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STUDY

Trying to Unearth a Recovery in Greece

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- Gradually, light at the end of the tunnel is reappearing. The emerging stabilisation in Greece is fragile and uneven across most sectors of the real economy.

- This assessment is balanced against concerns about the government's political resolve to continue implementing an agreed structural and institutional reform agenda.

- Political risk factors weigh heavily. The governing coalition of PM A. Samaras and the largest opposition party in parliament, the Coalition of the Radical Left known as Syriza have fundamentally different views on the way forward.

- Any attempt to put the Greek real economy back on a firm recovery footing will only be able to succeed when domestic banks contribute to this endeavour.

- The process of restructuring the Greek economy continues to be a work in progress. The search to define a new growth agenda charting the future course of Greece's political economy is in full swing.

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Introduction

In the summer of 2014 Greek archaeologists made a spectacular discovery in an ancient tomb on the Amphipolis site, roughly 100 kilometres from the country's second-largest city, Thessaloniki. They unearthed two sculpted female figures, termed Caryatids in archaeological parlance. The Ministry of Culture hailed the excavation as a major find from the era of Alexander the Great.

While the heritage ministry was celebrating the historic discovery, the finance ministry in Athens claimed that an economic recovery was just around the corner. The narrative now being articulated most prominently by Greek officials in Athens is that economic anxiety is giving way to Greekovery.

The good-news cycle during the summer was, however, tempered by a combination of political risk factors and concerns over persistently high mass unemployment. Economic stabilisation is starting from a low point of departure and is still somewhat precarious. It remains too weak and fragile across the real economy and has yet to be felt by most Greeks.

Where does Greece stand today, six years after the outbreak of a severe economic crisis that has had dramatic social repercussions and has contributed to major political changes in the country? Public debates in Greece centre on what successes and opportunities the reform process might have brought, while also addressing its defects and limitations. One key issue is whether Greece requires a third rescue programme, what compliance requirements would have to be imposed and how such a programme should be financed.

Irrespective of the feasibility of such a programme both Greece's economy and society stand at a crossroads. The direction that the country chooses will make it clear whether the current reform process can be sustained after the troika of international lenders – the International Monetary Fund (IMF), the European Commission (EC) and the European Central Bank, (ECB) – ceases to exert compliance pressure under the terms of a memorandum.

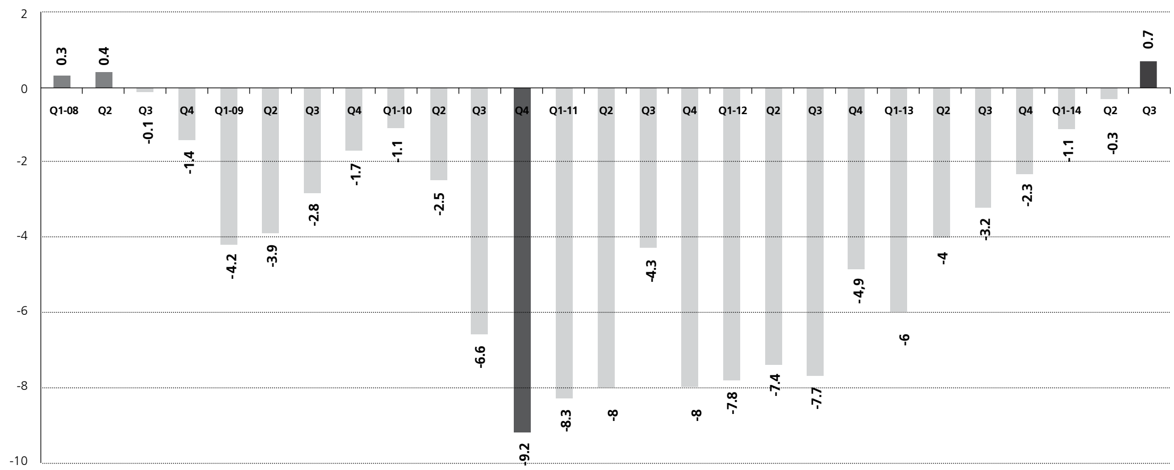
It remains to be seen whether better (economic) times are coming. There are equally good reasons to be cautiously optimistic and to retain a healthy dose of scepticism about Greece's immediate future. Much will depend on keeping political risk factors under control and continuing to work across partisan barriers.

1. Is There (Sustainable) Growth in Greece?

Greece finally exited its six-year long recession in the third quarter 2014. The Hellenic Statistical Authority ELSTAT reported in mid-November that the economy grew 0.7 per cent in the third quarter (compared to the same quarter in 2013). The positive third quarter reading is the first after 24 consecutive quarters of negative GDP performance dating back to Q3 2008 (see chart below).

Still, the economic damage from this recession is staggering. It will take the better part of a decade to bring Greece's economy back to the levels last achieved in 2007. Thus, some reflections about the state of play of the country's economic prospects are warranted. A mixed picture is emerging, moving between positive sentiment indicators and higher car sales numbers being counterbalanced by news about sliding land prices in the Attica region and a continuous decline in construction activity.

Figure 1: Quarterly economic performance in Greece, 2008 – 2014* (%)



*Quarterly performance in comparison to the same quarter a year earlier.

Source: ELSTAT 14th November 2014, detailed in Macropolis 2014b.

The emerging economic stabilisation is primarily the result of very successful tourism seasons in 2013 and 2014. In 2013 more than 17.5 million tourists visited Greece, a record since Athens staged the summer Olympics in 2004. Tourism arrivals in 2014 are on course to surpass the threshold of 20 million, according to the Association of Greek Tourism Enterprises (SETE). Tourism now accounts for about a fifth of the country's annual gross domestic product.

The other sector fuelling recovery is international demand for container shipping, of which Greece is a major provider. Greek companies own 16.1 per cent of the world's total merchant fleet, making it the largest in the world. The Greek shipping industry is a key factor in the calculation of the country's annual GDP, accounting for approximately five per cent in 2014.[1]

1. This contribution is calculated as net receipts to Greece from sea transports. According to sector representatives, shipping as a percentage of GDP will rise to 4.9% and 5.7% of GDP in 2014 and 2015, respectively, from 4.2% of GDP in 2013 (Hellenic Shipping News 2014).

But the sector's economic impact is rather different – and controversial – with regard to tax revenue. Managing Director of the IMF, Christine Lagarde, recently addressed the failure of rich Greeks to pay their taxes properly and on time. »When I have talked about Greece and its taxes before, I got death threats and we had to increase security… but is the shipping industry really paying its taxes? I don't think so« (Financial Times 2014).

The positive quarterly economic data from Greece should not lend itself to any triumphalism. German GDP grew by 0.1 per cent and that of France's by 0.3 per cent while Italy remains in recession. If these developments in the euro zone are interpreted as an ‚upside surprise' one can get a pretty good idea of the parlous state of the euro-area economy.

But considering where Greece is coming from after a record 24 consecutive quarters of negative growth the sense of relief among policy makers in Athens regarding the gradual recovery perspectives appear warranted.

The emerging recovery in Greece is still too frail and uneven across other sectors of the real economy and barely perceived by most people. While foreign tourist arrivals are booming, private domestic demand remains weak. Falling aggregate demand despite declining consumer price inflation reflects falling real earnings. The wage and pension reductions that have taken place over the course of the past four years are deep and ongoing.

Holding back on private household spending also mirrors the dramatic state of the Greek labour market. Official unemployment registered at 25.9 per cent in August 2014. While slowly declining from peaks reached a year ago, such a level is staggering, all the more when bearing in mind that it came at the height of the summer tourist season when fixed-term employment increases (see section 4).

Since 2009 the Greek public has grown accustomed to a steady stream of quarterly GDP data with negative values of 5, 6 or even 9 per cent. The nadir of quarterly economic performance was reached in the fourth quarter of 2010 when the economy contracted by 9.2 per cent in comparison with the fourth quarter of 2009. The last positive GDP quarter was the second quarter of 2008, with 0.4 per cent. That seems a long time ago, before the collapse of Lehman Brothers.

European Commission projections (2014b) estimate a return to annual growth of 0.6 per cent this year and GDP of 2.9 per cent in 2015. The leading Greek economic think tank, the Foundation for Economic and Industrial Research (IOBE), is slightly more optimistic for 2014, forecasting that the Greek economy will grow by 0.7 per cent (IOBE 2014).

The gradual but uneven economic recovery and the outlook for 2015 have prompted international credit rating agencies to start upgrading Greece. In September 2014 Standard & Poor's upgraded the long-term sovereign credit rating to B from B–, with the outlook set at stable in recognition of the »substantial fiscal adjustment« achieved by the Greek government. However, this positive assessment is balanced against concerns about the government's political resolve to continue implementing the structural and institutional reform agenda mandated by the Troika.

2. Debt Dynamics

The potential for economic recovery will be determined by Greece's capacity to manage its sovereign debt dynamics. For 2014 the Greek government expects a debt-to-GDP ratio of 174.8 per cent or 318.6 billion euros. This would exceed the sovereign debt level attained in 2011, that is, before the two debt restructuring operations of 2012 (see Figure 2).[2]

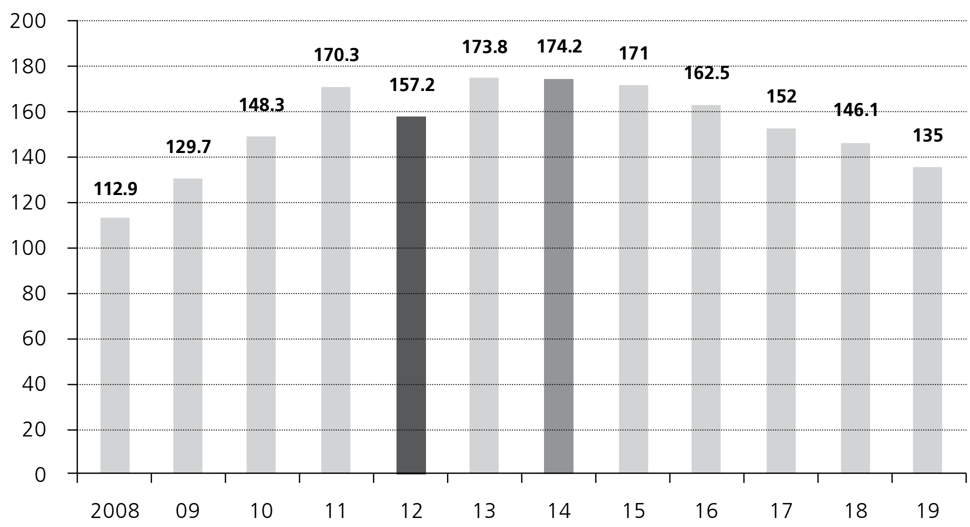
The focus on debt dynamics instead of the total volume of accumulated sovereign debt is critical in this respect. The increase in the ratio of Greek public debt to pre-restructuring levels in 2012 is a matter of concern if the economic recovery turns out to be feeble and uneven for a prolonged period of time.

The single most important factor impacting on the recurring rise in Greece's debt ratio has been the dramatic fall in nominal GDP, that is, the euro value of the country's economic output since mid-2008. Only if nominal GDP rises faster than the debt increase (in percentage terms) can we expect Greece to be able to avoid or exit this dangerous indebtedness trap.

Today, approximately 80 per cent of Greece's debt obligations are held in the portfolios and budgets of official creditors. In mid-2014 the official sector – euro-zone member states, the ECB, the IMF, the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) – were the key guarantors of Greece's sovereign debt.

This liability exposure of official creditors is the result of an unprecedented shifting of debt from the private sector to public institutions since 2011. The re-profiling of Greece's sovereign obligations means that any future debt restructuring will almost entirely affect the official sector of Greece's international creditors.

Figure 2: Greek debt-to-GDP ratio, 2008–2019 (%)*

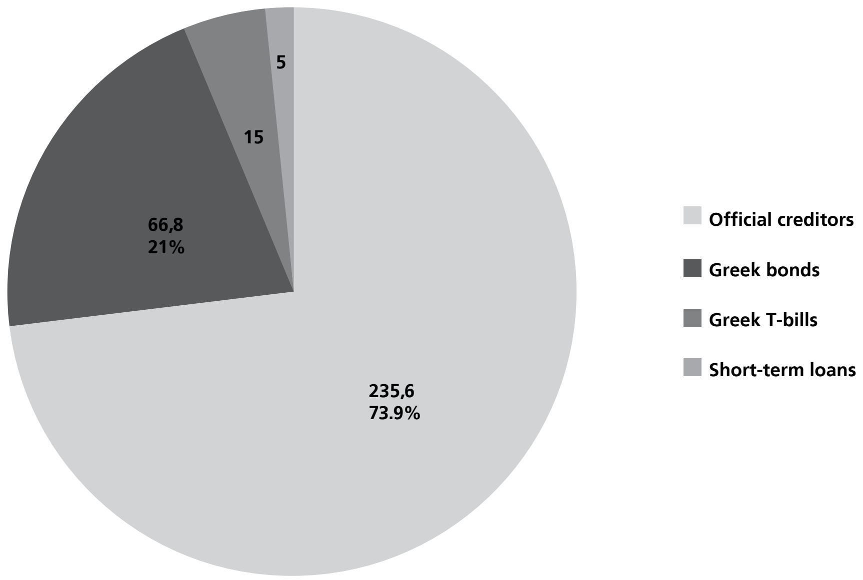


Note: * Data from 2014 onwards are projections.

Sources: International Monetary Fund, World Economic Outlook Database, April 2014 and IMF revisions, Macropolis, 2014a.

2. The Greek government's 2014 debt projections are included in the recently tabled 2015 draft budget. Without both debt reduction exercises Greece's total indebtedness would today be in the range of 380 billion euros, roughly equivalent to 208 per cent of annual GDP.

Figure 3: Configuration of Greek public debt, end-2014 (in billion euros)



Note: Data on the share of outstanding Greek bonds held by the ECB as a result of its secondary market purchases of sovereign debt in 2011/12 are not publically available.

Source: Data are from the draft budget for 2015 submitted by the Greek government to parliament in October 2014 (Nikas 2014).

Among the European creditor institutions the ECB, the EFSF, the ESM and euro-area member states would be affected most prominently. In short, this migration process has made them liable for public debts accumulated by Greece during the memorandum period since 2010.

Greece's second macroeconomic adjustment programme with the Troika from 2011 includes a provision that the country's debts must be reduced to 124 per cent of GDP by 2020. Greece has a moratorium on the interest payments on this debt of 10 years after the European part of the adjustment programme expires at the end of 2014. Furthermore, the average maturity of the European loans is currently 32 years and at a rock-bottom interest rate of 1.5 per cent.[3]

Despite these favourable parameters, there are also serious doubts about Greece's capacity to service its accumulated debt and to meet these numerical objectives. After six years of uninterrupted recession the economy's growth potential may be too weakened to generate the levels of GDP performance necessary to achieve such ambitious debt-to-GDP targets. The European Commission projections provide for an economic recovery reaching 0.6 per cent this year and a rate of growth of 2.9 per cent in 2015.

We should also take into account that it is by no means self-evident that Greece will be able to achieve a primary surplus (before interest payments) – preferably with an ever-increasing volume – in its central budget every year. Bringing the debt volume down to sustainable levels by stretching the repayment timetable from over 30 years to 50 years entails burdening the next generation with a major liability for which they are not responsible.

3. This arrangement does not apply to the IMF. Greece has to repay the Washington-based lender within 10 years after the IMF part of the second macroeconomic adjustment programme expires in the second quarter of 2016.

2.1 The Politics of Debt Dynamics

Given the magnitude of the challenge, the politics of debt dynamics in Greece have to be taken into consideration. Both the governing coalition of Prime Minister A. Samaras and the largest opposition party in parliament, the Coalition of the Radical Left – also known as Syriza – have fundamentally different views on the way forward regarding Greece's debt repayment obligations towards its international creditors.

Syriza has announced that in the event of it leading a government in 2015 the party would seek a profound change of policy. Syriza would not only reject any further budget »austerity«, but would also reverse the working arrangements with the Troika; in other words, cancel cooperation with the IMF and renegotiate current compliance requirements with Greece's official European creditor institutions.

Syriza would also call for an international debt conference for euro-zone countries, starting with negotiations on debt relief for Greece, but also including Portugal, Spain, Cyprus and Ireland, current and former programme countries. The largest opposition party views such a coordinated international approach as necessary, arguing that the debt accumulated by these euro-area economies is unsustainable and cannot be serviced through what it calls »band aid solutions«.

In Syriza's view, the blueprint for such a euro-area debt conference is the agreement reached in 1952 in London on the occasion of an international debt relief conference for the then West Germany. The agreement reached 62 years ago provided Berlin with a 50 per cent debt relief in exchange for a 30-year repayment process that was based on West Germany's export revenue. The last tranche was repaid by Berlin in October 2013.

Syriza's leader A. Tsipras has criss-crossed European cities in recent months to inquire whether there is sufficient critical mass to bring about such an international debt conference. While he is trying to build coalitions for such an initiative, Mr Tsipras' efforts are also an acknowledgement of the need for realpolitik at the European level.[4]

4. One political party in Spain, the newly created Podemos (»We can«), has voiced support for such an international conference call.

Syriza representatives are reaching out across Europe to explain their policy agenda to a wider public outside Greece. At the same time, Mr Tsipras has been received by the ECB president Mario Draghi in Frankfurt, German finance minister Wolfgang Schäuble in Berlin and even by Pope Francis I in Rome as recently as September 2014.

3. Overcoming the Credit Crunch in Greece's Real Economy

Any attempt to put Greece's real economy back on a firm footing will succeed only if domestic banks contribute. To date, this has not been achieved. Instead, local banks are still reluctant to lend to companies, especially SMEs.

In contrast to other countries of the euro zone – Ireland, Portugal, Spain and Cyprus – the Greek financial sector did not trigger the sovereign debt crisis in 2010. However, the four largest domestic financial institutions were heavily exposed to Greek sovereign debt in their bond portfolios.

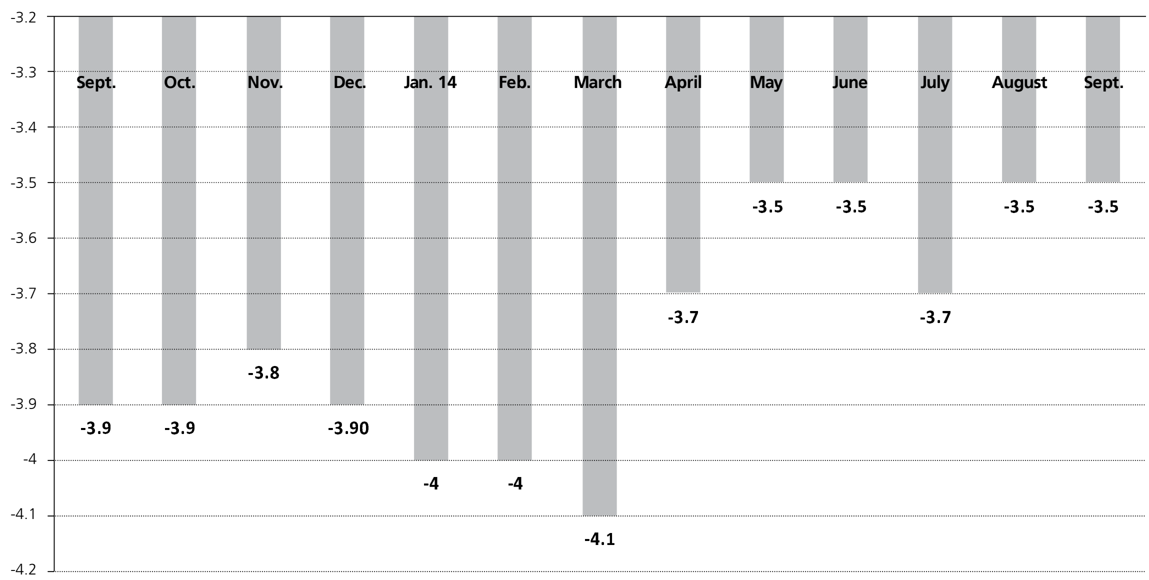
The so-called private sector involvement (PSI) in 2012 was the biggest sovereign debt restructuring imposed on private creditors. Consequently, Greek banks incurred heavy losses on their balance sheets. Because of Greece's exclusion from international capital markets the domestic lenders were not in a position to raise additional capital.

The available options were either to liquidate the banks with the alleged risk that Greece's financial sector would collapse, or to bail out the four largest banks through a state-sponsored recapitalisation. The latter was chosen, amid considerable political controversies.

The four »systemically important« domestic banks – National Bank of Greece, Piraeus Bank, Alpha Bank and Eurobank – were recapitalised in 2013 with almost 50 billion euros, which were provided from resources included in the second macroeconomic adjustment programme for Greece.

Despite this operation the credit crunch for private households and companies continues unabated in Greece (see Figure 4). Domestic lending institutions have not resumed their imputed mandate of providing the real economy with affordable and timely credit facilities. This applies particularly to small and medium-sized enterprises (SMEs), which constitute the backbone of the Greek economy.

Figure 4: Credit contraction in Greece, mid-2013–Autumn 2014 (year-on-year change per cent)



Source: Bank of Greece, Note on the Greek economy, 26 October 2014.

In light of the persistent liquidity deficits in the Greek real economy interest rates on available credit options for investment are far too high for many companies. Box 1 illustrates this.

> A medium-sized German firm that exports to southeast Europe would, on seeking a credit facility of 1 million euros from its local bank for up to five years, pay interest ranging from 2.5 per cent to 4 per cent. By contrast, a similar Greek company that has remained export-oriented despite several years of recession has to face credit charges of between 6 per cent and 8.5 per cent. These are the highest lending rates since Greece joined the euro zone in January 2001.

A normalisation of credit transmission channels through the Greek banking sector is urgently called for. The liquidity of domestic lenders can be improved only if two processes improve in tandem:

1. Greek banks gradually reduce their reliance on liquidity facilities from the ECB in Frankfurt. Following the successful recapitalisation of the four main banks international credit rating agencies have started to upgrade their credit ratings. This facilitates access to international capital markets.[5]

2. Greek banks must continue to strengthen their depositor base. Over the past five years local banks have lost more than 30 per cent of their customers' deposits. This drain on liquidity has only gradually been reversed.

Greek banks are further constrained in their lending activities by mounting non-performing loans (NPLs). Since September 2013 NPL formation is showing signs of slowing, albeit at a high level, totalling more than 75 billion euros (see Figure 5). These »red loans«, as they are called in Greece, correspond to roughly 35 per cent of banks' total loan portfolios.[6] The single largest

5. During the first round of the ECB's so-called Targeted Longer-Term Refinancing Operations (TLTRO) in September 2014 the four main Greek banks drew liquidity totalling approximately 5 billion euros. The ECB's ultra-cheap four-year loan programme is aimed at channelling funding to small and medium-sized enterprises. However, it remains to be seen how much and how quickly domestic lenders will forward these resources to the real economy.

6. The four main (systemic) banks in Greece reported the following ratios of NPL relative to their total loan portfolios for the first half of 2014: National Bank of Greece (29.30 per cent), Eurobank (33.60 per cent), Alpha Bank (35.10 per cent) and Piraeus Bank (38.80 per cent).

category of NPLs is consumer loans, which reached 49.3 per cent in mid-2014 (Papathogianni 2014). At such levels of NPL formation banks' willingness to lend to private households and businesses in the real economy is severely curtailed.

4. Labour Market and Unemployment

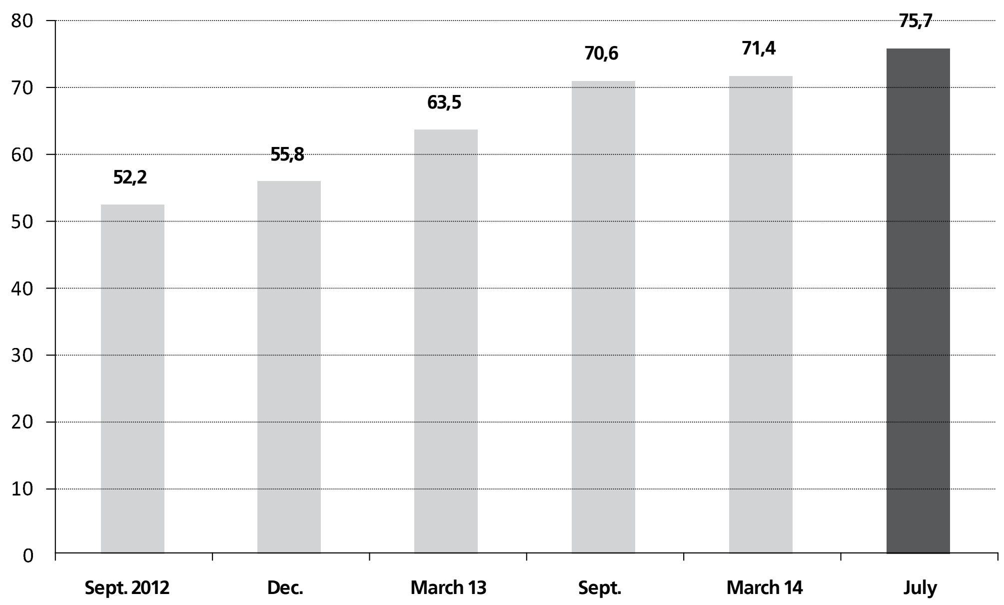
According to the Hellenic Statistical Authority (ELSTAT) Greece's jobless rate eased marginally to 25,9 per cent in August 2014 from 26,1 per cent in July. A year ago to the month (August 2013) the jobless rate was 27,8 per cent. August's figure was the lowest since two years. A further positive sign is that employment is rising again and outpacing increases in joblessness.

However, there is no room for complacency. With more than 1.24 million people still out of work claims that a turnaround in the Greek labour market is in sight are premature. Moreover, only 108,891 of those registered as jobless in August 2014 received the monthly unemployment benefit of 360 Euro, i.e. 11.2 per cent of the total (Macropolis 2014c).

It is a matter of concern that the August 2014 unemployment figures relate to a month during which the tourism sector employs people on a fixed-term contractual basis. Continuing to report high levels of mass unemployment while simultaneously registering record tourist arrivals suggests that bringing down the jobless rate is not – yet – possible even during the key summer holiday period in Greece.

Even if the balance between new recruitments and layoffs is gradually starting to turn positive this momentum is due mainly to seasonal factors, the legalisation of previously undeclared labour and domestic and EU programmes of subsidised employment creation.[7]

Figure 5: Total volume of NPLs held by Greek banks, September 2012–July 2014 (billion euros)



Source: Tzortsi (2014) and author's data.

7. Most of the job creation across sectors has a distinctly seasonal profile, such as fruit packagers, teaching staff at private schools, cleaners, wholesale commerce and specialised construction activities.

The youth unemployment rate (people under 25 years of age) stood at 49.3 per cent in August 2014, a significant reduction compared with the 58.2 per cent that was registered in mid-2013. For the first time in two years youth unemployment declined below the 50 per cent threshold. However, this level remains the second-highest ratio of registered youth unemployment in the euro zone, after Spain.

In the foreseeable future more than half of those employed in Greece will not regain their income levels from before the crisis. Salaries across the Greek economy continue to fall, declining by 1.4 per cent in the second quarter of 2014 (compared with the second quarter of 2013). This is the sixteenth consecutive quarter of falling wages in Greece's real economy.

This unabated downward adjustment of wages extends to working conditions. Those who do find work – mainly on a fixed-term basis – are frequently subjected to precarious employment conditions. We should also not forget that there are a growing number of employees in the private sector who continue to work without having been paid by their employers for months.

All told, a sustainable improvement in the Greek labour market is not yet visible. In its September 2014 Employment Outlook the OECD (OECD 2014b) expects the level of unemployment to remain above 26.5 per cent in the coming year. The hard truth and misery behind these figures is frequently difficult to grasp. One way of looking beyond the facts is to highlight developments and challenges that make it possible to paint a broader picture and provide a better understanding of the underlying situation.

5. The »Silent« Crisis behind the Crisis

The focus of policymakers and analysts on the macroeconomic conditions and consequences of the six-year recession in Greece cannot capture what we would call the »silent« crisis behind the crisis. The deeper layers of the recession are often without a face or voice. But there are significant indicators that mirror these underlying developments. Let us mention only three of them:

(i) Unpaid electricity bills in Greece are currently increasing at an annual rate of 30 per cent. More than 1.7 billion euros of unpaid bills have accumulated in the course of the past three years at the state-owned Public Power Corporation (PPC). More than half of that amount, approximately 960 million euros, concern private households unable to meet their electricity bill obligations. The accumulated debt adversely impacts on the PPC in terms of cash flow, its own payment obligations and its capacity to invest.

(ii) Such liquidity problems at private households and public utilities extend to the area of tax administration. According to the Business Environment Observatory of the Hellenic Federation of Enterprises (SEV) more than 400,000 tax cases are currently pending at various levels of Greece's administrative courts. These cases include VAT, personal income tax and customs taxation. One can only speculate about the amount of delayed tax payments, as well as how timely reimbursement of VAT could provide an injection of liquidity to the Greek real economy.

(iii) According to Eurostat more than 3.9 million Greeks lived in or on the edge of poverty in 2013 (Kathimerini, 5 November 2014). That number corresponds to 35.7 per cent of the Greek population. Since the beginning of the economic recession in Greece in mid-2008 the level of poverty across society has increased from 28.1 per cent. The single most important factor contributing to this increase is long-term unemployment (more than 12 months). Only neighbouring Bulgaria and Romania had a higher percentage of citizens living in or near the poverty threshold in the EU last year.[8]

6. Pre-conditions for a New Growth Agenda for Greece

One of the major challenges facing Greece's policymakers, domestic regulators and international creditors is to come up with a new growth agenda for the real economy. Macroeconomic adjustment since 2010 has focused primarily on fiscal consolidation and financial sector stabilisation.

8. Eurostat defines the threshold of relative poverty as 60 per cent of the average national household income.

However, the achievements in both policy areas have yet to translate into progress on productivity-enhancing reforms in the product, services and labour markets of Greece's real economy. A combination of outright resistance to such reforms and a widening sense of reform fatigue among key stakeholders in Greek society have held such endeavours back or even obstructed them.

The process of restructuring the Greek economy thus continues to be a work in progress. The search for ideas and the public debate on the future course of the country's political economy are in full swing. The following things have emerged from this vibrant discussion to date:

- The desire for policy alternatives is paramount. Despite a highly fragmented and polarised political environment calls for the formulation of policy alternatives, options and choices are loud and clear from many stakeholders in society.

- Burden sharing of the social costs remains critical. This includes preventing parts of society from shirking their contribution to the consequences of the reform agenda. The key issues are to reduce tax evasion and improve debt collection from those who can afford it.

- A sustainable economic recovery in 2015 must be broad-based across sectors, businesses and society. Tourism growth is expected to be the basic driver of such a recovery process, while domestic demand lags behind.

- It will not be enough to rely so heavily on this key sector of the Greek real economy. Tourism's connectivity to other sectors such as health tourism, eco-friendly tourism and transport infrastructure logistics must be further enhanced and promoted.

6.1 Elements of a New Growth Agenda

The Samaras government recently published its »Greece 2021« New Growth Model.[9] This agenda marks a clear departure from past practices and priorities. It argues in favour of shifting from the production of non-tradable to tradable goods and services. The focus is on boosting productivity and competitiveness and promoting the export orientation of the real economy. While the »Greece 2021« growth agenda merits close attention for its level of detail and horizontal policy proposals, the blueprint has received very little public advocacy.

The role of government is defined as providing supervision, regulation and support for growth initiatives. The programmatic objectives cover horizontal and sectoral policies, some of which are cross-cutting. They include the following objectives:

- ongoing rationalisation of tax administration, measures to fight tax evasion, further capacity-building initiatives in revenue administration;

- developing long-term sectoral strategies and adjusting regulatory frameworks to support pre-privatisation efforts;

- enhancing young entrepreneurship programmes for start-ups, promoting firm incubators, establishing micro-finance structures;

- upgrading vocational training programmes and social inclusion schemes;

- facilitating the absorption of EU-backed financial engineering instruments for (export-oriented) SMEs;

- simplification of administrative licensing procedures, digitisation of custom controls to facilitate the export orientation of businesses;

- rationalisation of procedures of administrative courts and expansion of out-of-court settlements;

- implementation of an integrated strategy for the management of human resources in public administration, e-administration and e-government.

The key sector supporting the economic recovery process is and will remain tourism. Its total direct and indirect contribution to the real economy is estimated as up to 25 per cent of GDP in 2014. The contribution of tourism to a new growth agenda for Greece has formidable potential and requires innovation at the regulatory level, linking tourism with other sectors and redefining the notion of tourist infrastructure. More specifically, this comprehensive approach includes, among other things:

9. See Greece 2021. The New Growth Model, Prime Minister's Office, presented to the Euro Group of finance ministers in April 2014.

■ The liberalisation of cruise tourism; that is, docking rights for cruise ships, port infrastructure modernisation for cruise ship anchoring, logistics infrastructure connecting ports to railways, connectivity to islands.

■ Sustained marketing and promotional activities concerning Greece as a tourist destination for different constituencies of tourists year-round. Travel writers and bloggers taking part in the Travel Bloggers Exchange (TBEX) Europe 2014 in Athens in October 2014 are a successful case in point.

6.2 Obstacles Standing in the Way of a Sustainable Growth Agenda

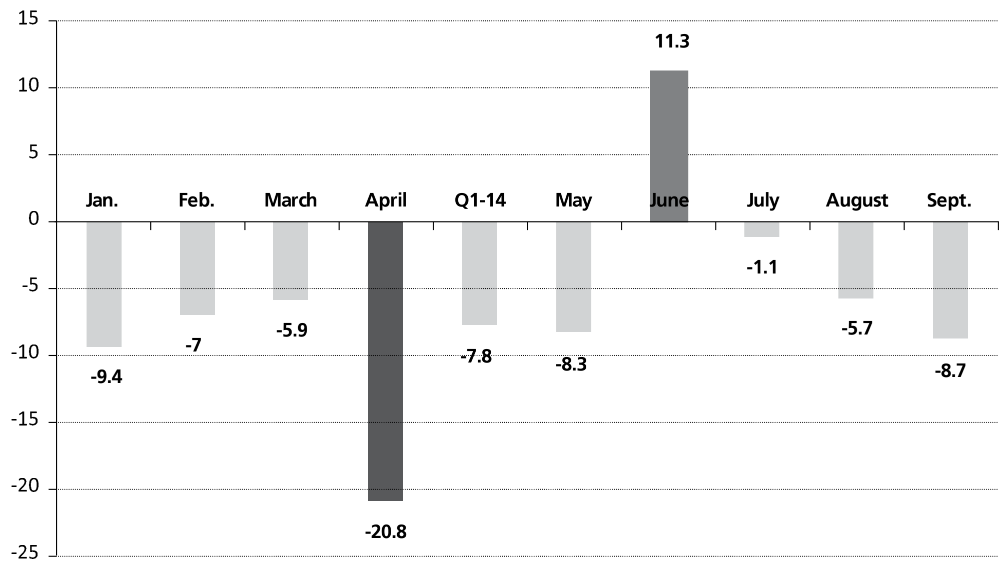
What follows from this new growth agenda for the existing macroeconomic adjustment programme for Greece? Could the 2021 growth agenda serve as roadmap defining priority areas of policymaking? Let us consider three key policy areas, namely exports, foreign direct investment and privatisation.

Since early 2013 Greece's export capacity has been questionable and is puzzling both policymakers and analysts (Böner et al 2014; Gros 2014). As Figure 6 illustrates, the economy's export performance is on a declining trend, with occasional wild swings in opposite directions in April and June. For the second year running, Greece will register a decline in exports in 2014.

The lack of export growth in 2014 is not an outlier. Already in 2013 Greece exported fewer products and services than it did in 2012. While countries such as Portugal, Spain and Ireland on the euro zone's southern and northern periphery recorded firm export growth, Greece could not match them. Despite declining real wage costs in the Greek economy since 2009 export capacity has not improved on the back of such changing price signals.

According to the OECD (2014a), Greece has experienced one of the largest falls in real wages across OECD countries (more than 5 per cent per year on average since the first quarter of 2009). This significant decline in private and public sector wages has helped to narrow the

Figure 6: Greece's export performance in 2014 vis-à-vis 2013 (%)



Note: * Exports exclude fuel products.

Source: ELSTAT, Monthly Bulletin, October 2014.

gap in unit labour costs with other euro-zone countries. But painful wage adjustments have yet to translate into a sustained increase in export volumes, albeit from a low point of departure.

Portugal is outperforming Greece on the export front and thus we have to ask why an export-led recovery has materialised in the former, but not in the latter? Standard economic theory suggests that wage adjustments would enable businesses to restructure their cost base, thereby yielding higher revenue and having a gradual multiplier effect on the real economy.

The fact that Greece reported a balanced current account in 2013 is not relevant here. This remarkable achievement after double-digit deficits (as a percentage of GDP) during the first decade of the new millennium is the result of a massive curtailment of imports and, by extension, the implosion of domestic consumption.

It has also become clearer that the credit transmission channel to the real economy in Greece requires institutional development and new sources of liquidity. But a focus on improved credit supply is only part of a new growth agenda. Greece equally needs more equity based growth, garnering higher levels of foreign direct investment (FDI). It is striking how little FDI Greece has been able to attract, despite good potential.

According to the OECD (OECD 2014b) total FDI inflows to Greece in 2012 reached 1.74 billion euros. A year later, the level had declined to 580 million euros (after three quarters). In the first seven months of 2014 FDI exceeded 1 billion euros. But that volume has to be put in context. Two-thirds of that amount concerns Eurobank's share capital increase through the participation of Capital Group Companies Inc. and Fairfax, totalling 741 million euros.

Table 1: FDI inflows in Greece as a share of annual GDP, 2009–2013*

Year	2009	2010	2011	2012	2013
%	**0.76**	**0.11**	**0.39**	**0.70**	**0.58**

Note: * Data for 2013 are preliminary and based on three quarters only.

Source: OECD 2014b.

Concerning FDI inflows as a share of GDP, recent developments are sobering. Foreign direct investment in the real economy is stagnating, in particular as a result of the deep recession and investors' worries during 2011/12 about whether Greece would remain a member of the euro zone. The damage resulting from what then became known as »Grexit« will take years to overcome.

Finally, the ambitious privatisation process lacks critical support from large constituencies in Greek society. The divestment process is frequently subject to political controversies and hampered by administrative delays and judicial proceedings. In many respects the difficulties of implementing privatisation announced in 2010 as part of the first economic adjustment programme reflect the institutional, administrative and political challenges that Greece continues to confront.

Figure 7 shows selected public utilities and state-owned enterprises that were gradually listed on the Athens Stock Exchange through IPOs and subsequent share capital increases over the course of the past 20 years.

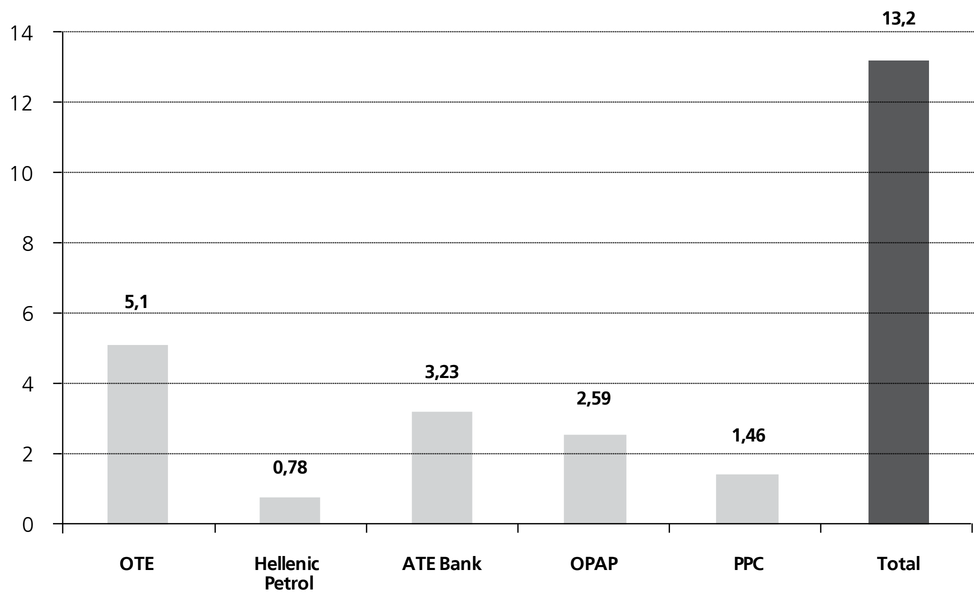
The total revenue generated during the period 1996–2011 amounted to roughly 13.2 billion euros. This reflected a time when Greek asset sales could fetch comparatively high prices and under completely different economic circumstances from those prevailing today. The single largest and most consistent revenue stream from the combination of privatisation and multiple share capital increases originated in the telecommunications sector (OTE).

When undertaking an unprecedented and politically charged privatisation process such as that of Greece since 2011 setting revenue targets is a risk prone enterprise. Instead, defining the rationale of the programme, the specific policy objectives and national strategies that are to be achieved in sectors such as airports, motorways, ports and energy prior to the completion of a sales agreement are far more important than the amount of revenue to be generated.

There has been no real public debate on these rationales and objectives, the necessary institutional preconditions and the political support that must frame such an endeavour since the Hellenic Republic Asset Development Fund (HRADF) started to operate in mid-2011.

The very practical obstacles, administrative hurdles, legal impediments and policy coordination demands make the conclusion of a privatisation project in Greece a gargantuan challenge. But they also underline what it takes to implement such an asset disposal programme against the backdrop of distressed markets and adverse economic conditions in Greece. Bringing the public on board remains a critical pre-condition during this work in progress.

Figure 7: Revenue from privatisation and share capital increases of state-owned companies in Greece, 1996–2011 (billion euros)



Note: Abbreviations: OTE (Hellenic Telecommunications), Hellenic Petroleum, ATE Bank (Agricultural Bank), OPAP (State Gaming Company) and PPC (Electricity Utility).

Source: Author’s own data.

The gradual recovery manifesting itself in Greece needs to be anchored on a wider platform of (export-oriented) sectors, investment volumes and modernisation processes in the wider economy. However, this endeavour is facing new headwinds and political challenges, which we shall address in the concluding two sections.

7. Managing an Orderly Exit from the Memorandum

During his visit to Berlin in September 2014, Prime Minister A. Samaras repeatedly emphasised that Greece does not require a third financial support programme from the troika of international creditors. In his conversation with Chancellor A. Merkel he argued that since April 2014 Greece has successfully returned to international bond markets after a forced three-year hiatus. Furthermore, the primary surplus achieved in 2013 and the one expected for this year underline that the government in Athens is in a position to finance its current expenditure requirements.

The European part of the second macroeconomic adjustment programme expires at the end of 2014, while the last disbursement from the IMF lending programme is scheduled in the spring of 2016. In the meantime the examples of Ireland and Portugal have attracted a growing number of followers in Athens. Dublin successfully exited its troika programme in December 2013 and was followed by Lisbon in May 2014. The government in Athens is thus determined to jump on the exit train and join both countries on the journey to regaining full sovereignty of its public finances.

The narrative in favour of an exit from the memorandum is being challenged by the ECB in Frankfurt. The ECB has drawn attention to the fact that Greek banks cannot continue to draw on liquidity facilities in Frankfurt if no further programme is agreed. Alternatively, Greece would need to register a credit rating upgrade to the level of »investment grade«. This development appears rather unrealistic at present. Greece's long-term sovereign credit rating is currently three notches below this critical ECB threshold.

This challenging condition raises the question of how an exit option can be devised that satisfies the Greek government's aspirations while recognising international creditors' demand for continued monitoring and appropriate financial backstops for Greece. What is clear nevertheless is that the troika method of imposing policy compliance has reached its limits in Athens.

The IMF has offered a so-called precautionary credit line (PCL). The PCL is a contingent or emergency funding facility. It forms part of the IMF's toolbox for countries exiting financial support programmes, emphasising a more gradual, phased disengagement process. Both Ireland and Portugal chose to reject such a precautionary credit line from the IMF, preferring a clean exit.

The Greek authorities are also seeking a post-bailout period without IMF participation. What the post-programme monitoring and compliance regime will look like for Greece in 2015 remains to be seen and is subject to complex negotiations at the European level. A European-style precautionary credit line, for example, from the ESM's resources, is one among various options.[10]

In the transitional phase of exiting the memorandum, a standby financial support mechanism for Greece would protect the country from potential turbulence in international bond markets of the kind witnessed in mid-October 2014. Thus exiting its international bailout programme is not a risk-free exercise for the Greek authorities.

8. Does Greece Need a New Programme, But Not a Memorandum?

What might be the key elements of a support programme for Greece? As one point of departure, the terminology would have to be crafted carefully. The term »Memorandum« has become associated negatively with the two predecessor programmes and is linked with a period that Greeks want to leave behind as quickly as possible. Rather, a new cooperation agreement, as it should be labelled, would emphasise the attainment of efficiency gains in the real economy, investment capacity and social cohesion.

Critically, the agreement would be structured in such a manner that it can obtain greater support among Greek citizens and participating institutions. Key to this process is the willingness of the Greek authorities to define and take full ownership of such a cooperation agreement. The pro-active participation of the public administration and the wider inclusion of domestic experts would strengthen this ownership objective.

In terms of substance, continued focus on fiscal consolidation and the stability of the banking sector, although important, cannot define a new support programme for Greece.

In order to strengthen the reform impetus in the Greek political economy it is necessary to broaden the focus and move beyond further interest rate reductions or maturity extensions on the official loans provided to Greece. Five reform areas are of particular importance:

10. The ESM offers two such options, a Precautionary Conditioned Credit Line (PCCL) or an Enhanced Conditions Credit Line (ECCL). See ESM 2014 for more details. An alternative would be to redirect unused resources from the bank recapitalisation fund, from which roughly 11 billion euros are still available.

(i) At the horizontal level the programme would have to formulate cross-cutting issues that affect all sectors of the real economy, in particular as regards Greece's domestic and foreign investment capacity. One area in which implementation delays and administrative deficits are particular concerns is the privatisation process. This approach does not imply a focus on revenue generation through disinvestment, but rather argues for alternative options, such as long-term leasing arrangements and greater leverage in the corporate management of public property.

(ii)In order to promote Greek export capacity, arrangements at the bilateral and/or European level should be explored that facilitate the availability of export insurance guarantees for Greek companies. The further rationalisation and digitalisation of customs procedures is part and parcel of such an export promotion policy.

(iii) For new businesses, including start-ups, the availability of micro-finance structures needs to be advanced in Greece. Frequently, new SMEs do not lack innovative ideas but seed capital, which are still hard to come by from local banks. A targeted implementation of European funding programmes and technical assistance laying the groundwork for micro-finance structures in Greece is absolutely necessary.

(iv) Apart from the conceptual reorientation of a new cooperation agreement for Greece, the focus should turn towards institutional capacity-building, executing agreed reform priorities at the regional and municipal levels. The support programme should identify ways to facilitate the financing and provision of technical assistance for Greece.

(v)The possibilities for combining various existing financing options for Greece have not yet been exhausted. This argument advocates strengthening synergies between different funding programmes and institutions, for example, by seeking to enlarge the group of financial backers of the Institution for Growth (IfG) with additional countries, banks and domestic as well as international organisations. The integration of new funding partners into the IfG would broaden its operational capacity and open new financing avenues, in particular for SME financing.

These agenda items remain central to Greece's prospects in the near future, with or without a new cooperation agreement.

9. Concluding Remarks

The structural adjustments currently under way in the Greek economy are primarily the result of drastic efforts by the governing authorities in Athens to adhere to the fiscal consolidation imperatives of the Troika. The »success« of these efforts has given rise to unintended consequences in terms of mass unemployment in the private sector, the implosion of domestic consumption, the root-and-branch reduction of public health care expenditure and cutting the public investment budget.

■ The productivity gains and cost reductions resulting from these policy decisions have been massive and painful. It would take more time to achieve such outcomes (preferably without the pain) by other means than fiscal consolidation. Structural reforms have another timetable in terms of taking effect and gaining traction.

■ Reformulating a growth agenda for the real economy requires better investment conditions, a social contract accepted both inside and outside parliament, predictable tax policies and their effective administrative application, reliability of the rule of law, transparency in applying justice, among other things.

This is a tall order and very much work in progress in Greece. There is no silver bullet for Greece's political economy and in light of the evidence presented here it would be misleading to promise one.

At the same time, new challenges due to geopolitical disruptions in other parts of the world are, literally, arriving on Greece's doorstep. We cannot exclude that headwinds are coming Greece's way that could adversely affect the economy's recovery potential in 2015 and thus also weigh on the country's debt dynamics. One such factor of potential turbulence is the economic effects of the EU's sanctions against Russia and the counter-sanctions adopted by Moscow because of the Ukraine crisis.

■ The Russian sanctions on EU food imports threaten to adversely affect Greece's recovery prospects, in particular in the agricultural sector and its export capacity. The value of trade between Greece and Russia was USD 9.3 billion in 2013, mainly in gas, oil and food products.[11] Tourism arrivals from Russia in the coming year could also have an impact if the sanctions regime is maintained or even escalated.

Another concern is continued stagnation in the euro zone, in particular among Greece's most important trading partners, namely Italy, France and Germany. Considering the country's weak export performance in 2013 and 2014 any further slowdown in demand for Greek products and services from this trio of euro area members would adversely affect any hope of an export-led recovery in Greece during 2015.

■ If the German economy stalls, it would have medium-term repercussions on Greek export products such as olive oil, feta cheese, yoghurt and pharmaceuticals.

Moreover, Greece's borders are not adequately secured and policed. The refugees arriving from Syria, Iraq and various states of the Maghreb are overstraining the administrative capacities of Greek border institutions and the provision of safe shelter centres. Since the beginning of 2014 the Greek border authorities have registered more than 17,000 new refugees, many of whom arrive by boat along the Aegean coastline.

■ The government in Athens has asked the European Commission to provide urgent additional funding to improve cross-border management with Turkey, the construction of reception centres for migrants and refugees and quicker registration procedures.

The fragile and uneven economic recovery manifesting itself needs to be made sustainable and spread more widely across the real economy and among different stakeholders in society. Sectors such as tourism, shipping and financial services are recovering faster than domestic consumption, export capacity and investment.[12]

■ »Horizontal« issues, such as improving tax administration, overcoming liquidity constraints in the real economy and burden sharing among all Greek citizens will determine the degree to which a sustainable growth agenda can redefine the potential of the country's real economy and provide a credible success story.

The risk that reform fatigue will gain ground, hand in hand with strong expectations that economic recovery will founder threaten the sense of progress that has been established over the past five years. Managing the expectations of domestic stakeholders and international creditors will be crucial in the medium term. If these expectations are pitched too high they may generate disappointment rather than a feeling that Greece's political economy is moving in the right direction.

11. The Russian market accounts for roughly 25 per cent of Greece's peach production and approximately 50 per cent of its strawberry exports. The Russian embargo contributed to a 1.8 per cent decline in fruit and livestock exports from Greece in August 2014.

12. Despite all the recovery rhetoric being articulated these days in Athens by government representatives, one should not lose sight of the remaining obstacles. In September 2014 the international credit rating agency Standard & Poor's demoted the Athens Stock Exchange from developed to emerging market status.

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