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Tragedies Like Greece Must Not Be Repeated*

This August the third bail-out programme for Greece came to an end, but this does not mean that the crisis is over. The country will feel its after-effects for a long time to come and it remains hard to say whether investors will ever get their money back. But the Eurozone can stop crises like Greece from happening again elsewhere by implementing reforms that strike a balance between greater fiscal discipline and more solidarity.

More than any other country, Greece stands for the horrors of the euro crisis. The crisis broke out there in autumn 2009 when it became known that the Greek state's budget deficit was far higher than previously reported. The years that followed were characterised by economic decline, bail-out programmes and growing political tensions both at a national level and between Greece and other creditor states. In 2011 it was decided to restructure Greece's public debt and a state bankruptcy in the Eurozone, previously inconceivable to many, became a reality.

But debt relief for Greece did not lead to its economic recovery. The losses that private investors were forced to sustain were too low, which was undoubtedly one of the major failures in managing the crisis. The costs of a state bankruptcy, in the form of upheaval in the financial system, were accepted without achieving the goal of the whole process, namely a sustainable restructuring of the debtor's finances.

In 2015, the crisis peaked once again when the Greek government refused to pursue the fiscal consolidation and reform policies that it had agreed to. The country nearly left the Eurozone, but a last-minute agreement on a new bail-out programme was reached instead. Three years later, in August 2018, this programme came to an end and Greece is now supposed to stand on its own two feet financially. Is that realistic?

Greece certainly has successes to report. Its public budget deficit accounted for 15 percent of gross domestic product (GDP) in 2009. In 2017, by contrast, its budget was balanced. In other words, the increase in public debt was brought to a halt. Similar developments were seen in international economic trade: in 2009 the current account deficit amounted to 12 percent of GDP and the country was living beyond its means. Today exports of goods and services almost match the level of imports. These economic adjustments, however, were painful for the Greek people. Economic growth slumped and economic output dropped by 23 percent between 2009 and 2016. The economy has now stabilised, with growth returning to a rate of 1.4 percent in 2017. The unemployment rate, which was 27 percent in 2014, is expected to drop below 20 percent for the first time in 2018.

All of these are major improvements, but to talk of Greece as having emerged from the crisis is very optimistic. Public debt still amounts to over 180 percent of GDP, a level which is incompatible with stable economic development. Its creditor states have pledged support to Greece for decades to come in the form of low interest rates (Greece is currently only paying around 1.5 percent interest on its debts), but it will take a long time to lower the debt mountain and it will cost a lot of money, which is needed elsewhere.

The creditor states expect Greek fiscal policy to deliver a sustainable primary surplus equalling 3.5 percent of GDP. With lasting low interest rates and nominal economic growth of three percent, the debt ratio would drop to 124 percent within ten years. But firstly, this is still too high for a small country without its own monetary policy; and secondly, it begs the question of whether Greece is actually able and willing to generate such high primary surpluses over such a long period of time.

On top of this, the banking system is heavily burdened by non-performing loans. At the end of 2017 they accounted for 45.6 percent of all outstanding bank loans. Greece urgently needs healthy banks that can finance new investments, but its present banking system's problems will constrain growth in the years ahead.

If Greece succeeds in achieving all of this, then the country will experience an economic recovery. But there is still a long way to go. Does this mean that Greece's creditors should offer it further debt relief? Taxpayers in creditor countries are not willing to do so. They have been promised too often in the past that every round of bail-out measures for Greece will be the last.

Initially, Greece needs to return to growth and financial independence on its own. Further relief on debt that is not due to be repaid for decades is less important in this respect than continuing to implement structural reforms. In return for the bail-out programme that is now coming to an end, the International Monetary Fund demanded an ambitious reform agenda, and especially greater labour market flexibility and more targeted social benefits. There is no guarantee that Greece will be successful with these reforms. If the country gets into financial difficulties despite its continued efforts to reform and implement fiscal discipline, its creditors will have no choice but to postpone repayment of the money they are owed once again.

What lessons can Europe learn from this crisis? The Eurozone needs both greater fiscal discipline and more solidarity. Greater fiscal discipline primarily means that private investors who lend governments money and earn interest in good times, are to be held liable in bad times and must accept that they may stand to lose money. Investors will only be more cautious about granting credit if this prospect is credible. This should prevent debt mountains like Greece's from arising in the first place. To achieve this, the banks in particular must be forced to hold lower volumes of government bonds. More solidarity means that individual member states that are afflicted by crisis despite complying with jointly agreed rules should receive a limited amount of support from other member states. If this can be achieved, tragedies like the one seen in Greece will not be repeated.

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