Keeping Greece afloat and hoping for supply-side growth…

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Vassilis Monastiriotis 2011-7-23

The agreement reached by the Eurozone leaders on 21 July does one great thing for Greece: it resolves its cash-flow problem, at least for the next few years. Unless something goes terribly wrong with the Greek economy, the new €109bn loan will see the country through its borrowing needs to 2014. Besides this, some €20bn of the new loan will be used by Greece to buy-back some of its maturing debt, with an estimated saving (reduction in its debt) of about €13bn. Another €13bn is expected to be saved by the 'voluntary haircut' included in the partial roll-over of privately-held debt, agreed with the Institute of International Finance. Additionally, the reduction in the interest rates charged on the eurozone loans and the extension of their maturity will also help, by slowing-down the spiralling growth of the Greek debt over the next 10-15 years. All in all, Greece has been offered an important lifeline involving also a small – but always welcome – reduction of its debt.

But this is it. The agreement falls short of addressing decisively, let alone solving, Greece's fiscal and economic problems. Greece remains insolvent and its debt remains unsustainable. It is not difficult to understand why: reducing the Greek debt requires rates of growth and primary surpluses that are just not possible in the current Greek context. In simple terms, it requires a nominal growth rate that will be higher than the sum of the interest rate charged to Greek loans and the share-to-GDP of the country's primary deficit. Today nominal growth is zero (roughly, -3.5% real growth plus inflation of +3.5%) while the primary deficit is at 4%. For Greece to start reducing its debt without any substantial change in its growth rates would require interest rates not of 3.5% but of -3.5%. It would require that somebody gives Greece money for free. Alternatively, it would require Greece to run permanently primary surpluses of over 4% of GDP – bear in mind that Greece has never achieved this in its history, not even for one single year.

So, what could have been done about this? Two things: a debt restructuring proper, with a eurozone-backed large-scale buy-back of Greek debt (through a much better capitalised EFSF or through a Eurobond) and a pro-growth strategy, a Keynesian-type orchestrated intervention to direct foreign (public and private) investments to Greece (the so-called "new Marshall Plan" or, in my preferred term, a Investment Pact for Greece). The agreement does neither of these. Rather, it remains very much on the theology of the past, as has been reflected in the terms of the Medium-term Programme that went through the Greek parliament in late June: a logic of further fiscal consolidation (tightened austerity) and faster structural reforms.

On the issue of debt relief / restructuring, all that is there is the savings of approximately 15% of GDP (at an optimistic estimate) that Greece will make from the €20bn buy-back and the private-sector debt rollover (if and when it happens). This is not a trivial number, but it is too little to make a real difference. But I think in fairness there was never any real expectation for anything more than this. Operating under the fear of the rating agencies (which threatened to declare as "credit event" anything that would create nominal losses for private bond-holders) and – I would add – under the fear that an "easy way out" for Greece would fuel complacency and weaken the pressure for fiscal consolidation and reforms domestically, the eurozone leaders were not looking for an agreement (or, as Aristos Doxiadis argues, could never reach one) on solving once and for all Greece's debt problem. They were looking for an agreement that would keep Greece afloat and avoid contagion across the eurozone. Fair enough – they have achieved this.

But what is more disappointing is what the agreement does (or, rather, what it does not do) about growth. On the face of it, one may be excused to think that the agreement does actually go quite some way with regard to this. After all, the statement released after the meeting calls for a "comprehensive strategy for growth and investment in Greece" (the final statement does not mention the "European 'Marshall Plan'" but the reference is there in the draft document). Only that, all that there is in the text in terms of a 'comprehensive strategy' is a reference to Mr Barroso's recommendation to allow a reduction of the co-financing requirement for the Structural Funds already

earmarked for Greece. And all there is in relation to the so-called 'Marshall Plan' is the commitment that "Member States and the Commission will […] provide exceptional technical assistance to help Greece implement its reforms".

This is of course not a Marshall Plan. This is rather a minute boost to the ailing economy (as the reduction in co-financing will increase the absorption of the Cohesion Funds) in exchange for an agreement by Greece to implement all-encompassing structural reforms under the tight supervision of the Commission (or the 'troika'). The recipe remains very much one of supply-side solutions. Market liberalisation, wage depression and the downsizing of the public sector are the ingredients expected to stimulate private investment and get the Greek GDP growing again – and, indeed, growing fast, by at least 3.5% per year, year after year after year. It seems that the events of June, the failure to meet the 2010 deficit objectives, the constant deterioration of government revenues, the fact that the economy continues to shrink faster than what is anticipated in the (periodically downwards revised) official projections, none of these has convinced the eurozone leaders that you cannot get out of a recession by austerity measures and supply-side structural reforms.

Unless, somehow, the new lifeline offered to Greece gives her also a new voice and resolve to put the issue of the Marshall Plan / Investment Pact more methodically on the European agenda, I don't think that there is much that Greece can do. Simply make sure that it remains afloat until 2014 and implement the most urgent of the structural reforms in the hope that the supply-side measures will work – and of course, as I was saying already in February 2010, **brace herself!**