The Greek Economy in Crisis: Causes and the Way Forward

Summary of the Prometheas Event

June 18, 2010

On Friday evening, June 18, the Hellenic Society Prometheas organized a panel discussion on the Greek economic and financial crisis at the Founders' Hall of the Greek Orthodox Church of St. George in Bethesda. This event attracted considerable interest, with some 120 members and friends of Prometheas in attendance, including representatives of the Greek diplomatic community and students from the American University and other colleges.

After some welcoming remarks by Lefteris Karmiris, the President of Prometheas, moderator Akis Calamitsis introduced the four panelists: Mikis Hadjimichael (presenter), Thanos Catsambas (presenter), George Georgiou (discussant), and Julia Clones (discussant). All recognized that, following the global financial turmoil, the Greek economic and financial crisis had come to a head owing to Greece's unsustainable fiscal deficit and public debt position, weak competitiveness, and loss of access to international capital markets.

In their presentations, the panel members focused on the underlying causes of the crisis, the ambitious adjustment and recovery program undertaken by Greece, and the risks and opportunities on the way forward. In reviewing the causes of the crisis, Hadjimichael emphasized that, since the late 1970s, successive Greek administrations had pursued generally expansionary fiscal policies financed largely by foreign borrowing; but systemic factors had played a large role as well, notably the rapid growth of public employment and the welfare state, the extensive corruption and nepotism, the widespread tax evasion, and the large losses of public enterprises. All together, these factors had led to a sharp increase in the public debt, from less than 20 percent of GDP in the 1970s to about 100 percent in the early 1990s and almost 115 percent in 2009. Over the same period, and especially in recent years, Greece's international competitiveness was eroded, as domestic inflation and cost

increases exceeded those of partner countries. Hadjimichael also emphasized that the crisis had been triggered by some more immediate factors, especially the large increases in the overall fiscal deficit and the public debt in 2009, the misreporting of financial data, the unconvincing initial measures of the new administration, the hesitant reaction of Greece's European partners, and the well-known deterioration of market sentiment. Hadjimichael finally noted that the authorities faced a number of options regarding the way forward, before deciding to pursue their current three-year program with the support of the European Commission, the European Central Bank, and the International Monetary Fund (IMF).

Turning to Greece's current program, undertaken with European and IMF assistance, Catsambas indicated that it is unprecedented in at least two ways: for the first time, European countries and the IMF are jointly providing financial support to a Euro zone member; and for the first time, the IMF itself is extending assistance on such a large scale to a member country in relation to its quota (or subscription). If the program is successfully implemented, European support to Greece would amount to Euros 80 billion and IMF assistance to Euros 30 billion over a three-year period. The first loan disbursements have totaled Euros 20 billion. Catsambas explained that the program aims at achieving fiscal sustainability, restoring competitiveness, and safeguarding the stability of the financial sector, while protecting the most vulnerable groups. To realize a major reduction in the overall fiscal deficit, from 13.6 percent of GDP in 2009 to 2.0 percent in 2015, and begin to reduce the debt burden, the program involves strong measures for increasing government revenue, reducing expenditure, and applying structural fiscal reforms. Catsambas reviewed the principal fiscal measures under the program, as well as the extensive structural reforms designed to revive the economy, improve competitiveness, bolster exports, and reestablish confidence. But he also cautioned that there were a number of risks to the program, and that success will require sustained efforts.

On their part, the discussants considered a number of selected issues. Georgiou noted the constraints facing Greece as a member of the Euro zone, especially the lack of an independent monetary policy as well as an independent

exchange rate policy. He expressed concerns about the very ambitious targets and timeframe of the program, and intimated that he would have preferred even more substantial European support of Greece's efforts. Concentrating her remarks on the structural reforms under the program, Mrs. Clones elaborated on the envisaged improvements in the pension system; the modernization of the public administration; the consolidation of local governments; the expansion of the so-called "green economy"; and the integration of the underground economy into the formal economy.

In the questions-and-answers session that followed, which lasted for almost one hour, there was an opportunity for the panel to return to a number of key issues. As regards the notion of abandoning the Euro, there was a consensus that such a step would not only be impractical but also disastrous for Greece. As to public debt restructuring, the general feeling was that such an initiative would be inappropriate at this stage. A large number of questions were raised and answered on various issues, including the impact of the current recession and the prospects for an early economic revival; the tolerance of the Greek population to the severe but necessary measures undertaken, including cuts in public sector wages and pensions; and the precise nature of certain structural reforms, particularly regarding pensions, the labor market, and the promotion of business and investment.

Finally, moderator Calamitsis made the following closing remarks, which touch upon some of the lessons learned so far from the Greek economic and financial crisis:

- It is always preferable for countries to act early to address growing economic and financial problems rather than postponing needed adjustment and reform measures. The longer such measures are delayed, the more severe and painful are the necessary adjustments.
- Adjustment and reform programs should focus on resolving the fundamental problems, while protecting the most vulnerable

groups of society and securing an early resumption of economic growth.

- **In the European Union (EU), the hesitancy and delayed reaction to the Greek economic crisis has been costly. It was only after bond markets had all but abandoned Greece and interest rate spreads had begun widening in other vulnerable EU countries that European officials acted in earnest with IMF support.**
- **For the future, it is essential for all EU member countries not only to respect established rules but also to bear in mind the importance of "solidarity" within the Union.**
- **The steps already taken by the EU, including the recent approval of a rescue plan for emergency lending, are in the right direction. But longer term measures are needed to bolster the monetary union with a stronger and more credible fiscal architecture.**