Another Greece, another Europe
Comments to Marica Frangakis's presentation
Turin, April 22, 2016

Vittorio Valli
Università di Torino
vittorio.valli @unito.it

General comments-1

- **I greatly appreciated the beautiful and stimulating presentation by Dr. Marica Frangalis.**
- **It is full of interesting insights and it is very rich, so that I will have to limit my comments to only a few of its aspects.**
- **I fully agree with her criticisms of austerity policy, and of the way in which European authorities treated the Greek crisis.**
- **The interventions were delayed, badly misplaced and more aimed at saving the credits of German and French banks, and to a less degree also of other countries (Italy included), than to really help Greece and Greek population. In fact EU austerity policies were of the "Washington consensus" type, a policy that had been discredited since the great 1997-8 Asian financial crisis, but continues to prevail in most economic circles.**
- **The EU policies were fully anti- keynesian and in Greece they contributed to badly worsen both the socio- economic conditions and the public debt/GDP ratio, since the denominator of the ratio fell down heavily in the 2008-14 years.**
- **There was, then, the perverse feedback:**

  restrictive macro-economic fiscal policies=> fall in GDP => rise in public debt/GDP ratio => further restrictive policies => fall in GDP, etc.

General comments-2

- **Alternative post-keynesian policies could have very different consequences. It would have been possible, as in the United States, to do an expansionary policy in the period of crisis based both on quantitative easing and expansionary fiscal and industrial policies, followed in the period of economic expansion by a very gradual long-run return to an acceptable public and private debt situation. Reductions in the rates of growth (not the levels) of public expenditures and tax revenues, can be administered during a period of economic expansion, but not during severe crisis, when they only lead to deflation and deeper and longer depressions.**
- **Naturally when the public debt/ GDP rate surpasses 130%, as in Italy and Portugal 130%, or 180% as in Greece, the task to return to a less risky and oppressive 80-100% level is very difficult.**
- **It might be necessary either a substantial hair-cut of the debt, or, if this in the EU is not politically feasible, a firm engagement of debtor countries to reserve a part of the rise of public revenues in expansionary periods to pay- back (in at least 30 years) a substantial part of public debt. It could be made through the emission of "euro-bonds", partly guaranteed by real public assets to be pro-rata conceded only at the end of the maturity of these bonds and only if the government cannot fully pay-back the debt.**

General comments-3

- Naturally all this would require great changes in EU and Euro-zone rules.
- Since the 1990s there were Maastricht agreements with two basic rules regarding public finance (public deficit/GDP < 3%; public debt/GDP < 60%), and then the “fiscal compact”, etc.
- Moreover, the ECB statute prevents the Bank to act as a lender of last resort.
- They are very bad rules, both from the technical point of view and for their fully anti-keynesian effects during severe crises, but they were unluckily signed by all the States entering the euro.
- Politically it is at present very difficult to change them, especially in periods of financial turmoil, but, for the time being proposals such as the recourse to less rigidity in the interpretation of “structural” public balance, or something as “Pavia’s declaration” proposal, would greatly attenuate the problems. On the long run it would be necessary a radical change in EU institutions and in EU rules.

Structural problems-1

- **Present Greek depression depends on long –run structural problems and the consequences of the great "double crisis" (financial and real) generated by the 2007 US sub-prime crisis, aggravated by the public finance turmoil.**
- **So, in order to have a steady sustainable expansion Greece (as Italy and other Southern European countries, but more than them) must face both severe structural problems and short-term ones.**
- **Greek main structural problems are :**
- **A) the structural deficit in the balance of current account (for more than 20 years up to 2013) and the consequent huge rise in external debt.**
- **B) the fact that Greek productive structure is mainly based on services and some agriculture and that industry is rather weak. This causes a structural problem to external accounts, since only some services, such as tourism, are exportable, while a lot of industrial goods must be imported. Remittances from Greek emigrants are declining, while foreign immigrants in Greece sent increasing remittances abroad. The revenues of tourism and shipping plus net remittances used to contribute to sustain the value of Greek currency before the entry in the Euro, but some industrial activities were not internationally competitive, and the heavy fall in the investment rate since 2007 has further decreased productivity and competitiveness.**

Structural problems-2

- C) The rapidly growing stock of external debt and the easy-going budgetary policy of the Greek government up to 2007 led to the fact that a very large part of public bonds were owned by foreign residents, so that when the financial crisis struck Europe in 2008-2010 the *spread* began to rise and in absence of a EU prompt and effective response, public debt became unsustainable.
- D) Most economists and political leaders greatly overlooked the importance of stock-flow relationships, largely operating also in Greece, where there was a rise in wealth up to 2007 and a heavy fall in the period of the crisis.

Two examples of important stock-flow relations:

1) If wealth declines there is a heavy fall in consumption and investment, then a further fall in GDP, employment, total wages and consumption, thus a further fall in wealth, etc.

2) If the banks are weak their propensity to concede loans declines, but in any case their stock of not-performing loans will steadily increase because of the deepening of the economic crisis. Thus banks' profits will greatly fall and some banks will be close to failure, but the State, in deep financial difficulties, will not be able to save them without the help of EU institutions or the IMF. But this help will be given only with severe conditions which will protract the crisis.

Table 1
Selected euro-zone countries in the years preceding the double crisis

Countries	*Current account of the balance of payments before 2008*	*Public debt/GDP ratio*	*Housing sector*	*Banking system*
Germany	Structural surplus since 2001. Large net external credit (a stock concept).	Acceptable ratio, but higher than Maastricht parameter of 60% since 2003.	Containment of housing prices.	Growing exposition to financial bubbles.
Greece	Heavy and very prolonged structural deficits (from the 1990s up to 2012): Very large external net debt.	Very high level and a large majority of public debt in the hands of foreign owners	Short bubble (2003-2007)	Fragile.
Ireland	Deficit from 2004 up to 2009.	Very low ratio.	Great structural bubble	Banks greatly exposed to housing bubble.
Italy	Prolonged structural deficit (from 2000 up to 2011): Net external debt.	Very high and a substantial part of public debt in foreign hands.	Modest bubble. A gradual, but persistent fall in housing prices has begun in 2011.	Relatively solid, with some exceptions (Monte dei Paschi, etc.)
Portugal	Heavy and very prolonged structural deficit from the mid-1990s up to 2012. Heavy net external debt.	Ratio slightly exceeding 60% up to 2007.	Relatively contained rise in housing prices.	Banks exposed exposed to financial bubbles.
Spain	Very prolonged structural deficits from the mid-1990 up to 2011.	Low ratio.	Great structural bubble.	Several banks greatly exposed to housing structural bubble.

Table 2. Greece and Italy: GDP, investment and unemployment

Annual average rates of change on real variables and %

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Greece									
Real GDP	3.4	-0.4	-4.4	-5.3	-8.9	-6.6	-4.0	0.7	-1.4
Real gross fixed investment	17.6	-6.5	-13.3	-20.8	-17.0	-28.5	-9.5	2.9	-16.6
Unemployment rate (%)	8.3	7.8	9.6	12.7	17.9	24.8	27.5	26.5	24.9
Italy									
Real GDP	1.4	-1.1	-5.5	1.7	0.7	-2.9	-1.8	-0.4	0.8
Real gross fixed investment	1.3	-3.2	-10.0	-0.6	-1.7	-9.4	-6.6	-3.4	0.6
Unemployment rate (%)	6.1	6.7	7.7	8.4	8.4	10.7	12.2	12.7	11.9
Source: Oecd (2016) . Preliminary estimates for 2015.									

Conclusions

- **My conclusions are close to the ones of Ms. Frangakis.**
- **However, being a comparative development economist, I might add some elements of long- run economic policy. Without a good period of *inclusive development with employment* it would be impossible to solve the severe financial problems of the country.**

Greece badly needs more physical capital and more knowledge. It especially needs *extensive investment*, concentrated, for example, on infrastructures, green energy production, green and smart housing, modern agro-production of clean and high quality food, more capabilities in e.-commerce e.-tourism and high-tech. niches. It is necessary to reduce the gap in R.& D. research vis- a vis richer countries and give more jobs opportunities to young people. In order to provide incentives to start ups and to all these activities, and to reduce financial dependence, it would be necessary to cut vast forms of tax evasion and tax erosion and reduce wastes in public administration.

In other words Greece ought to do many policies that also Italy badly needs, since in many aspects, we are so similar.