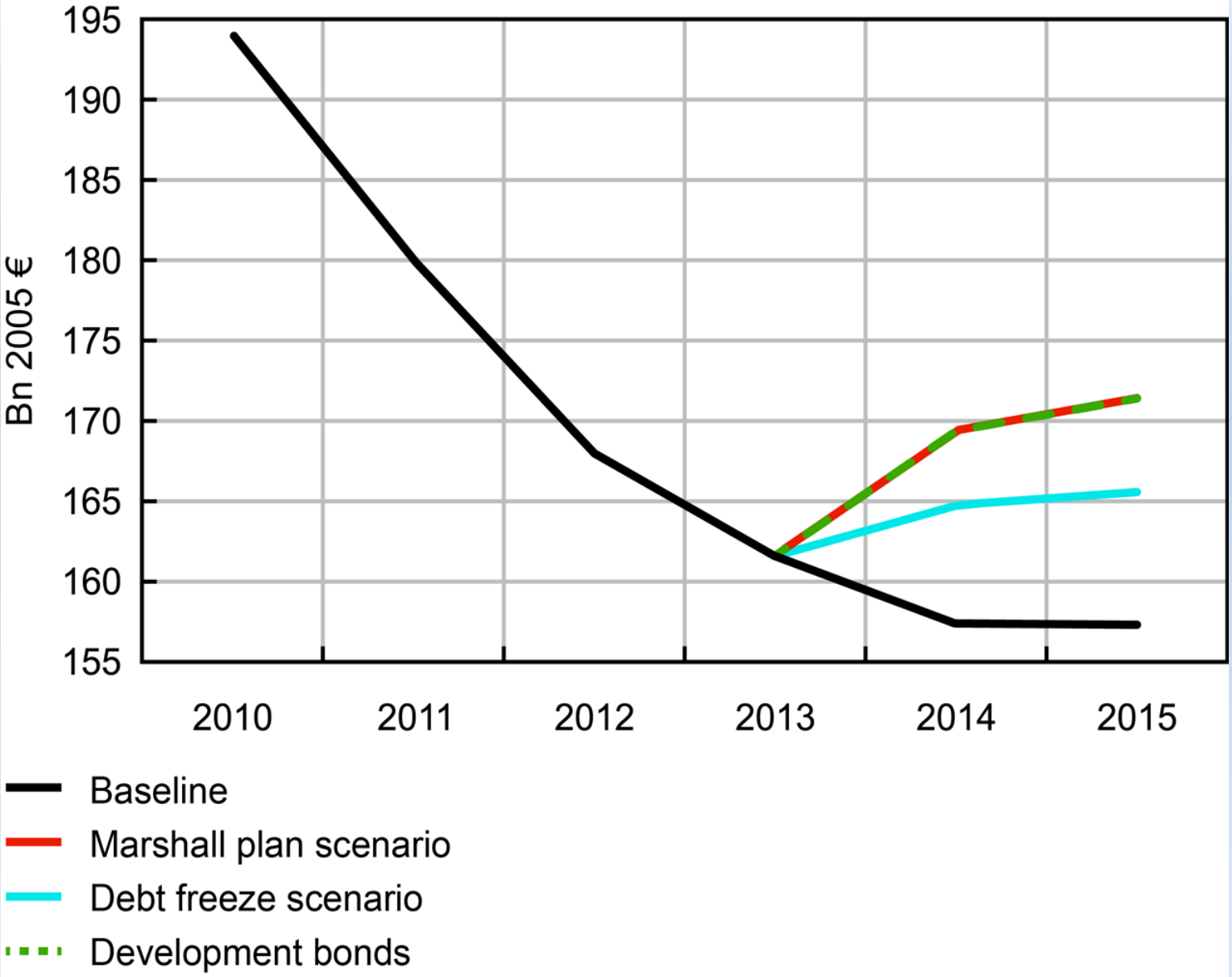
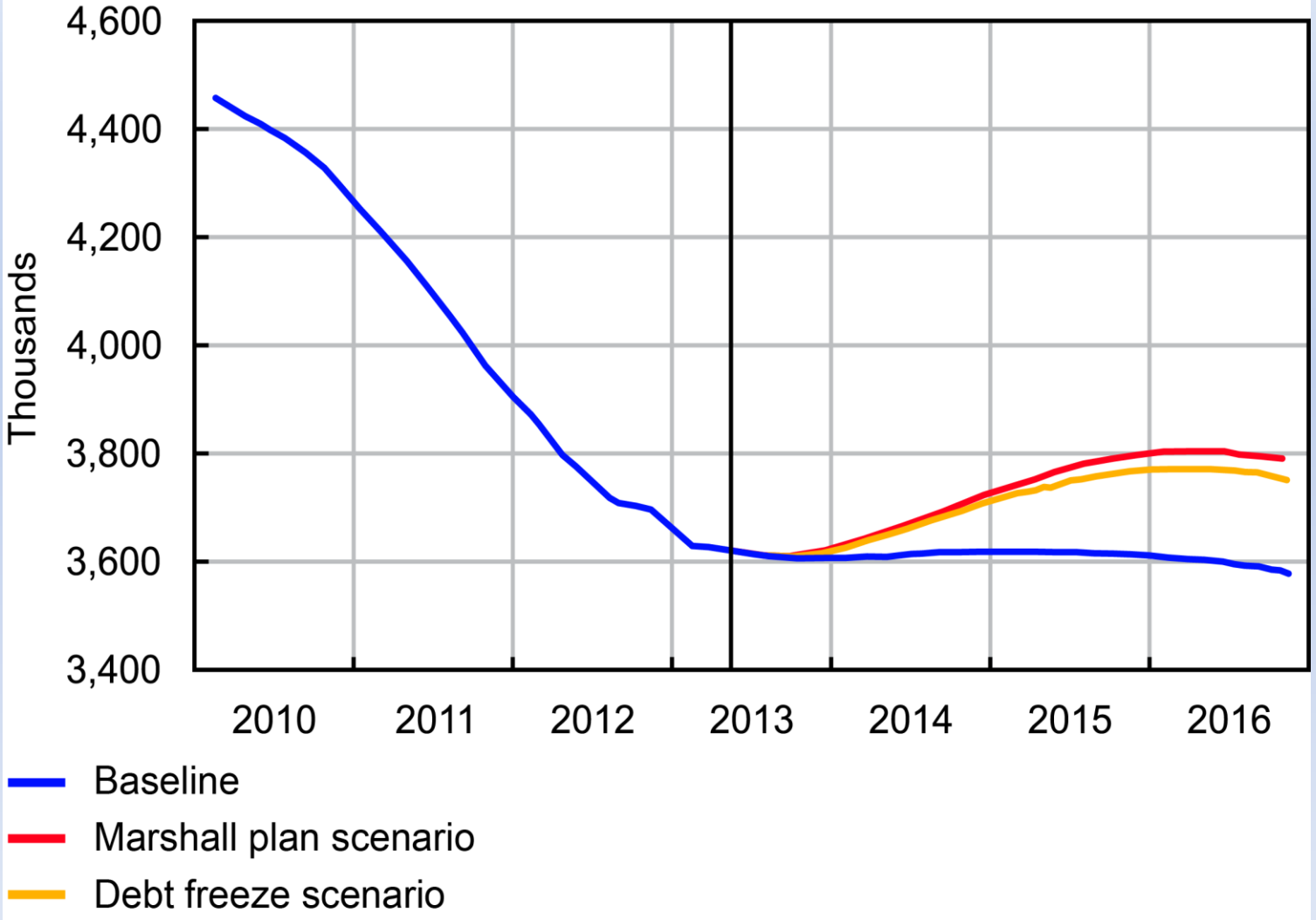


Figure 24

Greece. Alternative scenarios: Employment level



Source: ElStat

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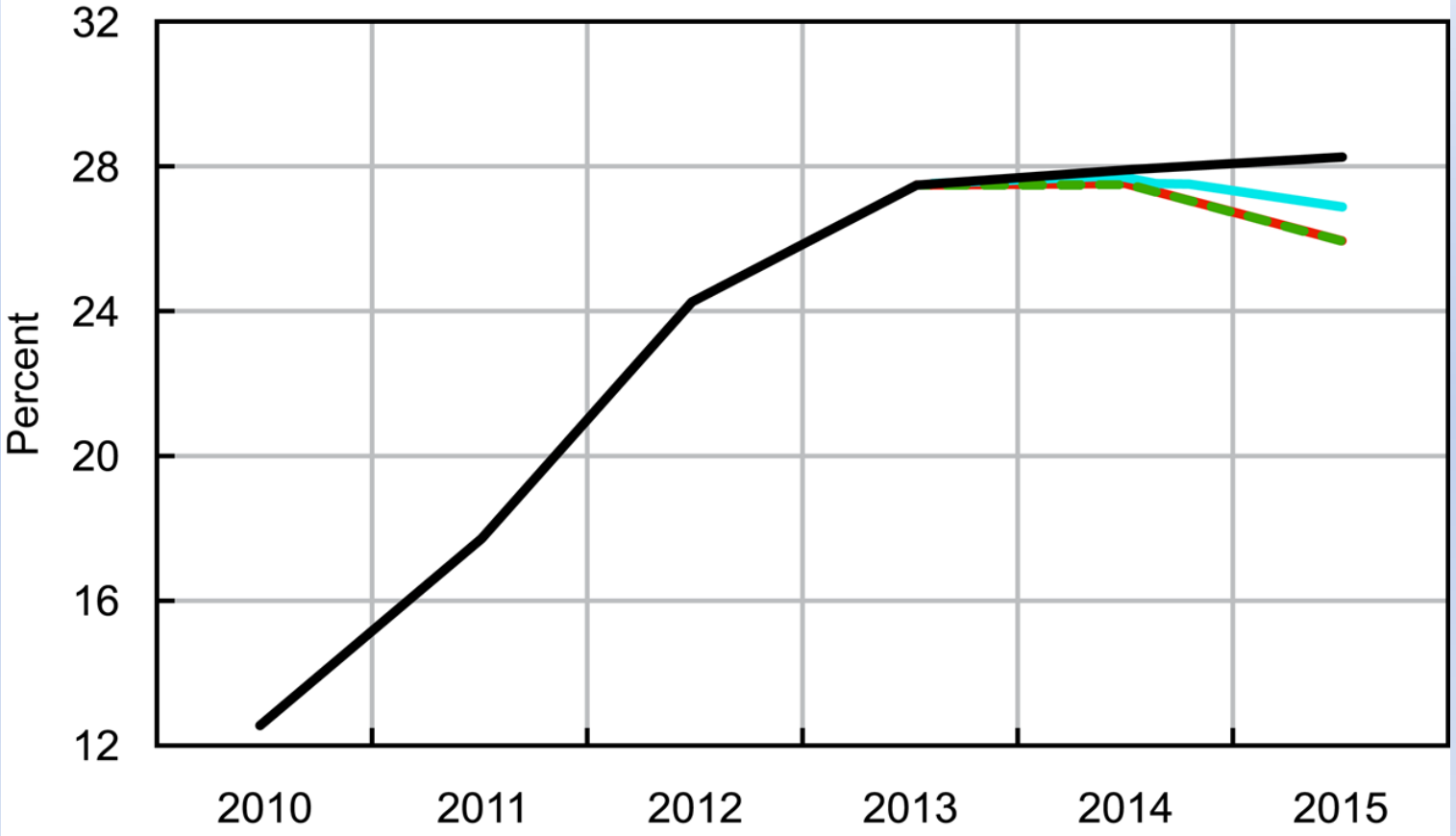
Figure 25

Greece. Alternative scenarios. Unemployment Rate



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TIME TO THINK THE UNTHINKABLE: A PARALLEL CURRENCY

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Important Issues to Consider:

- **Should it be convertible?**
- **Should it be backed by gold, reserves, future current account revenue, future tax revenue or nothing (fiat money)?**
- **How much parallel currency to inject?**
- **Which transactions should it be used for?**
- **Should existing financial assets be redenominated?**
- **Should foreign debt be redenominated?**
- **What would be the fiscal/monetary policy?**
- **Which institution would be the issuer of the parallel currency?**

A PARALLEL CURRENCY POLICY OPTION

FEATURES:

- **Responsibility for the parallel currency will rest with the independent Bank of Greece to avoid government exceeding the agreed upon limits**
- **Government perpetual Geuro bonds, transferable, denominated at zero interest, acceptable at par in lieu of tax payments to government employees, domestic suppliers and transfer payments recipients, controlled by the Central Bank**
- **One way convertibility, from Euro → Geuro**

PARALLEL CURRENCY USAGE

- Conversion of government loans held by the financial sector in Geuro (about 15 billion Euro)
- 50 percent of social benefits paid in Geuro (about 19.3 billion Euro)
- 30 percent of public sector wages in Geuro (about 7.2 billion Euro)
- Conversion of government accounts payable (Tax refunds, etc.) in Geuro

PARALLEL CURRENCY TO FINANCE A DIRECT JOB CREATION PROGRAM

- Research findings by the Levy Institute estimate the total cost for both direct job creation wages and indirect costs to be at approximately 7.1 billion Euros/year covering over 550,000 persons
- The multiplier of the program will create about 160,000 additional jobs and increase GDP by 11.6 billion Euros
- Tax revenues will also be increased by almost 4 billion
- The impact on imports should be smaller than in programs financed in Euro
- The program should be complemented with additional measures to increase productive capacity and provide some import substitution

ESTIMATED IMPACT OF A PARALLEL CURRENCY POLICY OPTION

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- If Euro "savings" are used to reduce the stock of debt, this policy option is somewhat contractionary
- If Greece continues paying interest on foreign debt at current rates, the growth path will be similar to our baseline scenario
- If the parallel currency option is in addition to the "debt freeze", the impact on the economy will be more substantial, and the consequences on the current account will be better

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