Seeking the "new normal" for the Greek economy

The Greek economy has emerged smaller from the crisis, while it continues to be introvert and dependent on a State that is too partisan and inefficient. Focus on the conditions that would allow the economy to grow should be a national priority. The key for the next few years will be to push the real GDP growth rate systematically higher than 2%. These are some highlights from the exclusive interview of Nikos Vettas, General Director of the Foundation for Economic and Industrial Research IOBE and Professor at the Athens University of Economics and Business for Greek BF

Interview by A.D. Papagiannidis

The year 2019 is an election year for Greece. In general terms, what is in your opinion the state of health of the Greek economy? How do you perceive the impression it makes to the global community - academic, market, political?

Through three successive programs, the central imbalances of the Greek economy have been corrected. Fiscal surpluses are now being obtained, the trade deficit has been significantly reduced, while a decrease in the unit labor cost contributes to improve competitiveness. Furthermore, the public debt does not represent an excessive burden in the short run, the risk of an immediate collapse has been minimized and some first steps are being made for regaining access to the capital markets.

However, GDP growth has been systematically weaker than planned and hoped, primarily due to the anaemic growth of investments. Total investment is even below the level required to cover the capital stock depreciation and it is not obvious how it can grow stronger in the next years, especially considering the very low level of domestic savings. The overall concern is that the current recovery depends heavily on the low starting base, as a result of the deep recession, and on solid demand growth in Europe and other trading partners. As these effects weaken, so will the middle-run growth potential of the Greek economy.

How would you approach a SWOT analysis for the Greek economy in the years ahead? Would you term yourself an optimist due to the resilience the economy has shown? A pessimist, with the tendency it shows to go back to earlier structural weaknesses?

The key to growth in the next years will be how fast the economy turns towards having a higher level of investment and exports. For this to happen, not only a substantial increase in the level of investments is required, but also that it is directed to sectors and companies producing internationally tradable goods or services. Room to achieve growth through consumption does not exist, as net foreign lending will remain limited.

Thus far, the process of adopting such a new growth model has been quite slow. Unless it accelerates significantly, growth will be sluggish, at best, and the danger of derailment will be ever present, reinforcing a vicious cycle of high risk and low investment in all sorts of investment, especially long term investment in physical or human capital.

Growth is the national priority

Compared with other European economies, decreases in prices and wages have contributed towards increasing relative competitiveness. Opportunities for investment can be found in a number of areas, from transport, energy and logistics to food and tourism. A sizeable gap has been gradually created following the collapse of all construction activity in the last few years. Comparative advantage also exists in high-tech services and manufacturing, sectors that are less capital intensive and more dependent on innovation. However, significant obstacles exist. Public administration and weak institutions continue to burden the business environment and to decrease overall productivity. Current and projected needs in public finances imply a high tax burden on capital and labor, keeping away investors and highly educated scientists and professionals. Perhaps worse, the overall signal that has been sent during the crisis years is clearly not that of a country that has decisively left behind the pathogenies that led to the crisis.

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So, rather than declaring optimism or pessimism, it is more urgent to focus on the conditions that would allow the economy to grow. It is not perhaps an exaggeration to say that this should become a national priority. If we continue on the track of the last few years, the economic and social consequences of stagnation will be dire and may well lead to another crisis.

The economy emerged smaller

You have lived through - and studied and tracked - all of the crisis years, a crisis that has been with us for the last decade. To you, which are the turning points?

While Greece succeeded in fixing its inherited main economic imbalances, it did so primarily through a deep recession and to a much smaller extent through reforming its structures. The Greek economy and society proved to have enough of a survivor instinct to accept the adjustments and successive cuts in incomes and standard of living that became necessary, so that a full collapse is avoided. The ability, however, to converge on a growth plan and to implement structural reforms has been essentially absent. Or, rather, it was not so much the ability that was absent, as the will to support, or even to accept, changes.

Given the depth of the crisis, the fact that the dominant growth model abruptly reached its limits and the need to rebalance debts and entitlements, one would have hoped that the Greek economy would emerge from the crisis much stronger. Many other economies have done so, following their own crises in Europe and elsewhere. In contrast, our economy has mainly emerged smaller, and its main pathogenies have not been fixed. It continues to be excessively introvert and dependent on a State that is too partisan and inefficient. The deep crisis was too good an opportunity to miss in order to significantly reform the country and, unfortunately, it has been missed. This does not mean that good progress cannot be made in the future. But ten years is sufficient time to improve how the economy works.

A toxic environment

With no intent to minimize the size of the initial challenge, most of the blame should be put on the politics around the three successive Adjustment Programs. Parties in government and opposition failed to agree on a minimum set of essential reforms that were obviously needed from day one, including pensions, the tax system, depoliticizing and modernizing public administration,

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speed of justice and quality of education. With extreme political rhetoric, high risk of a collapse and lack of vision about the ultimate direction of the country, the overall environment became toxic. It was, thus, no surprise that investors as well as people decided to leave.

Regarding turning points, the initial stages were obviously crucial. In the midst of extreme uncertainty, the notion that the programs were an enemy that should be fought emerged as dominant in the larger part of the political spectrum and society. There have been several opportunities since, where more clarity and consensus could have been obtained, but that did not happen. Serious mistakes were, of course, also made in the design and management of the Programs from abroad. This refers in part to the focus and sequencing of reforms. But more importantly, the threat of pushing Greece out of the Eurozone may have been effective in forcing legislation of the programs, but its deleterious effects froze investment, minimized the ability for implementation and prolonged the crisis.

You have also experienced, at close range, the tumultuous last 4 years, which have brought Greece and the Greek economy to the very brink of Grexit. To you, which was the real cliff-hanger moment?

Obviously, the events around the referendum in the summer of 2015 are the peak drama in the crisis period. The bank holiday and the imposition of capital controls, were results that will burden the Greek economy, through a decrease in confidence, for several years to come. Only part of this confidence has been regained since, and it will take a long time for the events to be erased from the collective memory of citizens and investors. Taxpayers also suffered a significant loss through the need that emerged to support the banks again with capital. There was overall backtracking from the progress that had been made until then in rebalancing the economy.

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On the positive side, the period after the summer of 2015, was the first since the outbreak of the crisis when the political opposition was not threatening to undo the program and derail the economy once its turn comes to win elections. That the larger part of the political spectrum, including those taking extreme positions in the past, eventually agreed that leaving the common currency was not a reasonable option, that fiscal discipline should be maintained and that Greece needs to proceed in agreement with its Eurozone partners is highly significant and should not be minimized.

The worse outcomes of the last ten years

At the same time, both within the country and from its creditors and partners, interest has been gradually restricted to the fiscal developments, with much less attention paid to growth enhancing policies. For those controlling the economy from abroad, it has become clear, especially after the summer 2015 events that, if Greece is not fully 'unreformable', certainly it is extremely hard to change, at least as long as there is not a strong internal political consensus to that effect. That Greeks have grown to associate 'reform' with the deterioration of their living standards and become reluctant to support changes, may be one of the worse outcomes of the last ten years.

It is of interest that the Greek economy has been viewed by many as making good progress in the last three years, basically because it achieves its fiscal targets, even though its growth performance is weak.

Do you accept the analysis that Greece has exited the Adjustment Programmes era? That it is back to normal - be it a "new normal"?

Formally yes, but in substance no. Greece still has an extremely high foreign public debt, and the measures for its gradual reduction, so that it does not excessively burden the economy, will be decided over time in agreement with the European partners and institutions. The last Program has ended, in the sense that there are no provisions for new money, but the financing link will continue to exist through the management of the debt obligations. Likewise, on the structural front, new measures will not be imposed through a program, and there will be a higher degree of freedom, but there will be constant monitoring through the European Semester mechanism and post-Programme enhanced surveillance.

GDP systematically higher than 2%

The key for the next few years will be to push the real GDP growth rate systematically higher than 2% and certainly not to let it slide towards 1%, as will be its tendency. For that, key structural reforms should be implemented, by giving priority to the taxation, pensions and education systems, so that they converge with those in other small and dynamic European economies. Along with protecting weak households, strengthening the banks and modernizing public administration, this constitutes the policy agenda that is required for Greece to decisively exit the crisis years. The goal

is, of course, for the standard of living to converge with the average - and much higher - in the Eurozone. This should be the goal as the 'new normal'. If, instead, 'normal' is interpreted as a return to the habits of excessive State control of business activity and irresponsible fiscal policies, the crisis will return much sooner than we may think.

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Does the international community show towards Greece the same acceptance/optimism that the Greek paper yields make proof of?

That investors are gradually returning to the Greek bonds and stock market is, of course, a very positive development. A lot more ground needs to be covered, in this regard, and this should be expected to happen, given the continuing loose monetary policy in Europe. After all, the last Adjustment Program was already completed many months ago, last summer.

However, the situation remains fragile. In terms of financial investments, there is still a distance to be covered until the country gains regular access to the markets, obtains 'investment grade' status and the spread from other comparable economies becomes more reasonable.

In terms of investments on the ground, as well as the overall prospects of the country, the dominant view is still extremely cautious. It will depend on specific policy actions until, and of course emphatically after, the national elections if the growth prospects will remain weak or the economy may enter a new path. bf