An insider's view of Greece's Euro-Crisis: Why the road to redemption must also be paved with skilful intentions

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Why the Road to Redemption must also be paved with Skilful Intentions

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The present paper aims to make three main points:

1. **The main aim of the Greek economy's intended adjustment (on the basis of the Memorandum with the Troika) is to make it vastly more outward-looking and export-oriented than hitherto.** This will involve a massive structural transformation. The fiscal-consolidation aspects of the adjustment are also, of course, essential—the colossal past mismanagement of the country's public finances is certainly what triggered the crisis. But for the long-term survival of the Greek economy, structural reform will be more important, and this has not been sufficiently appreciated by Greek governments. Compounded by the effects of the protracted recession, Greece's exit from the crisis, and its return to long-term sustainable growth, will therefore take a long time.

2. **Greece's future lies in the euro.** This may not seem self-evident, especially to an audience in a country like Britain. But the euro-sceptic argument that the problems of the Eurozone's peripheral countries result from the Eurozone *per se* is a misconception. Notwithstanding the failures of the last four or five years, the Greek economy has demonstrated and sustained improved performance in a number of areas since Greece joined the monetary union in 2001.

3. **Greece may be an extreme example of debt-fuelled growth and low savings—a wider phenomenon that afflicts the West as a whole.** Though Greece may be an unusually severe case in this regard, it is not totally unique, and other countries have their share of similar weaknesses which must not be allowed to get out of hand.

**Greece needs a more outward looking economic model**

Greek revenues from exports of goods and services are currently equivalent to about 24% of GDP. The corresponding average figure in the Eurozone is 46%. Despite the fact that in 2012 Greece was (still) the 28th richest country in the world in per capita income terms, it ranked only 123rd in terms of the share of its exports in percent of GDP, especially odd for an economy with a small domestic market. Such a low level of foreign earnings is not sustainable, nor can Greece's living standards continue to rely on escalating foreign borrowing, especially public borrowing. If Greece wants to regain its

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3 A few figures are highly illustrative: public debt as a percentage of GDP hovered around (an already dangerous) 100% for ten years starting in the mid-1990s. By 2009 it had risen to 130%,
2009 living standards, it will have to support this recovery with revenues from real exports rather than from loans. This implies a near-doubling of exports of goods and services – yet this has not been properly understood, neither by the Government, as will be explained below, nor by firms.4

The envisaged increase in exports will require massive and far-reaching transformations. Though exports of goods and services have improved recently, they are no higher than they were at their peak in 2008.5 Budget cuts, including for funds for export-promotion drives, are not helping, but neither is the overall recession which has eroded firms’ domestic-customer base. Many firms were driven to bankruptcy before they could reorient their products abroad, assuming they had the capacity to do this. A new export surge would no doubt require new investment—but spending for plant and equipment has dropped sharply since its peak in 2007, falling to an estimated 13% of GDP this year from almost 27% in 2007 and about 19% in 2009. One contributing factor for this investment decline is the plight of the banks and the general lack of liquidity.

On the plus side, Greece has performed one of the world’s greatest ever fiscal consolidations. The budget deficit has come down from over 15% of GDP in 2009 to less than 3% (projected) this year. We are now looking forward to the prospect of a series of annual primary surpluses. Greece already has the largest budget surplus in Europe by far, in cyclically-adjusted terms.6 And Greek governments have persevered despite very adverse – and some would say “myopic” – reactions from financial markets.7 This fiscal rebalancing was certainly a pre-condition for putting the Greek economy on a sounder


4 In a recent survey conducted by the Economic University of Athens, sales managers at 116 firms stated that, among 8 big changes that the crisis brought to their departments, the category “new opportunities for exports” came last.
http://www.eltrun.gr/wp-content/uploads/2013/07/%CE%B5%CE%BF%CE%B1%CE%BC%CE%B7%CE%BD%CE%B9%CE%B1%CE%AF%CE%B1-%CE%AD%CF%81%CE%B5%CF%85%CE%BD%CE%B1-%CF%80%CF%89%CE%B8%CE%AE%CF%83%CE%B5%CF%89%CE%BD%CE%99%CE%BF%CF%8D%CE%BB%CE%B9%CE%BF%CF%8213.pdf.

5 The huge pre-crisis current-account deficit has been tamed as a result of lower imports owing to the recession, rather than higher exports.

6 The Greek Finance Ministry estimates this at 6.4% of GDP.

7 “Based on the possibility that multipliers are expected to be higher in the current crisis context, short-term increases in the debt ratio following consolidation (relative to a baseline scenario of no consolidation) are likely for Belgium, Cyprus, France, Greece, Ireland, Italy, Portugal, Slovenia and Spain. However, these debt increases are expected to fade within maximum three years from the beginning of the consolidation programme, when financial markets behave normally. In order to assess the direction of fiscal policy, it is therefore relevant to take into account that the debt ratio is a lagged indicator, and that it is relevant to consider the adjustment made in structural terms. Based on planned consolidation efforts, the projected debt dynamics in some EU Member States implies it will in any case take many years for the debt ratio to get below its 2012 value, also in case of normal financial markets.” See, Katia Berti, Francisco de Castro, Matteo Salto, Effects of fiscal consolidation envisaged in the 2013 Stability and Convergence Programmes on public debt dynamics in EU Member States, European Commission, EUROPEAN ECONOMY, Economic Papers 504 | September 2013, p. 3; http://ec.europa.eu/economy_finance/publications/economic_paper/2013/pdf/ecp504_en.pdf.
footing, making it more competitive and less prone to wasting resources. The ensuing recession has also made wage levels more competitive.\textsuperscript{8} All this should help restore confidence, which should, inter alia, support a recovery of investment spending.

But the only real hope for a sustained recovery at this stage is to push ahead with the structural and administrative reform agenda. Implementation of these reforms will be crucial for Greece to be able to shift (eventually) more resources to the tradable sector, as well as to attract more foreign direct investment (another area in which Greece does very poorly\textsuperscript{9}). On this score, however, Greece has been much less successful. According to the World Economic Forum (Davos), Greece this year placed a poor 91\textsuperscript{st} out of 148 countries in their Global Competitiveness Index.\textsuperscript{10} As recently as 2011, Greece ranked 100\textsuperscript{th} out of 185 countries in the World Bank’s overall “ease of doing business” list, and 135\textsuperscript{th} in the world in the “starting a business” category.\textsuperscript{11} Fortunately thanks to Greece’s adjustment programme, the country’s performance improved markedly in 2013, climbing to 72\textsuperscript{nd} position in the world overall, and 36\textsuperscript{th} in the “starting a business” category.\textsuperscript{12}

Given the way the whole Greek adjustment programme has been conceived – with equal doses of fiscal consolidation and structural and administrative reforms – one might expect the Greek administration to be doing everything in its power to push through, fast, the reforms necessary to make Greece less bureaucratic and more outward looking.\textsuperscript{13} However, experience suggests that this has not been the case. Though some progress has undeniably been made – in fact, the OECD places Greece first in terms of the progress achieved in the area of structural reforms\textsuperscript{14,15} – it has not been rapid

\textsuperscript{8} In the period 1999-2009, the cost of labour increased by 50%. In just the past three years, it has fallen 20%. See, European Commission, \textit{Member States’ Competitiveness Performance}, 25/9/2013; http://ec.europa.eu/enterprise/policies/industrial-competitiveness/monitoring-member-states/files/el_country-chapter_en.pdf. \textit{Disposable income} (i.e., including the effect of higher taxes) has fallen by an estimated 40%.

\textsuperscript{9} As a percentage of GDP, the stock of inward FDI in Greece is no more than a quarter of what it is in the EU as a whole (2010-2012: 12\% in Greece vs. 45\% in the EU). See, UNCTAD, World Investment Report 2013, 27/6/2013; http://unctad.org/sections/dite_dir/docs/wir2013/wir13_fs_gr_en.pdf.


\textsuperscript{11} http://www.doingbusiness.org/reports/global-reports/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB12-Chapters/Country-Tables.pdf

\textsuperscript{12} http://www.doingbusiness.org/rankings

\textsuperscript{13} The national trade facilitation strategy was announced as late as November 2012. It features 25 measures aimed at reducing the time needed for export by 50\% and costs by 20\% by 2015. The strategy is focused on simplifying the cumbersome pre-customs and customs procedures. Under a more enlightened ranking of priorities, one would have expected much more ambitious targets, to come into effect much sooner. Even so, by end-October 2013, the Commission’s Task Force in Greece, in its 5\textsuperscript{th} “activity report”, noted the existence of serious delays in the implementation of the current programme; http://europa.eu/rapid/press-release_IP-13-981_en.htm.


\textsuperscript{15} The Brussels-based think-tank The Lisbon Council for Economic Competitiveness and Social Renewal also placed Greece at the top of its list of adjusting countries in both 2012 and 2013; this list includes the 17 Eurozone members plus Poland, Sweden and the United Kingdom. See, The Lisbon Council, \textit{The 2013 Euro Plus Monitor – From Pain to Gain}, 3/12/2013.
enough – for reasons that are both ideological, and practical. Ideological, because from
the very beginning the relevant ministers, with some notable exceptions, approached
the structural reforms agenda with a mixture of hostility and fear, and alien to their
usual modes of thinking. Practical, because the administration itself does not like change,
especially when it itself is the target; it typically opts to avoid alienating the public; and to
a large extent it does not have the competence and skills to administer the
medicine in the most intelligent way possible. And the need to maintain politically
sensitive inter-departmental equilibria usually means that when the axe falls, it falls
indiscriminately (i.e., horizontally), rather than on the basis of a new, more efficient,
prioritisation of actions.

The end result of this dysfunctional governance is that every three-monthly review by
the Troika is transformed into a political thriller, with the government at worst dragging
its feet, or at best falling behind, in the implementation of prior commitments, including
commitments in the structural reform agenda, which makes no sense at all. This
causes delays in the disbursement of the financial instalments from the Troika; it
undermines the ultimate effectiveness of the structural measures themselves (since, by
the time the new measures are enacted, the recession’s hold has further damaged the
rationale for new business initiatives); and it encourages an anti-Memorandum, and
hence anti-reforms, culture – for which even the Government is not entirely guiltless.
All this then leads to talk about the need for a “comprehensive solution” regarding the
debt. But however the debt question is resolved, it will not alter the country’s obligation
to, inter alia, improve its tax mechanisms, reorganise the public administration, and
accelerate the dispensing of justice. These obligations are prerequisites not just for the
smooth disbursement of the financial instalments, but much more importantly for the
recovery of the Greek economy from its present comatose state.

http://www.lisboncouncil.net/news-a-events/515-new-policy-brief-the-2013-euro-plus-
monitor-.html.

16 Recent examples include the payment of State arrears to the county’s two biggest water
authorities, something that had been agreed in principle last July (an agreement with the Athens
water company was still pending at the end of October); the adoption of the new lawyers’ code,
again, part of the liberalisation of professions which, according to the original plan, should have
been completed by June 2011; and the Government’s insistence that the country’s two defence
industries can survive as commercial enterprises via the signing of new export contracts, when it
is known that today they exist thanks essentially to state subsidies and that for 20 years such
contracts, in the required numbers, had not been forthcoming.

17 A case in point is the liberalisation of road transport. The first such bill was tabled in April
2010, but reactions from the profession, and inherent weaknesses in the bill, delayed the
adoption of a truly liberal law until the beginning of 2012. By this time, the recession had taken a
firm hold and therefore undercut the incentives for new commercial activity in general, and in
the road-transport sector in particular, despite significant cost reductions.

18 The press reports that the two coalition partners (New Democracy and Pasok) are preparing a
joint document in the form of a new programmatic agreement that will reportedly stress, inter
alia, the following three points: (i) emancipation from the Memorandum, (ii) no new fiscal
measures, and (iii) no imminent elections. Earlier versions reportedly included a – highly-
controversial – call for a new arrangement with Greece’s lenders to deal with the debt, but
evidently this was later withdrawn. See press reports, 22-24/10/2013.

19 For example, lack of competence can mean that a new tax bill can take much longer to draft
than otherwise. In the meantime, tax revenues remain under par because of the weaknesses of
the existing system. To compensate, the Government increases budget cuts, for example in areas
such as R&D, undercutting efforts to modernise the economy.
Possibly because the Troika wanted to show that progress was being made at least in some areas, the emphasis of its conditionality—if not exactly prioritised—does seem to have been on seeking concrete results on the fiscal side. Here things are more measurable and quantifiable; it is easier to assess the progress being made or not made. But this distorted perceptions of the policy mix being promulgated and the focus of public discourse shifted away from the real challenge—the structural one—to the viability and desirability (or otherwise) of more and more budget cuts and tax increases. This debate made the environment for meaningful structural change even less auspicious. “Meaningful structural change” means a shift away from consumption and imports and toward investment and exports, consistent with a regenerated private sector acting in its own best interests. People should not imagine that just because the Government has finally managed to put some order in its finances, the economy will recover without further ado, and automatically rebalance. On the contrary, three-and-a-half years into the adjustment programme, despite the fact that a minimum critical mass of legislative changes and economic improvements are now in place and despite signs that the depression is finally bottoming out, the real transformative challenge still lies ahead.

**Greece’s future lies in the Eurozone**

Until recently, Greece was under relentless attack from various centres, mostly (but not only) in the Anglo-American world, advising her to leave the “straitjacket” of the euro and seek a quick recovery through a devaluation of the currency. What the textbook analysis overlooks is the fact that what Greece will need to do is shift the equivalent of an extra 15% to 20% of GDP to the export sector, if it is to lay solid foundations for long-term recovery. A devaluation may benefit incumbent exporters for a while. But how Greece is going to get all the new entrepreneurs needed to rebalance the economy to set up shop in a world of now prohibitively expensive imports of fuel, machinery and components is anybody’s guess. Unless, of course, Greece restricts itself to exporting olives.  

20 A little-reported success story, in this connection, is that internal devaluation has worked for at least one sector, a sector that happens to be one of the country’s main foreign-revenue earners, viz., tourism; this trend enabled the sector to achieve what will probably prove by year-end to be its best results ever.

21 According to the search engine Trivago, Greece now ranks the 4th cheapest country among 24 European countries in terms of average hotel-room rates. Turkey, a significant rival, has now become the 4th most expensive. This is a complete reversal of the statistics from just a few years ago. Furthermore, this result was obtained without the huge upheavals that would accompany a real devaluation, including much more expensive imports, which – imports – are vital to a modern, sophisticated tourism industry.
It is only by remaining inside the Eurozone that Greek economic policy will abide by the rules of rationality and effectiveness. Outside the monetary union, Greece will lose the well-tried benefits of externally-imposed discipline and relapse into a state of perennial weakness and economic instability, characterised by a bloated government (this is the natural tendency born of the kind of democratic politics prevalent in Greece), high inflation, and a series of futile devaluations substituting for real structural change.

Thanks to the EU's strengthened economic governance, including revamped fiscal rules, as well as an enhanced role for macro-prudential policy, there is less chance that Greece will again massively break the rules and find itself in the mire it is in now. Instead, one should hope that Greece will pick up where it left off in the early years of EMU membership—provided, of course, the external environment is not too unfavourable. In the meantime, it should not be forgotten that GDP in Britain and in the Eurozone, Greece's biggest markets, is still lower than it was in 2008, which of course does nothing to help Greece's recovery.

In the mid-1990s and in 2000, efforts by the Greek Government to put its finances in order to meet the Maastricht criteria were rewarded with an improved performance from the private sector. From 1996 until 2008, Greece enjoyed one of the highest GDP growth rates in the EU15, most years coming second behind Ireland. As mentioned above, part of this was artificial, especially starting in 2004, being based on foreign borrowing by the Government. But those years also saw productivity increases greater than practically anywhere else in the EU15, three times higher than in Germany, Spain or Portugal. Exports grew at rates slightly above the EU average, mainly thanks to receipts from shipping and a diversification of goods exports toward the Central and Eastern European emerging markets. Reflecting the economy's new strength, there was a wave of outward direct investments, principally in SE Europe, contrasting with the traditional export of people not capital. After decades of protectionism and looking inward, Greek firms and Greek banks became regional actors. At the same time, Greece absorbed nearly 1 million immigrant workers and their families and gave them jobs—no mean feat for a country of 11m people.

And for those who still have their doubts about the wisdom of Greece's joining EMU, let them consider one last fact. In 2010, Greece ranked 22nd in the world in the United Nations Human Development Index. This index takes into account not only per capita income, but also other qualitative attributes of development, such as infant mortality, education, income distribution, etc. Greece not only ranks high globally but also in the region; in 2010 it actually ranked above Italy, Austria, and the U.K. Something right, therefore, must have happened in Greece in the last ten to fifteen years.

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22 Ten of the 28 EU members, including Germany, had given, by July, regulatory authorities the job of conducting macro-prudential policy. Meanwhile, an EU law that sets out broadly the way macro-prudential tools should be used comes into effect next year.


The West must change its growth model too

Even if Greece eventually carries out successfully its own reform programme, its long-run growth potential will depend on what happens in the rest of the EU and the economies of the Western world in general. Here we are confronted with a series of big question marks. The latest financial crisis has revealed a number of persistent features in the West’s growth model that are, at the very least, questionable. Let us mention them briefly:

(a) Western countries have displayed a chronic inability to pursue sound fiscal policies, including building up surpluses in booms, and a tendency to run budget deficits even when times are relatively good, which is an abuse of classic Keynesian counter-cyclical policies.26

(b) The same countries have a tendency to rack up debt. We all talk about how irresponsible Greece was to chalk up a public debt equivalent to 130% of GDP back in 2009. But if you add countries’ public debt to their private debt, Greece doesn’t look so bad.27

(c) Savings rates have been notoriously poor in the West for decades, thanks no doubt to the West’s ability to attract savings from the rest of the world.28 In future the savings rate, as a concept, will likely feature much more prominently in any economic debates.

(d) The financial distortions created during the credit boom years and the ensuing credit crunch are still cause for considerable concern. The international financial system is still functioning so badly that the West’s recovery could easily end in another crisis.

(e) Western technical progress is insufficiently imaginative. Technology has been the main area of western dominance until now. But despite the seemingly dizzying pace of technological change witnessed in recent years thanks to the computer and Internet revolutions, it would appear that innovation today overall is focused more on securing efficiency gains within existing broad patterns of production, and less on creating entirely new categories of products and services (as cars, airplanes, electricity, the

26 A quick look at government financial statistics over the past decade – when conditions were generally deemed to be, on the whole, quite satisfactory – reveals that none of the original members of the Eurozone ever registered any real budget surpluses to speak of, with the exception of Finland, Ireland, Spain and tiny Luxemburg – certainly, none of the bigger countries that have now become the self-proclaimed high priests of fiscal orthodoxy; [http://ec.europa.eu/economy_finance/db_indicators/gen_gov_data/documents/2013/spring2013_series_en.pdf](http://ec.europa.eu/economy_finance/db_indicators/gen_gov_data/documents/2013/spring2013_series_en.pdf), p. 154

27 If one looks at debt as a whole (public plus private, for 2011), in Greece it stood at about 260% of GDP. In the United States, it was 279% of GDP; in Spain it was 363%; and in the U.K. it was an astonishing 507% of GDP. And unfortunately for the U.S. and Britain, these two countries were No. 1 and No. 2 in the world in terms of external debt – proof, again, that the euro has little to do with the current state of affairs in the West. See Martin Wolf, “A hard slog in the foothills of debt”, *Financial Times*, 14/3/2012.

28 In the years leading up to the financial crisis (2003-2007), saving rates in the West ranged from 25%-26% of GDP in, say, Austria and Belgium, to around 15% of GDP in the UK and the U.S., while in Greece it was around 13%. In contrast, in India, for example, gross savings as a percentage of GDP came to 33%, in Saudi Arabia 43% and in China 48%. See, The World Bank, Gross savings as a percentage of GDP, [http://data.worldbank.org/indicator/NY.GNS.INTR.ZS?page=1](http://data.worldbank.org/indicator/NY.GNS.INTR.ZS?page=1).
telephone, radio and antibiotics were in the late 19th and early 20th centuries). It is only the latter kind of innovation that can lead to more employment and even thwart the accelerating pace of income inequality, a huge new emerging problem in its own right, especially in the U.S.

But even if the final observation is too pessimistic an assessment of future technological prospects, in the final analysis we will still have to learn to live less on credit – supplied largely by the hard-working savers of Asia – and more by our own wits, i.e., our ability to invent, to innovate, to save, to invest and to produce. This great transformation of our societies is only beginning even as we try to pick up the pieces from the latest financial crisis, indeed, even as relative economic power shifts away from the West. In Greece we have even further to go because we squandered the opportunities for reform that were provided by the high growth rates accompanying the early years of Eurozone membership. Nevertheless, there is room for guarded optimism because Greece (perhaps like the proverbial canary in the coal mine) already has a head start—it has slowly and painfully begun to learn its lesson and knows it cannot return to the free-and-easy ways of the past. It knows it has to go through a massive and painful structural transformation if only to stay afloat. How many people in the West are aware that, unless they, too, introduce painful changes, they might – just might – have to say goodbye to the ever-increasing affluence of previous decades and adjust to a brave new world of permanently lower expectations?
About the author

Constantine Papadopoulos is Advisor on European and Economic Affairs at The Eurobank Group, Athens. He advises top management on international, European and domestic economic and financial developments, as well as on regulatory and institutional reforms in the financial-services sector.

Between January 2010 and July 2012, he was Secretary-General for International Economic Relations & Development Cooperation at the Hellenic Ministry of Foreign Affairs, Athens (equivalent to junior minister), where he was responsible for shaping and implementing Greece’s policies in the area of economic diplomacy, including official bilateral and multilateral relations, promotion of trade and investment, and development cooperation. He represented Greece on the EU’s Foreign Affairs Council/Trade. He was National Coordinator for Greece’s €550m Hellenic Plan for the Economic Reconstruction of the Balkans (“HiPERB”).

Between 1998 and 2010 he was Advisor for European Affairs at Eurobank EFG, Athens, providing political, economic and financial analysis for top management, as well as publishing related Bank reports read by a wide domestic and international audience.

From 1986 until 1998, he was a career diplomat with a special interest in EU affairs. He served in the Greek Embassy in London between 1990 and 1993. He was a member of the Greek team that negotiated the EU Treaty of Amsterdam (1997).

Dr. Papadopoulos holds a B.A. (1975), M.A. (1976) and D.Phil. (1984) in Economics from the University of Sussex, England, and has taught and published academic (Oxford, Harvard) and non-academic articles in the areas of economics, European integration, Greek-Turkish relations, etc. He is a Fellow of the Weatherhead Center for International Affairs, Harvard University (1997-98). He was born in Athens in 1954.

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SEESOX is part of the European Studies Centre at the University of Oxford. It focuses on the interdisciplinary study of the Balkans, Greece, Turkey and Cyprus. Drawing on the academic excellence of the University and an international network of associates, it conducts policy relevant research on the multifaceted transformations of the region in the 21st century. It follows closely conflict and post-conflict situations and analyses the historical and intellectual influences which have shaped perceptions and actions in the region. In Oxford’s best tradition, the SEESOX team is committed to understanding the present through the longue durée and reflecting on the future through high quality scholarship.

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- To support high-quality teaching and research on South East Europe;
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- To spearhead intellectual exchanges and debate on these issues among networks of individuals and institutions beyond Oxford;
- To foster cooperation between the academic and the policy making communities.