Lessons from Greece

In October 2009, the Government of George Papandreou announced that Greece's public deficit that year was going to exceed 12% of GDP, twice as much as previously estimated. In reality, the deficit ended up exceeding 15% of GDP. It was the prologue of a true Greek tragedy.

After nine years, three bailout programmes – the last of which ended in August – and the largest debt restructuring in history, Greece has managed to stabilise its economy and is beginning to grow. However, the cost of this long process of adjustment has been tremendous: GDP has fallen by 25%, the unemployment rate exceeds 20% and public debt stands at over 180% of GDP.

From the experience of Greece, we can draw at least five lessons:

i) Transparency and the quality of the information provided by governments is of the utmost importance (a maxim that, of course, also applies to companies). The review of the deficit in 2010 represented a mortal blow to the credibility of the Greek institutions and resulted in the immediate loss of access to the markets. The poor quality of information (either because it was not correctly compiled or because it was directly falsified) also made any early detection of the imbalances that were accumulating in the public accounts a difficult task.

ii) The costs associated with a sustained loss of competitiveness within the monetary union can be enormous. Before the crisis, Greece's current account deficit exceeded 15% of GDP. Given that resorting to an exchange-rate adjustment was not an option, closing this gap has required an enormous and costly internal devaluation in order to recover the competitiveness that had been lost. In fact, the process is not yet over: it seems incredible but, despite the reduction in domestic demand, Greece still imports more than it exports.

iii) There is a high price to pay for questioning ones country's membership of the monetary union. After accounting for the impact of these doubts, the cost has been very high, with additional declines in economic activity and outflows of deposits. Besides mere statements, a country's commitment to the euro is demonstrated through its willingness and capacity to implement an economic policy that promotes competitiveness, sustainable public finances and an equitable sharing of the costs of the financial crisis (which requires strong resolve in the face of interest groups protecting certain privileges).

iv) Fiscal discipline in the good times is key for being able to manage during a period of slowdown or recession. In the years prior to the crisis, with reasonably good growth, Greece recorded fiscal deficits of around 6% of GDP, while the public debt stood at over 100% of GDP. The situation before the arrival of the Great Recession, therefore, was one of extreme vulnerability. The good years were not used as an opportunity to put the country's accounts in order and gain the fiscal headroom necessary to implement countercyclical policies when they would become necessary.

v) The Economic and Monetary Union (EMU) needs to be strengthened. Greece has suffered much more than it should have, due to the financial fragmentation which exists within the Union, due to the *doom loop* between sovereign risk and banking risk, and due to the absence of a European fiscal authority with the capacity to absorb asymmetric shocks within the EMU. The Banking Union (BU) and the European Stability Mechanism (ESM) are intended to cover these deficiencies, but they do so imperfectly, since the BU is still incomplete and the ESM is not a true European treasury.

As for the Greek tragedy, we still do not know how it will end. The EU has recently extended the maturities of the Greek debt by 10 years, which gives the country's Government a substantial respite. It also ensures a long performance. It remains to be seen if its ending can be a happy one.

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