STUDY

Defining a Growth Strategy for Greece

Wishful Thinking or a Realistic Prospect?

JENS BASTIAN

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- Since 2010 Greece has been trapped in a depression-like economic slump with soaring unemployment. The third programme includes further fiscal austerity requirements, while seeking to introduce more flexibility in terms of balance of adjustment and the implementation timetable.

- It is increasingly clear, compared with other countries in the euro area, that any definition of a growth strategy for Greece is subject to a set of economic preconditions, institutional parameters and policy narratives that currently do not apply to any other member state.

- Given that the future of Greece's membership in the euro currency union is repeatedly called into question, with capital controls in the banking sector in place since the end of June 2015 and its working relationship with its euro area peers is defined by the need to rebuild trust from scratch, then any growth prospects for the country's real economy are under a dark cloud of uncertainty.

- The Greek growth agenda presented in this contribution consists of a mixture of sectoral and horizontal policy interventions. The former include sectors such as tourism, energy and agriculture. The latter focuses on taxation, the operational business environment and investment capacity, public as well as private.

- Given the track record of implementing a reform agenda over the past five years, under the auspices of international creditors, an effective monitoring mechanism for the execution of such policy interventions is crucial, but remains politically fraught.

Table of Contents

Introduction

After five years of crisis management, the question of Greece and its adherence to or rejection of fiscal austerity programmes is a recurring nightmare for policymakers in Athens, Brussels, Berlin, Frankfurt and Washington. After the adoption of the first macroeconomic adjustment programme in 2010, which was supplemented by a second one in 2012, five different governments have come and gone in Athens. In 2015 alone, Greece will have experienced two general elections, the first on 25 January, the second on 20 September and, sandwiched between them, a referendum on austerity policies on 5 July.

The different governments have covered almost the entire ideological spectrum of Greek politics and have operated in various coalition arrangements. Six prime ministers have been involved with international creditors in an endless exercise of trying to reach agreement on far-reaching policy compliance requirements in exchange for multi-billion-euro financial assistance. This rescue architecture has yielded both intended and unintended results that extend well beyond Greece's borders.

After complex and politically contentious negotiations with a quartet of international creditors, the government of Prime Minister Alexis Tsipras reached agreement on a third financial assistance package totalling 91 billion euros in mid-August 2015. The agreement with the International Monetary Fund (IMF), the European Central Bank (ECB), the European Commission (EC) and – as newcomer, turning the troika into the quadriga – the European Stability Mechanism (ESM), is the third macroeconomic adjustment programme for Greece in five years, after the first in 2010 and the second in 2012.

Since 2010, Greece has been trapped in a depression-like economic slump with soaring unemployment. The third programme includes further fiscal austerity requirements, while seeking to introduce more flexibility in terms of the balance of adjustment and the implementation timetable.

Adopting a raft of economic, fiscal and administrative policy changes in exchange for multi-year financial assistance remains politically contentious in Greece and among the international creditor quadriga. Re-establishing trust and credibility are essential parts of the new programme agenda after seven frustrating months of attempts to reach a viable compromise.

In the course of these acrimonious and increasingly divisive debates hitherto taboo issues among euro area member states have been publically debated and recommended, most prominently a German-led group of northern creditor countries proposing a temporary exit of Greece from the single currency in exchange for sovereign debt reduction. Greece's possible exit or exclusion from the euro – termed Grexit – will henceforth represent a red line that could be crossed or threatened in relation to a recalcitrant member state.

Micro-managing the Greek real economy remains the focus of international creditors. Greece has to comply with reform requirements that range from streamlining the VAT system, broadening the tax base to increase revenue, eliminating the 30 per cent discount on consumption tax for certain Greek islands, liberalising Sunday trading laws and improving the long-term sustainability of the pension system to issues such as ensuring the independence of the state statistical agency, overhauling the civil justice system and increasing VAT on bread produced in bakeries.[1]

Such micro-management includes hundreds of detailed reforms linked to programme conditionality. It focuses on the adoption, implementation and evaluation of numerous individual legislative measures and administrative acts. For five years many criticisms have been levelled at this approach. For example, the troika of international creditors has been accused of acting like an accountant, ticking off boxes if numerical targets have been achieved. What is lost in this procedure in terms of political economy is the fact that the Greek government has lost its political sovereignty.

It remains to be seen whether policymakers, international creditors and investors will continue to treat Greece as an exception and outlier, rather than as a precedent inside the euro zone. At the end of 2014 Greece accounted for just 1.8 per cent of euro zone output and roughly 0.3 per cent of the global economy.

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).

Those creditor countries in the euro area who interpret the macroeconomic adjustment programmes administered to Greece as a »re-education programme« have placed their bets on the outlier narrative. They argue that firewalls had to be established in order to protect the rest of the vulnerable member states inside the single currency.

What is nevertheless increasingly clear compared with other countries in the single currency is that any definition of a growth strategy for Greece is subject to a set of economic conditions, institutional parameters and policy narratives that currently do not apply to any other member state.

Put otherwise, when the future of Greece's membership in the euro area is repeatedly called into question, with capital controls in the banking sector in place since the end of June 2015 and a working relationship with its euro area peers defined by the need to rebuild trust from scratch, then any growth prospects for the country's real economy are under a dark cloud of uncertainty.

Therefore, defining a growth agenda for Greece requires a level of political stability, fiscal outlook and currency predictability that is not called into question at every turn. Stating the obvious is not obvious under present circumstances in Greece.

The Greek growth agenda that will be presented in this contribution consists of a mixture of sectoral and horizontal policy interventions. The former include sectors such as tourism, energy and agriculture. The latter focus on taxation, the operational business environment and investment capacity, public as well as private.

Given the track record of implementing this reform agenda in the past five years under the auspices of international creditors, an effective monitoring mechanism for the execution of such policy interventions is crucial, but remains politically fraught.

1. The Greek economy prior to 2010

From the turn of the millennium until mid-2009 the Greek economy was largely debt-financed and consumer-driven. This started to collapse through the exclusion of Greek sovereign and subsequently corporate borrowing from international bond and capital markets. It is important to recall that the collapse was not the result of the system having been discredited domestically. The debt-financed resources necessary to fuel a state-driven growth agenda in Greece first became unaffordable and then entirely unavailable in early 2010.

One of the best independent academic economists in Greece, who also has extensive experience in public office and corporate affairs, Tasos Giannitsis, recently argued that a private sector driven integration in globalisation only started in earnest in Greece with the adoption of the first and second macroeconomic adjustment programmes of 2010 and 2012 (Giannitsis 2013).

Put otherwise, with the exception of the shipping industry (including shipping finance) and to a limited degree also domestic lenders, private sector agents such as telecoms, insurance companies and small and medium-sized enterprises operating in product and service markets lagged behind in their attempts at full integration into economic globalisation.

Sociologist Giannis Boulgaris (2013) argues that this delay was mainly caused or obstructed by recurring state capture of economic affairs in Greece. This does not imply that integration and participation in globalisation did not take place in Greece. Rather, there was hardly a level playing field for all those wishing to enter the competitive game.

Integration in globalisation processes accelerated after Greece's accession to the euro area in 2001. It also provided new openings for private sector market participants, in particular large companies and financial institutions starting to expand into neighbouring countries in southeast Europe. However, the rules of the game and their application continued to be defined and driven by the state until the growth agenda started to hit a wall in 2009 (Pagoulatos 2014).

At its root, the crisis in Greece was not generated by banks, as in Ireland, Cyprus and Spain. The powder keg was a debt overhang accumulated over decades, which accelerated dramatically after Greece joined the single currency in 2001. Further structural characteristics of the Greek real economy include the following:

■ Throughout the first decade of Greece's membership of the monetary union consumer spending was the biggest contributor to the real economy, reaching 70 per cent of GDP before the sovereign debt crisis in 2010.

■ Tourism contributed 17 per cent of GDP in 2014. The sector has employed 341,000 people in the past year.

■ For the Greek real economy to function effectively domestic businesses need to import 80 per cent of raw materials and finished products. This level of import dependency is among the highest in the euro area. More specifically, in 2014 Greece imported 42 per cent of its food requirements and a total of 84 per cent of its energy needs (crude oil and refined petroleum).

■ By contrast, exports only made up 32 per cent of Greece's economy at the outbreak of the sovereign debt crisis in 2010/11. Export growth during the past decade was mostly based on refined petroleum. If this product category is excluded, the export growth Greece recorded between 2001 and 2010 quickly evaporates. Throughout that period the export structure remained focused on commodities.

■ Two other structural parameters characterise Greece's problems. First, despite troika-mandated cuts to pensions starting in 2010, spending on pensions as a share of GDP stood at 14.4 per cent in 2013. This expenditure level was the highest in the euro zone, before Italy (14.0 per cent), France (13.5 per cent) and Austria (12.9 per cent).

■ According to the OECD, in 2012 Greece had the lowest VAT revenue ratio[2] in the euro area, namely 0.37 per cent. VAT accounted for 21.2 per cent of total tax revenue in 2012, above the OECD average of 19.5 per cent (Shah 2015). Greece has numerous discounted VAT rates on items including catering, restaurants, exemptions for various Greek islands and farmers. Harmonising VAT rates for product categories and services has been a recurring controversial compliance requirement between the Greek authorities and its international creditors.

2. The OECD defines VAT revenue ratio by measuring a country's rates of VAT payment and collection capacity. A ratio of 1 would reflect the perfect enforcement of a sales tax system that applies a single VAT rate to all expenditure on goods and services consumed in an economy.

■ The Greek shadow economy is estimated to account for 24 per cent of the country's economic activity in 2013 (Schneider 2014). That compares with 21 per cent in Italy, 19 per cent in Spain and Portugal and 13 per cent in Germany.

■ Greece's economy continues to be dominated by cash transactions. According to the ECB (2012), Greece has the smallest number of electronic payments per head in the euro zone. The introduction of capital controls and limitations on cash withdrawals since the end of June 2015 may have an unintended by-product of giving Greeks of all ages an incentive to start using electronic cards and retail payment systems.

■ Greece is one of only five NATO members (out of 28) that meets the goal of spending 2 per cent or more of GDP on defence. Such a level of military expenditure before and even more so during the crisis years is a matter of repeated controversy with international creditors. In the ongoing negotiations with international creditors the government has pledged to curtail military spending.

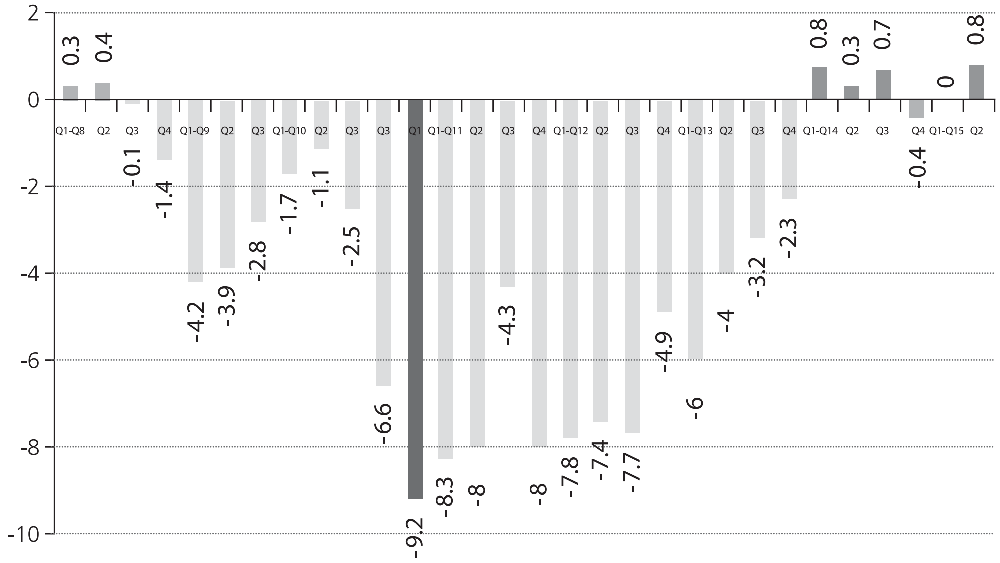
2. The premature »Greecovery« narrative in 2014

Bringing Greece back to sustainable growth has been a work in progress since 2009. As figure 1 illustrates, Greek seasonally adjusted GDP at constant prices fell by 0.4 per cent, quarter on quarter, in the fourth quarter of 2014, after a 0.7 per cent increase in the preceding quarter. Greece's economy stagnated in the first quarter of 2015 (0 per cent growth).

However, it confounded recession forecasts by expanding 0.8 per cent in the second quarter of 2015. Compared with the same period a year earlier output in Greece rose by 1.6 per cent. This quarterly GDP figure represented the largest year-on-year increase since 2008. Household expenditure (for example, spending on cars, electronics and furniture) was the main contributor to this development.

The 24 successive quarters of economic contraction that were finally overcome in early 2014 represented a record for a member state in the euro area. Optimistic voices such as the former conservative Prime Minister

Figure 1: Quarterly economic performance, Greece, 2008–2015 (%)



Source: Hellenic Statistical Authority (ELSTAT), Quarterly GDP data, August 2015.

Antonis Samaras (*Nea Dimokratia*) quickly exploited this positive development for political gain by coining the term »*Greecovery*«.

This premature assessment proved short-lived. The emerging positive signs were achieved primarily on the back of a record year in the tourism sector and continued high demand for tanker capacity provided by the Greek shipping industry.

But maritime shipping as a key part of services exports has »few real links with the rest of the economy« (Gros 2015). Rather, for over a decade the Greek shipping industry has been decoupled from the rest of the national economy. The legal corporate tax immunity that the shipping industry enjoys further highlights the decoupling thesis.[3]

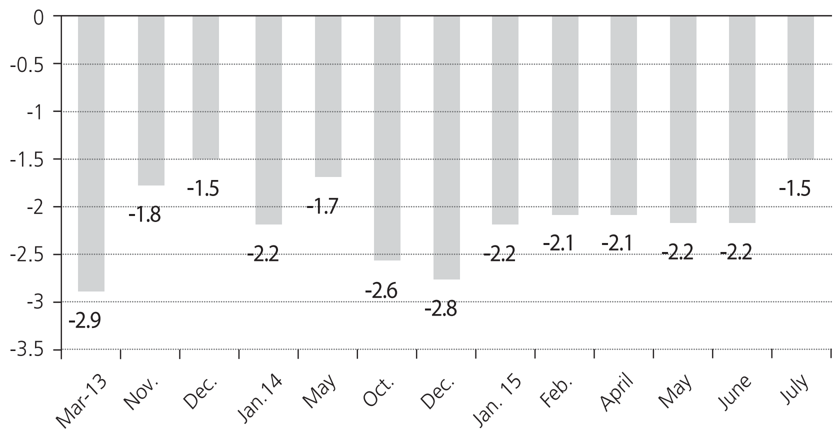
3. The Greek shipping industry is further characterised by the fact that its business is transacted in US dollars. This limits the sector's exposure to adverse impacts from the current capital controls in place in Greece (see chapter 5 for more details).

By contrast, other sectors – such as construction – weak retail numbers and stagnating consumer demand, as well as persistently falling credit transmission to the real economy underlined how limited and premature any talk of a Greek »success story« was.

Moreover, Greece's declining trade deficit since 2011 only has argumentative merit if its root cause is clearly stated, namely a dramatic collapse of imports, not an export-led reconfiguration of the Greek economy. In fact, the value of exports in 2014 was 27.17 billion euros, as against 27.57 billion euros in 2013. The decline in export capacity in 2014 was 1.4 per cent, a trend also registered the previous year.

As figure 2 illustrates, Greece continues to be trapped in deflation. The country has endured an uninterrupted, 30-month long (!) deflationary spiral. Put otherwise, for more than two years now Greece has been an inflation outlier inside the euro zone. Possibly, the data becoming available in the months ahead will signal an end to this spiral. As VAT changes are implemented on thousands of

Figure 2: Deflation in Greece: 2013–2015 (monthly change, year-on-year) (%)



Source: Hellenic Statistical Agency (ELSTAT): Monthly Reporting, September 2015 non-EU harmonised data).

products and services, we can expect an upward impact on the consumer price index (CPI).

In sum, while individual sectors of the real economy began to display modest evidence of a turnaround, the presumed recovery never reached the middle of Greek society. Neither did it prove resilient enough in the face of mounting political uncertainty near the end of 2014.

The initial signs of recovery beg the question of what defines economic success in Greece today? Hyping the recovery because the real economy was finally starting to grow again, but hardly creating new jobs does not constitute much of a success story. Put otherwise, does success Greek-style entail double-digit unemployment rates and real income per capita that is still below the pre-crisis level of 2009?

Furthermore, the combination of weak consumer demand, a prolonged credit crunch in the real economy and the underlying effects of capital controls suggest that positive economic data will be hard to come by in the second half of 2015.

Even though the second quarter (2015) data surprised many observers and analysts, we must anticipate weak GDP performance for the full year, with unemployment remaining above 20 per cent. Instead of an uneven recovery that is far too dependent on sectors such as tourism and shipping the forecasts point to a recession.

3. Debt migration and debt sustainability

In the second quarter of 2015 Greece's total public debt reached 340.4 billion euros. When measured as a proportion of GDP that corresponds to nearly 176 per cent. After Japan's debt-to-GDP ratio of 245 per cent, Greece's level is the second-highest national debt in the world.

The question of sovereign debt reduction for Greece – frequently also termed debt relief or debt restructuring (although they do not mean the same in terms of process and substance) – has become an increasingly divisive issue among the country's international creditors.

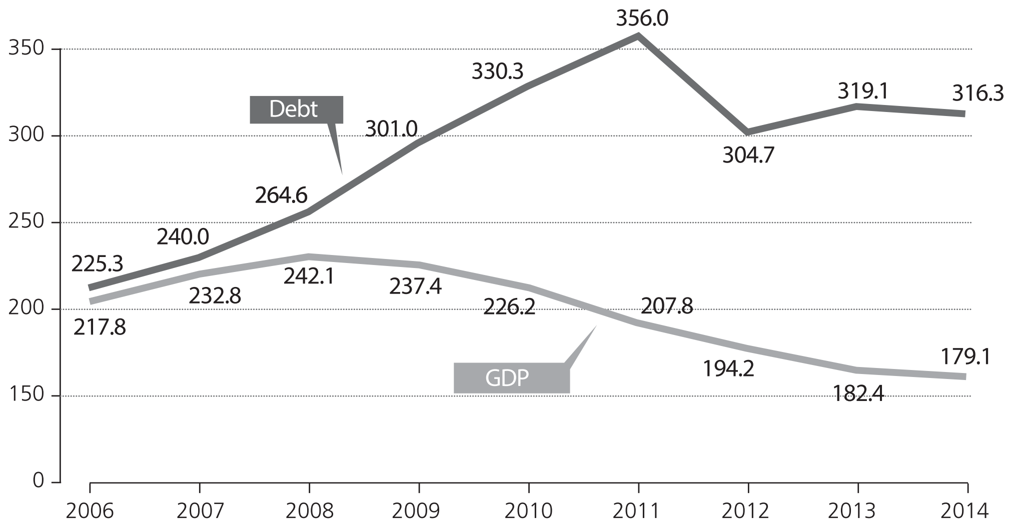
In particular the IMF has repeatedly made the forceful case that any third financial assistance package for Greece must include new approaches to easing the country's sovereign debt. Unless European creditors are prepared to contemplate a substantial debt reduction, the Washington-based lender has signalled that it would not support any new funding agreement.

The IMF's stance on Greece's unsustainable debt burden has evolved since 2013 when it first called on its European troika partners to seriously reconsider their approach to Greece's accumulated debt. This change of perspective is influenced by three structural factors:

(i) The configuration of Greece's debt since the onset of the sovereign crisis has been characterised by a migration from private bond holders to official sector indebtedness. This debt migration was further accentuated with private sector involvement (PSI), a haircut on private bondholders totalling billion euros in 2012.

In mid-2015 only 12 per cent of Greece's sovereign debt was in the hands of private sector creditors. Official European creditor institutions (the EFSF and ECB) and the European Stability Mechanism (ESM) were the key lenders to Greece, while the IMF had outstanding loans to Athens totalling 20.63 billion euros.[4]

Figure 3: Greece's deficit (billion euros)



Source: Author's own longitudinal data collection, supplemented by ELSTAT August 2015.

4. Greece's interest payments on its official sector loans currently stand at 2.5 per cent of GDP. Ireland and Portugal, both of which also had financial assistance programmes under the troika, face more burdensome payback terms than Greece.

(ii) The IMF is currently the only institution that carries out a debt sustainability analysis for Greece. As figure 3 illustrates, the divergence between annual GDP performance and the dynamics of indebtedness have been growing ever further apart in the Greek real economy.[5]

The IMF projected in mid-2015 that Greece's sovereign debt could reach 200 per cent in the next two years! For the IMF such levels of indebtedness for a country that is simultaneously excluded from international capital markets and in the midst of a double-dip recession are clearly unsustainable. Its mandate prevents it – and various non-European representatives sitting on the institution's governing board, including from Asia, Brazil and Canada, concur – from continuing to lend to Greece, with the reputation of the Fund at stake.

(iii) The IMF's debt sustainability analysis and the political-economy conclusions resulting from it have created a policy conundrum for the European creditor institutions. While the Washington-based institution continues to maintain its senior creditor status, it is asking European official creditors to engage in a substantial debt reduction towards Greece in which the IMF itself will not participate.

It therefore comes as no surprise that the Greek government is actively using the IMF's line of argument in the arduous negotiations to push for greater debt reduction. It is equally no surprise that some European institutional creditors and euro zone finance ministers are rather critical of such beggar-thy-neighbour policy recommendations issued by the IMF.

Greece's debt dynamics will be further adversely impacted if a third financial assistance agreement is reached with its international or European creditors. The reservation underlines the possibility that the IMF may not participate as a lender in such a third programme. Furthermore, the real economy outlook is such that the current assumption that Greece could gradually and continuously grow out of its accumulated debt burden is an illusion.

5. The dark gray line highlights the debt dynamics between 2006 and the end of 2014, while the light gray line tracks annual GDP performance for the same period. Both lines are denominated in billions of euros.

The most immediate issue to be addressed concerns Greece's capacity to meet its short-term repayment obligations towards the IMF and the ECB from mid-2015 until mid-2018. Roughly two-thirds of these obligations are owed to these two institutions.

Once this major challenge is overcome – and it remains moot whether it can be overcome – the obligations in Greece's repayment calendar ease considerably for most of the decade to follow.

Put otherwise, the country's short-term solvency is at stake without further financial assistance. Equally, Greece immediate debt repayments risk undercutting any chance for the real economy to start growing again. Greece's underlying medium-term solvency is rather a matter of hard-core politics around the contentious issue of debt reduction. The options being proposed by the IMF include steps such as forgiving some of Greece's debt or putting a three-decade moratorium on debt repayments.

These options do not square with the European focus on general assurances of further discussions about reducing annual repayment obligations by widening the payment periods and/or reducing interest rates. Germany, the Netherlands, Finland, Slovakia and the Baltic states remain resolutely opposed to any Greek debt restructuring of the nominal amount due. However, Berlin, the Hague, Helsinki, Bratislava, Tallinn, Riga and Vilnius take a more nuanced stance on debt rescheduling.

Thus, the current debate on the sustainability of Greek debt has to focus more on the short-term debt repayment obligations than on the country's overall debt-to-GDP ratio. More specifically, it is Greece's debt profile, and not the total nominal amount, that matters most at present. However, this perspective should not obscure the fact that Greece's accumulated debt is in effect unpayable. Greece's European official creditors will concede this uncomfortable truth and explain it to their respective parliaments and constituencies when they cease being in denial.

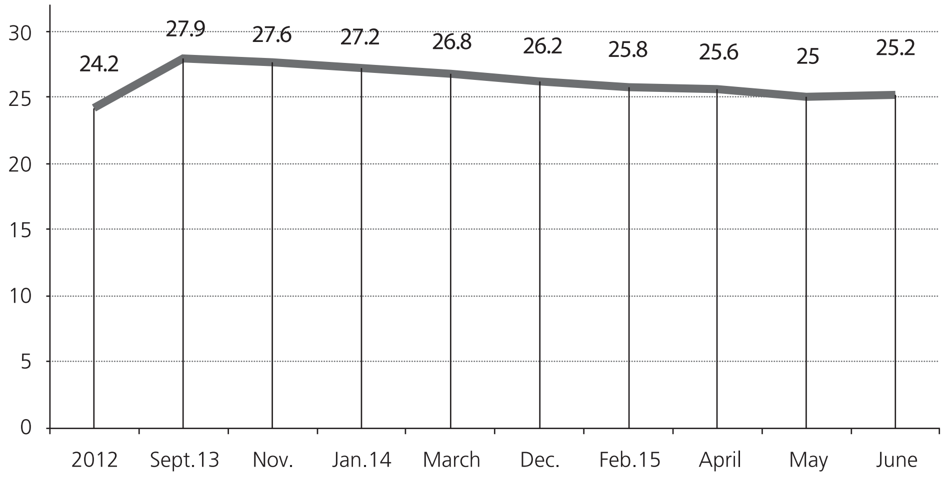
It remains to be seen whether the European official creditor institutions can agree a combination of measures with Greece such as debt rescheduling that include a lengthening of maturities, additional grace periods and even lower interest rates. But it is not certain that such an arrangement would be enough to entice the IMF to remain a member of the troika of institutions lending to Greece and supervising the implementation of reform.

4. Economic outlook for Greece in mid-2015

In light of the developments and uncertainties during the first half of 2015 it is currently near impossible to make any medium-term predictions about the country's economic future. Political uncertainty, the sword of Damocles of Grexit speculation or threats and the implementation of the third financial assistance package complicate near-term economic projections. The only element in such a quandary that appears more reliable is that all projections have to be prepared to shift downward in the short term.

Unemployment remains the single largest economic and social challenge facing the Greek authorities and the citizens affected by it. In June 2015 registered unemployed at the Greek Manpower Organisation (OAED) reached 1.24 million people, or 25.2 per cent. This level remains the highest in the euro zone, according to Eurostat, followed by Spain, with 22.5 per cent (June 2015).

Figure 4: Unemployment, Greece, 2010–2015 (%)



Source: Hellenic Statistical Agency (ELSTAT), monthly reporting series, September 2015.

The gradual decline in early 2015 was due primarily to the early start of the tourist season. This bright spot should nevertheless not deflect attention from the fact that with the introduction of capital controls at the end of June 2015, many businesses were subsequently obliged to lay off some of their staff or even close down entirely. Hence, we must anticipate an increase in registered unemployment in the second half of 2015, which is already evident in June.

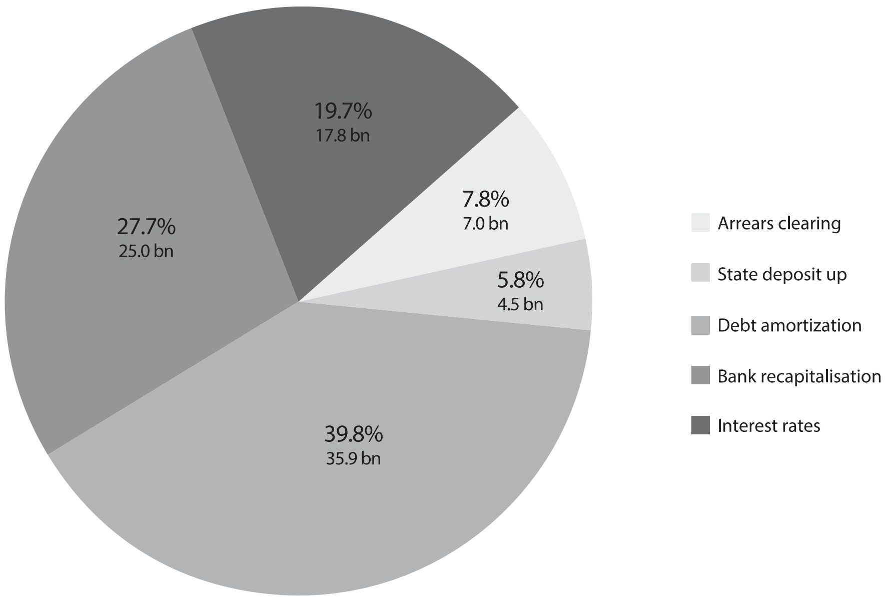
The number of long-term unemployed is continuing to grow, while that of unemployment benefit recipients steadily declines. Of the registered jobless in July 2015, a total of 56.29 per cent were long-term unemployed (out of work for longer than 12 months). The OAED unemployment allowance is only paid out to those without a job for up to 12 months. In July 2015 the recipients totalled 152,480 citizens, or a mere 10 per cent of the total registered unemployed in Greece.

Beyond these statistical references are significant structural changes in the Greek labour market. Since 2010 full-time employment has declined by almost half-a-million workers. Meanwhile, part-time work has almost doubled in size and is increasingly becoming the norm for Greek citizens. More specifically, according to the annual GSEE (2015) report on the state of the Greek economy and labour market:

- part-time employment has risen by a staggering 90 per cent since 2010;
- women represent 57 per cent of this increase;
- part-time work is replacing temporary work as the main alternative to full employment in Greece.

The European Commission adjusted its estimates regarding the course of the Greek economy in mid-July 2015. It now expects a 4 per cent of GDP contraction for the full year and the continuation of the recession in 2016 by 1.75 per cent. Moreover, instead of an initial expectation that Greece could achieve a primary budget surplus for the second year running, the outlook now suggests a primary deficit of up to 1 per cent in 2015 and a minuscule surplus of 0.5 per cent in 2016.

Figure 5: Gross financing needs, Greece, August 2015–July 2018 (billion Euros)



Source: European Commission, www.macropolis.gr

The imprecise nature of these macroeconomic projections affect how Greece's funding needs are to be assessed by international creditors for the coming three years. Among the troika the estimates range between 74 billion euros (European Commission) and 85 billion euros (IMF). This translates into annual needs of 10.4 per cent of GDP for the 2015 to 2018 for the former creditor and funding needs exceeding 15 per cent of GDP for the latter institution.[6]

5. Impact of capital restrictions on the Greek real economy

On 29 June 2015 the Greek government imposed capital controls that included daily restrictions on cash withdrawals and limitations on international money transfers. Greece thus became the second country in the euro area – after Cyprus in April 2013 – to close its banks and implement capital controls. The capital restrictions will adversely affect the functioning of the real economy. The motive for introducing capital controls both in Cyprus and Greece was to prevent a silent, digital bank run turning into an exodus of panic withdrawals by private households and businesses that threatened to ruin banks. However, the political context in which these controls were introduced in Athens and Larnaca was fundamentally different. While the former challenged most of the austerity demands of the international creditors, the latter cooperated with them.

When capital restrictions were introduced long lines of citizens forming at ATMs became a familiar street ritual. The effects on the real economy were immediate and severe. An economy that had slowly started to grow again for most of 2014 fell back into stagnation because of political uncertainty and a loss of confidence in recovery potential. In the first quarter of 2015 Greece slid back into recession.

The effectiveness of capital controls has been most evident in slowing the flow of deposits out of Greek banks. Greek banks lost 25 per cent (roughly 40 billion euros) of their total deposits between December 2014 and mid-2015. In June a peak of about 1 billion euros a day left the accounts of domestic lenders. After the introduction of capital restrictions this level declined to as low as 100 million euros a day.

But whatever the level of outflows, the liquidity constraints of Greek banks are acute and severely hinder any meaningful lending capacity to businesses and private households. The temporary closure of banks and the extension of capital controls have aggravated the downturn in the Greek real economy. This particularly affects the export and import capacities of domestic companies.

Initially, import applications valued up to 50.000 euros per client per bank required a special licensing process involving the Greek Central Bank's Banking Transactions Approval Committee. The threshold was subsequently raised to 100,000 euros at the end of July.

Before the introduction of capital restrictions for private households and the corporate sector the Greek economy registered monthly imports amounting to approximately 3.7 billion euros. But in the course of the first four weeks of capital controls that volume dropped to 1.58 billion euros. Thus, any easing of these capital restrictions would help to enable the real economy to return to some degree of »normalcy«.

This development reflects a larger structural deficit of the Greek corporate environment, namely its low degree of self-sufficiency. With the introduction of capital controls import payments in cash and in advance have become all the more prevalent. Importers have increasing difficulties obtaining fresh supplies from foreign providers who are demanding upfront payments. Because Greece does not have any significant foreign exchange reserves the authorities in Athens are not in a position to offer any compensatory alternatives, such as letters of credit guaranteed by reserves.

While larger companies can sustain such cash demands from their foreign suppliers for a longer period of time, the SME sector in particular is reaching the limits of sustainability. Deprived of credit by their local bank branches and experiencing a deterioration of asset quality that could be provided as collateral, these SMEs

6. Since 2010 the European Commission has been a member of the troika in Greece. But in contrast to its peers – the ECB and the IMF – it was not a creditor in the first two macroeconomic adjustment programmes. This lending architecture changed in July 2015. The EC provided Greece with short-term bridge funding totaling 7.2 billion euros through the European Financial Stability Mechanism (EFSM). The funds were used to repay the IMF (with whom Greece had fallen into payment arrears), a maturing sovereign bond held by the ECB and debt owed to the Bank of Greece.

have had to resort to (temporary) closures, cancellation of contracts and not paying staff due to a lack of liquidity.

On the exporters' side of the real economy, capital controls adversely affect the safety net of export guarantees from international agencies and insurers. Since mid-July 2015 public export-guarantee agencies in Germany (for example, Hermes) and in the United Kingdom (the UK Export Finance Agency) no longer process applications for protection on exports to Greece because of the crisis. They are equally reconsidering their cover policy in light of recently imposed foreign exchange controls.[7]

How long the capital controls will remain in place in Greece is difficult to predict. If the experience of Cyprus is any indication, then we should assume that restrictions on the movement of capital will take years to unwind. They were introduced in Cyprus in April 2013, but only in June 2015 were the last capital controls removed. At present it does not appear that the Greek government has a ready-made exit strategy for lifting capital restrictions.

6. State of the Greek banking sector

In anticipation of possible »bail-in« legislation, which was adopted in an omnibus bill on 22 July, citizens and businesses started to draw down their current account deposits as much as possible. Nobody wants to be caught off guard with too much liquidity in their bank accounts if and when current speculation about a bail-in turns into harsh reality.[8]

Furthermore – and more importantly – confidence in the sector, a sense that domestic lenders will be able to deliver the banking services they need to citizens and businesses on time has been broken. The repair work that will need to start once banks open for business again will take months and cannot be fast-tracked through marketing, re-branding or handing out free water bottles.

In fact, as the Brussels agreement between the international creditors and the Greek authorities underlines, a sizeable part of the proposed third financial assistance package will be reserved for bank recapitalisation needs and possible resolution requirements.

The 13 July 2015 Brussels agreement between Greece and its international creditors includes recapitalisation needs that could reach 25 billion euros. But prior to replenishing the capital of Greek banks some could rather be shut down if they were deemed insolvent by the ECB as supervisory authority.

The short version of this recapitalisation–resolution nexus implies that the domestic banking sector in Greece, as it exists today, will not be the same in the months ahead. Consider the following developments:

■ The ECB has been providing Emergency Liquidity Assistance (ELA) through the Bank of Greece to the four largest domestic lenders. ELA peaked at 90.4 billion euros at the end of July 2015 and currently stands at 89.7 billion euros.

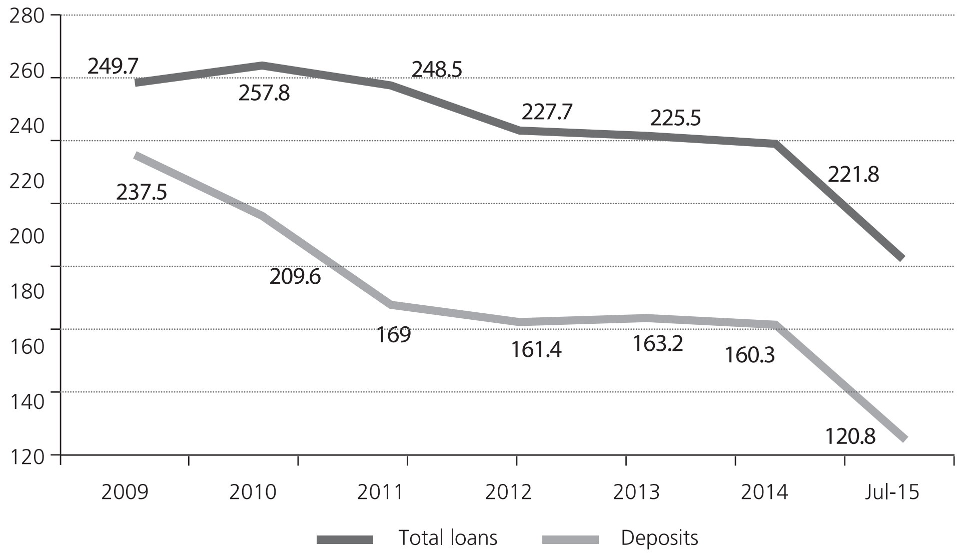
■ Together with the volume of lending which Greek banks have received through the euro system – 33 billion euros – their total exposure (124 billion) now exceeds (!) the remaining level of deposits, which declined to 120 billion euros in July. This was the lowest level in the balance of deposits since May 2003.

■ The amount of deposits that have left Greek banks since October 2014 is of such magnitude that Greek lenders will have enormous operational difficulties convincing citizens and businesses to return some of that capital flight to the banks' vaults.

7. In 2014, UK companies exported £1 billion ($1.56 billion) in goods and services to Greece. UK Export Finance's annual report for 2013–2014 showed that the agency has around £5.5 million at risk in Greece, having offered guarantees for products ranging from cheese to medical packaging (see www.wsj.com).

8. Apart from public speculation about bail-in options, the possibility of senior and/or junior bond holders of Greek banks being obliged through a »haircut« to contribute to the recapitalisation of domestic lenders cannot be excluded. Such a procedure was adopted in the case of Portugal's Banco Espirito Santo in 2014 when the institution was split into a good, viable bank and a »bad bank«.

Figure 6: Total loans and deposits in Greek banks, 2009–2015 (billion euros)

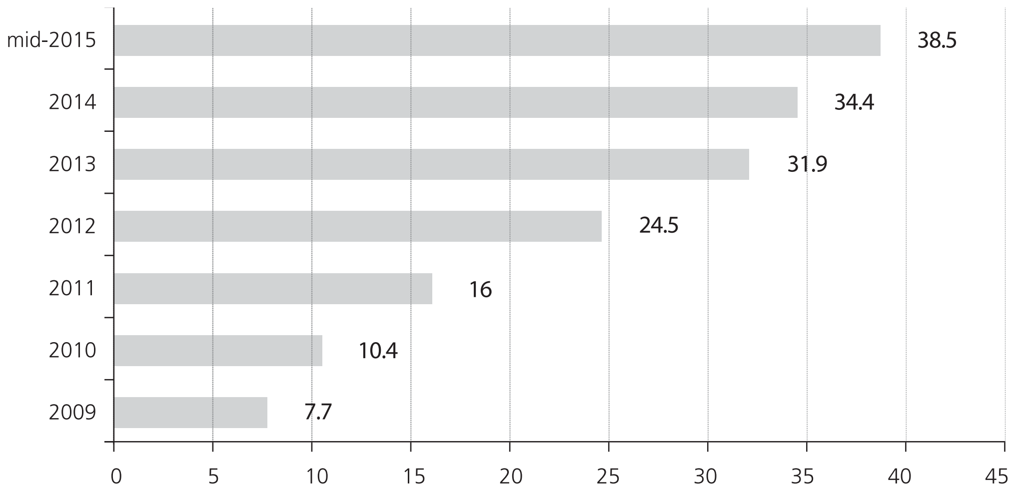


Source: Author's own longitudinal data collection, supplemented by Bank of Greece, August 2015.

■ In the meantime, non-performing loans (NPLs) have continued to increase at an alarming rate, closing in on 40 per cent of banks' total loan portfolio in mid-2015, equivalent to approximately 100 billion euros. Most challenging in this respect is the fact that loans that were refinanced in the course of the past year are again starting to turn into NPLs. This does not augur well in terms of clients' repayment capacity in the coming months.

■ Based on Q1-2015 data, Greek banks' balance sheets registered about 40 billion euros of loan loss provisions, covering almost 60 per cent of impaired loans. Such levels of provisioning not only cut into the asset side of the balance sheet, but also fundamentally hinder domestic lenders from expanding their lending capacity to the real economy.

Figure 7: Greek banks' non-performing loans, 2009–2015 (% of total loan portfolio)



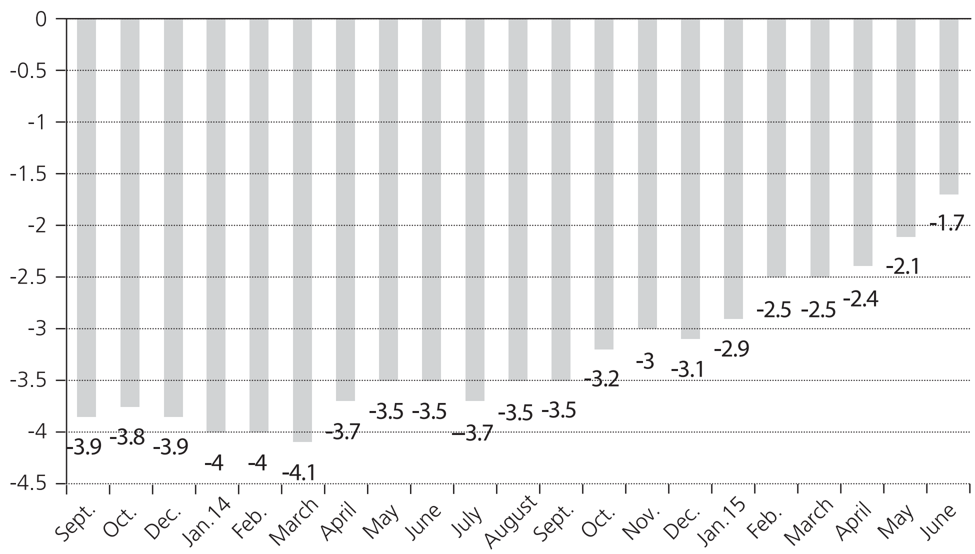
Source: Author's own longitudinal data collection, supplemented by Bank of Greece, August 2015.

■ Apart from increased NPL formation the asset quality of Greek banks is also declining because they are the single largest private domestic holders of Greek government bonds and T-bills. The value of the Greek government bonds in banks' portfolio has declined by more than 50 per cent since May 2014.[9]

■ Nearly half of the capital of the four largest domestic banks relies on so-called deferred tax assets. In accounting terms, deferred tax assets constitute an allowance on banks' balance sheets. Their corporate taxation levels can be reduced in future years if they register losses in the past. The ECB and the European Commission have announced that they will look into this controversial accounting practice, which is also being used to bolster banks' capital in Portugal, Spain and Italy.

9. After the European Central Bank the single largest foreign investor in Greek government bonds is the German insurance group Allianz. Through its subsidiary Pimco Investment Management, Allianz has increased its holding to 1.2 billion euros.

Figure 8: Credit crunch in the Greek economy, 2013–2015 (monthly change, year-on-year) (%)



Source: Author's calculations based on monthly data provided by Bank of Greece, August 2015.

■ The closure of Greek banks and the introduction of capital controls have contributed to the emergence of a shadow banking system in the country's real economy. Money under a mattress, in safe deposit boxes or transferred abroad during the past months will not easily return to accounts whose holders cannot know if a bail-in soft option may have to be implemented in due course.

The four systemically important banks in Greece will have to prepare for a rigorous stress test by the European Central Bank (ECB) in autumn 2015. The necessary scrutiny of lenders' balance sheets, their level of reliance on deferred tax assets, non-performing loan dynamics and the consequences of higher funding costs because of their months-long reliance on ever-rising emergency liquidity assistance all mean that these banks face a confrontation with some rather uncomfortable truths.

Whatever policy recommendations or restructuring obligations may emerge from the ECB's stress testing exercise, the four largest lenders would be well advised to start planning today. Their list of prior actions could include calls for capital increases, demands for portfolio restructuring, downsizing their branch networks, further selling of non-core assets and possibly merger or resolution obligations. In short, today's Greek banking landscape looks set for a major overhaul leading into 2016.

Whenever the capital controls are terminated, such a development would not immediately suggest that Greek banks are fit for purpose. The optimistic assumption that domestic lenders will rush to re-open the spigots of lending to the real economy in order to maximise available funds from the proposed 35 billion euro investment package will not square with reality on the ground.

The European investment scheme is massive and includes front-loading available resources through commercial banks. But the potential intermediary institutions such as the *European Investment Bank* (EIB) or the *European Bank for Reconstruction and Development* (EBRD) will not soon enter into contractual relationships with domestic lenders whose capital basis is uncertain and whose balance sheets display increasing signs of deteriorating asset quality.

Greek banks do not match their euro area peers in terms of direct exposure. But the harm they could do to the real economy in Greece should not be underestimated. In view of declining trust in financial institutions, their operational capacity will be hindered by underlying balance sheet legacies and tested by domestic challenges concerning the future architecture and mandate of Greek banks.

7. »Grexit«'s sword of Damocles as an impediment to economic recovery

The risk of a Greek exit from the single currency has been a recurring theme since 2012 when the country witnessed back-to-back general elections. But the Grexit scenario has taken on a completely different dimension since the *Syriza*-led coalition government of Prime Minister Alexis Tsipras came to power in January 2015.

Two unprecedented developments have reshaped the euro narrative and possible exit scenarios. For one, members of the so-called Left Platform faction of Greece's governing Syriza party have publically embraced the option to return the country to the drachma and increase state control of the real economy.

Second, after months of inclusive and frequently highly divisive negotiations between the new government and its international creditors, the Grexit risk moved from an option to an outright recommendation at a euro summit in Brussels in July 2015.[10]

The proposition of a »time out from the euro area« was first voiced as a »Plan B« option by Slovenia.[11] It became an official policy recommendation from the German finance minister Wolfgang Schäuble during the meeting of euro zone finance ministers in Brussels on 11–12 July 2015. The Netherlands, Slovakia, Finland and the Baltic states were reported to have endorsed the proposal, while France, Italy and Cyprus were adamantly opposed to it.

10. The former Greek finance minister Yanis Varoufakis in fact argued against Greece's decision in 2001 to join the single currency.
11. Slovenia first put forward the idea of a Plan B for Greece in April 2015 during a contentious meeting of euro area finance ministers in Riga, Latvia.

The willingness of senior Syriza representatives and various euro zone finance ministers to publically entertain the option of Greece leaving the euro zone in exchange for debt reduction has let the genie out of the bottle. But the Schäuble proposition was not new. The German finance minister made a similar proposition to his then Greek counterpart Evangelos Venizelos in September 2011. The proposal was rejected outright by the latter, while the former could not garner any support for it among his euro group peers.

A taboo has now been broken in terms of the irreversibility of euro area membership. More importantly, for the first time member states of the euro area have used the exclusion threat against another member as a negotiating tool. From a fringe idea it has become a mainstream policy option. The strategy of taking negotiations to their limit – and possibly beyond – will be remembered by other euro area members in the future.

Lost in the whiteboard debates about Grexit risk are the potential economic consequences and social costs. But the losses would be dramatic for the real economy and its citizens. A new currency would have to devalue immediately. Some predictions go as far as a devaluation of 70 per cent against the euro. This staggering depreciation would mean an immediate fall in living standards and disposable income for the local population.

Given the import dependency of the Greek economy shortages in areas such as construction goods, energy supplies, pharmaceutical and food products would quickly appear. The introduction of a new currency on the back of a five-year recession and deep budget austerity would risk turning Greece into a de facto failing state, perpetuating an already existing humanitarian crisis. It would take years to repair the damage to the social fabric and economic infrastructure.

Finally, the experience in Argentina in late 2001 is instructive. Argentina defaulted on USD 93 billion in sovereign debt towards international creditors and subsequently abandoned the pegged currency regime between the local Peso and the US dollar. But activating this default option and introducing the currency changeover created long-term uncertainty over the legal status of Argentina's accumulated debts, be they private, corporate or sovereign.

More than a decade later, Argentina still has not regained access to international bond markets as a sovereign debtor. Litigation with private bondholders is ongoing in various jurisdictions, particularly in federal courts in the United States. The cautionary lessons for Greece concern the risk of becoming a financial pariah in Europe and having fewer options at its disposal to stimulate a domestic recovery of the real economy.

Moreover, a wave of litigation from creditors and suppliers must be expected. The Greek authorities are ill prepared for such a long drawn out legal battle on various international fronts. In short, the near-term economic and social calamities are considerable and the longer-term consequences of Grexit are unknown. It is a high-risk strategy to test this proposition in practice.

8. Defining a sustainable growth agenda in Greece

Addressing the problems with Greece's political economy entails a long 'to do' list. The fight against tax evasion and corruption is pivotal. The economic and labour market outlook for the remainder of 2015 remains bleak. The social situation of Greek society is appalling in many respects.

Depending on which side of the fence one prefers to sit, more optimistic or pessimistic versions prevail. The biggest concern – irrespective of one's position – is that any economic improvements will not translate quickly into tangible results and benefits that are experienced first-hand by citizens and businesses.

Moving out of an economic depression to a level of stabilisation takes time, including setbacks. In terms of private consumption the domestic economy remains compressed. The 2015 budget forecast a further decline by 1.2 per cent. Soaring unemployment risks further stretching the patience of Greek society in general and the individual perseverance of its citizens in particular.

The process of simultaneously overcoming a fiscal crisis and a severe economic recession is long, arduous and fraught with political battles and high social costs. Breaking the cycle of austerity and economic contraction is critical in that respect.

Without a massive investment programme from various European institutions this vicious cycle cannot be broken in Greece. Nor can the authorities in Athens do the heavy lifting in terms of mobilising the necessary financial resources for such large-scale investment programmes.

It is thus one of the few pieces of good news to emerge during the first half of 2015 in Greece that the London-based *European Bank for Reconstruction and Development* (EBRD) in March announced the launch of a five-year investment programme in the country. The volume of funds pledged are in the range of 500 million euros per year.

They are primarily earmarked for SME lending and equity investment in sectors such as logistics, agriculture and tourism. It will be interesting to see whether the EBRD will also invest in Greek banks in the context of their forthcoming recapitalisation. In 2014 the EBRD took a 5 per cent stake in the *Bank of Cyprus* as part of a 1 billion euro capital raising effort. But going forward with such potential commitments is subject to Greece staying in the euro zone and implementing the third financial assistance programme agreed with its international creditors.

The four »Rs« of a Greek Growth Agenda

Some analysts (for example, El-Erian, 2012) have argued that it takes »four Rs« to fundamentally reshape and redefine Greece's economic agenda. These are: *recapitalisation* (of banks), *rehabilitation* (of public expenditure), as well as *restructuring* and *recovery* (of the economy).[12]

All four components of this R-chain have deteriorated in Greece since early 2015. Recapitalisation of domestic lenders is back on the agenda, for the second time within two years. The fiscal state of affairs is dire as a result of the return of recession, the introduction of capital controls and the lack of any investment component, private and public.

12. During the past decade Greece has had no shortage of domestic and international policy recommendations that detail how and why a new growth agenda or even model is necessary. See, for example, Porter (2003), McKinsey (2012), Hellenic Republic (2014) and IOBE (2014).

Defining a multi-year growth agenda for Greece comprises a mixture of sectoral and horizontal policy interventions.[13] The proposals tabled here emphasise macro-economic challenges and argue the case for structural reforms.

Political will to move in that direction and sustain it against those who want to defend the status quo as rent seekers is paramount. The interventions will require government policies that include ambitious analytical tools and new mechanisms of enforcement and impact evaluation.

Such an endeavour will put further demands on a Greek bureaucracy weakened by decades-old administrative deficiencies, clientelism and the effects of massive expenditure cuts in the civil service since 2010.

Given this challenging point of departure before a new growth agenda is implemented in Greece reform domains must be identified and prioritised. This undertaking is fraught with obstacles, not least backsliding in the implementation process or unintended reform outcomes. But these challenges are not an argument against developing an ambitious agenda. The policy regime must:

- be embedded in the long-term debt sustainability of the country's public finances; this includes eliminating tax exemptions, scrutinising public expenditure and civil service reform;

- mobilise public and private investment capacity, with a particular focus on access to finance for SMEs; in order to secure financing joint action is required by the Greek authorities and European institutions, including the Commission, the *European Investment Bank* (EIB), the EBRD;

- supporting social cohesion and active labour market policies; this includes means-tested benefits, training programmes, job placement initiatives for young unemployed people, lifelong learning activities and so on;

- targeted sectoral interventions in which Greece can maximise its competitive advantages:

13. I am grateful to Antonis Kamaras for sharing his reflections with me on this subject.

  – a strategic shift in tourism to expand the season and connect the sector with other industries, such as medical tourism, infrastructure expansion in eco-friendly tourism and so on;

  – exploitation of renewable sources of energy, optimisation of the energy mix, broadening regional energy cooperation such as TAP (*Trans Adriatic Pipeline*);

  – in agriculture a renewed push towards export markets is essential in categories such as dairy products, olive oil, selected fruits and vegetables;

  – Greek underperformance in the production and utilisation of generic pharmaceuticals is striking; here is a major market opportunity for import substitution;

  – Greece's financial services industry has established a large network of subsidiaries and branches across southeast Europe. While its position in Macedonia, Serbia, Albania, Romania and Bulgaria is consolidated, the Greek financial sector is not yet a major player in Turkey (with the notable exception of *National Bank of Greece* and its Turkish subsidiary *Finansbank*).

The restructuring and recovery of the Greek economy stands at a crossroads. What direction the country, its society and economy want or need to take is vibrantly being discussed among stakeholders and interest groups. The deliberations are influenced by the demands and expectations of Greece's international creditors.

Our contribution to this public dialogue is the attempt to sketch out what some of the elements and conditions of a growth agenda for Greece could look like. This can be summarised in terms of the following five cornerstones and their subcategories:

(i) As long as domestic demand remains stagnant and investment compressed, export-led growth cannot form the basis for economic recovery. Paramount are targeted policy interventions supporting an international business culture for Greek companies within the framework of a *national export strategy.* Greece needs to enlarge its export base in terms of both the number of exporting businesses and the type of products it exports. An export promotion strategy for Greek goods and services is critical.

(a) To illustrate the task at hand with a telling example: Greece has a high-value product in abundance, which it fundamentally underutilises in terms of export capacity, namely olive oil. Greece is the third-largest olive oil producer in the world. It exported 60 per cent of its output to Italy in bulk in 2011. Italy then converts this olive oil with its own production and sells it as extra virgine, product of Italy! This procedure »allows Italy to capture an extra 50 per cent premium on the price of the final product« (Daley 2012).

(b) Increasing commodity exports as a share of annual GDP would be a quantitative objective within such a revitalised export orientation. That includes reducing the number of days it takes to receive export licences and complete the administrative export process from the current 19 days to single digits (Milonas and Athanassopoulos, 2013: 19).

(c) Other export options include financial services, in particular through the network of banking subsidiaries that Greek lenders have successfully established over the course of the past two decades in southeast Europe. However, any gains made in the past are increasingly constrained by the operational and regulatory uncertainties that the parent companies currently face in their home market.

(d) There are, however, various Greek listed companies that successfully export their products to dollar markets and have registered significant revenue growth because of the favourable shift in the exchange rate of the euro against the US dollar. *Kyriakidis* (marble mining), *Ellaktor, GEK Tern* and *J&P Avax* (construction), *ELVAL* (aluminium) or *Kleemann Hellas* (elevators) are examples of vibrant export-oriented companies that continue to gain market share and contracts abroad.

(e) A national export strategy must also be complemented by enlarging the capacity for import substitution. Such an approach cannot be exclusively the result of the multi-year recession, which has compressed imports because of the breakdown of consumer demand. Some initial examples of targeted import substitution are starting to appear in various sectors, for example, in domestic food production, financial services and »buy Greek« advertising campaigns. But we should refrain from any short-sighted optimism. A coherent and coordinated import substitution strategy has yet to materialise on the Greek horizon.

(ii) The taxation climate for **doing business in Greece** is in an endless cycle of change and reform. Some layers of red tape are starting to be removed. Legal restrictions are being curtailed. The OECD (2013) acknowledged as much in its competition assessment of Greece. But it also emphasised that overcoming barriers (for example, in sectors such as retail, tourism, food processing and building materials) remains work-in-progress in Greece. The ever-changing tax administration and the rising tax burden for companies in Greece is proving to be a disincentive to either launching a business or maintaining the capacity to operating one.

(a) It is essential that the finance ministry in Athens engages in a solutions-oriented dialogue with local tax offices and corporate representatives about the suffocating levels of taxation and the rising administrative complexity of collecting due revenue.

(b) Predictability of tax administration over time is key in this respect. The arbitrary nature of changes to the tax code every six months are counter-productive and only further raise institutional confusion. Codifying and simplifying tax legislation and implementation regulations[14] would be a huge boost to facilitating production incentives and export orientation, in particular for SMEs.

(c) Over 400,000 tax cases remain pending in Greece's administrative courts. VAT cases stand out, with an average resolution time in courts of 9.3 years (SEV, 2014). The toll these

14. The World Economic Forum (2013) publishes an annual competitiveness survey based on interviews with company executives. The focus is on the regulatory burden in 148 countries surveyed. Greece's position in the 2013 report was 144th. Among the European countries surveyed, only Italy ranked lower, at 146th. What concerns Greek and foreign investors most is the random nature of the process in terms of timing and new tax or regulations levied. The capacity for companies to plan ahead for investment and job creation is not facilitated by such arbitrary decision-making on the part of political and regulatory authorities.

waiting periods have on private households and enterprises in terms of missing liquidity is staggering. Improved opportunities for the extra-judicial resolution of such tax cases remains a paramount reform requirement in Greece.

(d) According to the General Secretariat of Public Revenue Greek firms wait an average of almost 300 days for their VAT refund applications to come through. In mid-2014 the total amount owed by the state in VAT refunds reached 883 million euros (ekathimerini 2014).

(e) VAT refund delays are part and parcel of the rising total payment arrears which the Greek state is accumulating towards third parties, most of which are exporters. In September 2015 arrears had reached 5.3 billion euros, equivalent to over 3.2 per cent of annual GDP. By not paying domestic suppliers, delaying VAT refunds or withholding investment expenditure various Greek governments have used creative accounting for their budgeting. But they are also perpetuating the liquidity shortfalls of domestic businesses.

(iii) Any growth agenda for Greece will have to include maximising existing and mobilising new funding avenues and access to specialised financing facilities. In 2014 the Greek authorities succeeded in increasing their absorption of available EU Structural Funds to unprecedented levels. A total of 87.97 per cent of all funding – equivalent to 3.6 billion euros – was absorbed in 2014, putting Greece in the top three countries in the EU. Because of the Syriza government's inexperience or incompetence in managing complex EU funding programmes, Grexit risk and capital controls the absorption level in 2015 is in danger of declining considerably.

(a) The *National Strategic Reference Programme* – the EU financing framework for Greece for the period 2014–2020 – offers specific crisis-related opportunities. Combined with financial assistance and technical expertise from European multilateral institutions, such as the EIB, the EBRD and the *Council of Europe Development Bank* (CEB), initiatives need to be implemented to support SMEs, particularly with working capital and in expanding their export orientation.

(b) In June 2013 the EIB signed an agreement with three Greek and three foreign banks, making available 500 million euros in cross-border trade facilitation. The trade finance arrangement includes the EIB providing foreign banks with appropriate guarantees in favour of Greek banks for letters of credit and other trade finance instruments.

(c) In early 2013 Germany's public investment bank KfW signed an agreement with Spain's ICO Bank to grant Spanish SMEs financial assistance of roughly 1 billion euros. Such a targeted credit scheme for SMEs would also be most welcome in Greece. But in order to qualify for such a lending facility Greece would have to establish a state financing body.

(iv) The formulation of a comprehensive *SME policy framework* for Greece with the inclusion of all stakeholders. Consultation is essential, in particular when designing a needs assessment and recommending priority actions that have input from SME organisations. Such a policy framework would have to be integrated into the wider public debate about Greece's economic stabilisation and growth agenda.

(a) An SME policy framework needs the in-depth cooperation of public authorities and private sector entrepreneurs. This public–private consultation process extends to implementation capacity for agencies tasked with utilising financial engineering instruments provided by EU funding programmes. After an extensive and hitherto unprecedented consultation process with all major stakeholders in July 2013 the *Hellenic Bank Association* (HBA) submitted a report on how to improve access to finance for SMEs in Greece (HBA 2013).

(b) The SME policy framework needs a clear prioritisation of sectors that are seen as growth clusters, based on indicators such as job creation potential, growth outlook, export orientation and a focus on product innovation. Such a comprehensive and inclusive approach must also give added impetus to reaching out to and cooperating with research institutes and university networks in Greece, public and private. The development of new products and services by SMEs needs the pro-active involvement of and interaction with innovation centres that exist in Greece, for example, at the public *University of Volos* or the private *Alba Graduate Business School* in Athens.

(c) Public–private partnership networks for sustainable SME development in Greece cannot circumvent the delicate issue of finding ways and means to gradually move away from a grant mentality and reduce assistance dependency. EU funding instruments and national top-up capacity remain important and necessary policy tools. But the reliance on such instruments risks cementing incentive structures that fail to match such funding facilities with resources mobilised more strongly from the private sector.

(d) A comprehensive SME policy framework also needs to give added emphasis to the growing and increasingly insurmountable tax burden of SMEs in Greece. According to the World Bank Doing Business 2015 report Greece was among eight countries out of 189 surveyed that increased (!) the tax burden for SMEs in 2013/14 (see World Bank 2015).

(v) Attracting investment funding requires private financing resources and synergies from available public European sources. Encouraging new business ventures in Greece requires formulating, promoting and executing an investment-led growth agenda. But domestic and foreign investors are reluctant to commit resources in a country whose solvency is frequently uncertain, where Grexit risks persist and elections are a recurrent means to solve political problems.

(a) Getting on the radar screen of (foreign) investors is currently a difficult task in Greece. Apart from the tourism sector, the challenge consists in moving up asset managers' priority list of investment destinations. It is not in Greece's interest to become a prime location for bottom-feeding foreign investors and speculative hedge fund managers.

(b) Attracting foreign direct investment remains a work-in-progress in Greece. Since 2011 no privatisation programme has enjoyed broad-based support in the Greek parliament, and more generally in Greek society. Improving the quality of the investment climate in the country remains paramount. According to the World Bank's 2015 Doing Business report, Greece is ranked 26th out of 28 EU countries. Only Croatia and Cyprus are ranked lower by the World Bank (2015).

(c) A coherent communication strategy to promote an investment-led growth agenda has yet to take root and win over a majority of Greek citizens. In the view of many Greeks the various privatisation programmes are nothing more than selling off the family silver at knockdown prices rather than auctioning off state-controlled companies or providing longer concession rights to manage and modernise state infrastructure assets.

(d) Potential foreign investors need to be given the »red carpet treatment« rather than the »red-tape nightmare« that they still encounter or hear about in Greece. Simplification of licensing requirements, reducing the amount of time and signatures necessary to register a business or subsidiary and clarity in tax administration are key elements of such an agenda.[15] The work of the *Invest in Greece* agency and the creation of an *Investors' Ombudsman* in May 2013 are steps in the right direction of such red carpet treatment.

(e) The World Bank is currently providing technical expertise to various government ministries and regulatory authorities to substantially improve the country's ranking in its annual Ease of Doing Business report. The 2015 edition ranks Greece in 61st position, improving from last year's 72nd place among a total of 189 economies surveyed by the World Bank with regard to business regulations for domestic firms (World Bank 2015).

15. The quotations are from the Minister of Development Kostis Hadzidakis (see Smith 2013). Attracting FDI and making sure that investors stay for the long term is creating innovative incentive structures in Greece. The Greek parliament passed a law in early 2013 that provides five-year residence permits to non-EU citizens who are prepared to purchase real estate property anywhere in the country in excess of 250,000 euros.

(f) In some indices Greece improved considerably compared with a year ago, such as starting a business (36th) and cross-border trading (52nd). The World Bank report noted with satisfaction that the Greek government in 2013/14 introduced a simpler type of limited liability company and abolished the minimum capital requirement when starting a business and registering it with the authorities (page 74).

(g) But Greece is still the lowest-ranked country among euro area members in the annual World Bank report. Much remains to be done to fully accommodate FDI and improve Greece's image as a business destination. Vested interests and rent-seeking mentalities of powerful pressure groups are pulling against economic reform. Oil refining and fuel distribution continue to be in the hands of cartels. Areas such as dealing with construction permits (66th), contract enforcement in the judicial system (98th) and registering or transferring a property without the obligatory presence of a lawyer (161st) highlight the flip side of regulatory reform requirements in the World Bank Doing Business 2015 report.

These different work streams form the cornerstones of a sustainable growth agenda in Greece in the years to come. But they cannot provide instant success. Rather, in taking root they will only bear fruit in the medium term and by overcoming sustained opposition from special interest groups bent on preserving the status quo and rent seeking.

Any economic recovery programme will have to make a fundamental switch from focusing on fiscal austerity and belt-tightening measures to sustainable growth and job creation. Until then the Greek economy may continue to be characterised by low growth levels, persistent high unemployment, deflation and sovereign debt levels that limit public borrowing and investment.

9. Bringing the diaspora Greeks »on board«

Among the widely dispersed millions of diaspora Greeks in Australia and Canada, as well as in the United States, the United Kingdom, Switzerland and Germany there are many well educated, internationally experienced citizens who are more than willing to do their share of supporting the reform efforts in Greece.

Although many have pursued successful careers abroad and have entrepreneurial roots in their adopted countries they are prepared to come back to Athens, Patras or Thessaloniki. In their luggage they bring back the determination to take part in an unprecedented challenge for Greek civil society, namely overcoming the stigma of their home country as the »sick man« of monetary union and the repeat offender of fiscal profligacy.

This reverse migration back to Greece seeks to repudiate the stereotype that the business ideas of Greeks can only prosper abroad, while at home they face discouraging hurdles. In addition, diaspora Greeks are far less attached to party political polarisation and ideological tags.

Let us explore a number of examples to illustrate what kind of initiatives can emerge under such testing conditions. The first is directly linked to the country's sovereign debt crisis. The non-profit NGO *'Greece Debt Free'* is the combination of two initiatives by Greek citizens in the United States and Greece.[16] Together they have established an alliance that seeks to buy outstanding Greek government bonds that are being traded on secondary capital markets.

Once they have bought the bond they hand it over to the Greek debt management agency PDMA in the form of a donation. Through this arrangement the PDMA – and by extension the finance ministry in Athens – can retire the bond and therefore subtract it from the accumulated public debt. To date, the joint initiative 'Greece Debt Free' has managed to purchase sovereign bonds totalling 3.12 million euros and retire more than 2 million euros' worth of Greek sovereign debt.

16. For further information on the organisation of Greece Debt Free and their modus operandi see http://www.greecedebtfree.org.

It goes without saying that such volumes cannot change the profile of accumulated public debt in Greece. They are too small and it is not the leading objective of those supporting the initiative. But 'Greece Debt Free' does tell us something about the wealth of ideas und the willingness of Greeks abroad and at home to join forces and work towards innovative solutions that appeared highly unlikely to materialise just a few years ago.

The second example concerns *The Hellenic Initiative* (THI).[17] The defining principle of THI is to mobilise the Greek diaspora as an investment community across a variety of countries. The THI is a global, non-profit, secular institution whose vision is to marshal the Greek diaspora and philhellene community to support sustainable economic renewal for Greece and its people.

This alliance of Greeks, primarily located in the United States and Germany, focuses its activities on the promotion of economic issues and seeks to lend practical expertise for investment projects driven by the corporate Greek diaspora.

Both outreach initiatives have much in common in terms of their objectives and solidarity for the country of their ancestors and children. They point to a new capacity-building exercise of the Greek diaspora.

These activities are most welcome and illustrate the understanding of its participants that their contribution from afar is urgently needed. This manifestation of a can-do spirit by members of the diaspora needs to be taken advantage of more regularly in Greece by political and regulatory authorities.

But there is also a flip side to this line of argument. Many members of such private initiatives among the Greek diaspora, in particular younger citizens, share a deeply seated lack of trust towards any state intervention or hijacking of their ideas, creativity and joint activities. Their spirit of innovation and willingness to join forces is frequently paired with a widespread hesitation, if not reluctance to engage in cooperation with Greek ministries and public institutions.

17. For further information on the Hellenic Initiative see http://www.thehellenicinitiative.org.

Keeping a distance from the Greek political establishment implies for many members of the organised diaspora avoiding state capture by political parties and functionaries whose reservoir of trust has been eroded.

This defensive positioning is not without its critics. The flip side of this is that returning diaspora Greeks are sometimes viewed as well-intentioned citizens who nevertheless have not experienced first-hand the drama of the crisis and the ensuing social costs for their brethren in Greece. In occasionally not so-veiled criticisms some say that the community of diaspora Greeks has so far not had to share the burden of salary cuts, pension reductions and escalating tax levies.

Put otherwise, the economic crisis has had an impact on the Greek diaspora. Established political affiliations are changing for those abroad. A sense of responsibility to contribute goes hand in hand with keeping distance from state authorities. In particular fourth generation Greeks living and working in Germany are challenged by the deteriorating state of bilateral relations.

What is nevertheless striking is the lack of outright incentives or tangible initiatives being offered by various Greek governments since 2010 to activate the investment spirit and cooperation capacity of many members of the diaspora.[18]

To illustrate, no Greek government to date has considered the introduction of a diaspora bond for those Hellenes willing to invest in such a security from abroad. Such an investment facility is regularly used by Israel and even the euro area member Italy regularly issues such diaspora bonds.

Investing political capital in the mobilisation of diaspora Greeks is an opportunity that risks going to waste when it is most urgently needed. Make them an offer they can't refuse! The inclusion of the diaspora Greeks in the public reform debate may yield fresh ideas, a can-do attitude and improve bilateral relations in their country of choice.

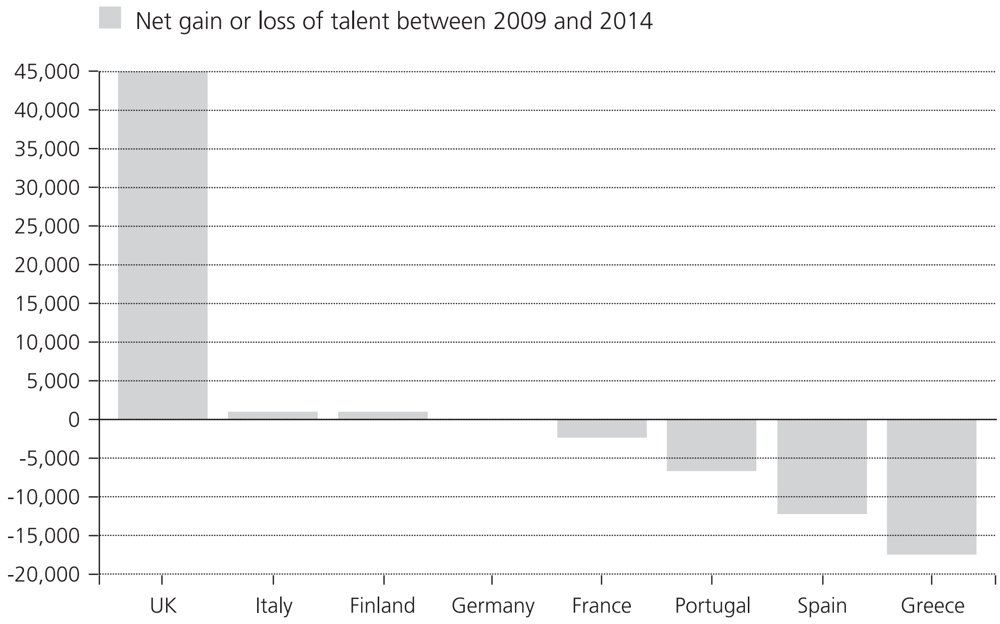
18. Both predecessors to PM Tsipras had personal ties to the Greek diaspora after experience abroad. PM George Papandreou (PASOK) was born and raised in the United States, while his successor PM Antonios Samaras (New Democracy) studied there. By contrast, PM Tsipras has never lived, studied or worked abroad.

10. Should I stay or should I go?

Any realistic growth agenda for Greece will also have to address the challenge of curtailing the country's relentless exodus of highly educated professionals and scientists. Rephrased in political economy parlance, the loss of human capital which the Greek labour market has witnessed in the course of the past five years is staggering.

Since 2010 Greece has turned from a country of net immigration into an economy whose citizens are heading towards the exit signs (see figures 9 and 10). In the early 1990s Greece became a country where people from Albania, Romania, Serbia and Bulgaria migrated after the start of the transformation processes in these countries. Moreover, ethnic Greeks from the former Soviet Union saw new opportunities to settle in the Hellenic Republic, particularly after the adoption of the euro in 2001.

Figure 9: Brain drain in the crisis years: Greeks depart on an odyssey for jobs



Source: Eurostat 2015

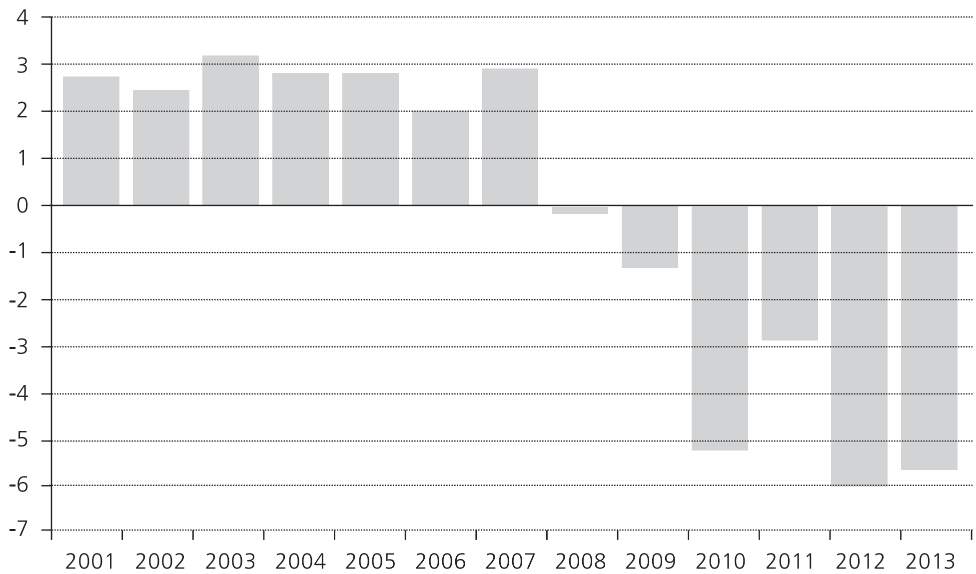
This inward migration stream has fundamentally changed since 2008. Greece is now a place which its own citizens are leaving behind while we are also witnessing return migration to the neighbouring countries as a result of the multi-year recession. More specifically, an estimated 135,000 Greeks with post-secondary degrees have left their homeland since 2010 and are working abroad. An estimated 40 per cent of these new, younger labour migrants are working or seeking work in Germany.[19]

This observation leads us to the conclusion that while Greece's exports are stagnating in material terms, the country's real economy is in fact unintentionally succeeding in other export areas, namely qualified labour, through continuous and increasing emigration. In light of Greece's battered economy citizens of different ages, gender and educational background are voting with their feet in droves.[20]

The continuous loss of human capital includes representatives from the corporate sector, entrepreneurs and start-up companies who are taking their labour and business ideas abroad, not least for the fact that they lack domestic funding opportunities from commercial banks as well as timely licensing requirements. Reversing this brain drain appears under the current circumstances almost impossible.

Without a multi-year investment programme and job creation prospect it is difficult to argue the case why a young, multi-lingual computer scientist, a nurse or a banker with 15 years of experience in corporate lending should stay in Greece instead of leaving.

Figure 10: Greece crude rate of net migration



Source: Eurostat 2015 - The ratio of net migration during the year to the average population of that year, expressed per 1,000 people

19. According to ELSTAT from 2010 to the end of 2013 about 218,000 Greeks emigrated. The traditional destinations are Germany, Austria, Switzerland, the United Kingdom, Canada, the United States and Australia. But Greeks are also seeking new opportunities abroad in destinations such as Qatar, South Africa and Hong Kong. For more details see Angelos, 2015.

20. By contrast, no EU country has had to accommodate a greater number of legal and illegal migrants from the Middle East and Africa than Greece. In the first six months of 2015 alone, according to the UN, Greece was the single largest point of entry for 68,000 migrants heading to Europe.

11. Conclusions

With *Syriza* winning the general elections in Greece in January 2015, a left-of-center party came to power in a euro zone member state that was determined to change fiscal austerity. However, in a fundamental over-interpretation of the mandate it received from the Greek electorate, Syriza focused on altering the entire playing field for European economic policy.

Such gamesmanship was bound to be rejected first-hand by other member states of the euro area and European institutions, such as the Commission in Brussels, the ECB in Frankfurt and the ESM in Luxembourg.

Syriza's attempt to illustrate that the narrative of TINA[21] politics has its limits and can be transformed has manifestly failed on the ground in Greece. It has also been delegitimised wholesale by the small-minded and naïve manner in which the Greek government of PM Tsipras sought to advocate it among its European peers. This experience has made the question of whether there are any feasible policy alternatives available near impossible to answer. While many agree that the euro area needs a counter-narrative to the German-led policy of fiscal rectitude, its conceptual formulation and real-time implementation is in short supply. The negotiation strategy of Greece's ruling Syriza party has not contributed to the positive identification of such a counter-narrative.

Put otherwise, the Syriza-led government in Athens has received very little in return for its misguided efforts to stand against the European economic and fiscal orthodoxy. The bitter confrontation with the country's creditors has left Greece's left-wing government isolated inside the euro zone. Moreover, PM Tsipras now needs to champion a set of policies mandated by the international creditors he was initially elected and had pledged to oppose.

The Grexit risk remains on the policymaking agenda. It has been established as a threat or negative sanction that can be mobilised at any time. Crossing this red line also renders any vision of what the euro area stands for rather null and void. Notions of solidarity as a defining principle of the European project are now subject to root-and-branch re-evaluation. The single currency is in the process of being downgraded into nothing more than a reversible fixed-exchange rate mechanism, devoid of any unifying ulterior objectives.

In other words, the vision of the single currency as a grand political project, a view frequently heard in Paris, but less so in Berlin, has been called into question. Any strategic benefits for Europe as a whole are now taking a back seat to manifest national economic self-interest. The German-led economic Weltanschauung or orthodoxy prevails in the euro zone. Those questioning or even challenging the parameters of this political economy worldview do so at their own peril.

Efforts to preserve Greek membership in the common currency union come at high political costs, given that cleavages between north and south, large and smaller countries, lenders and debtor countries, euro area members and EU-only members have only deepened in the course of the past months.

It will take time for this inconvenient truth to sink in and to understand its medium-term consequences. The earlier all the stakeholders involved speak the truth to their people about this development the better for all concerned in the euro area.

The issue of Greece's debt sustainability and short-term repayment obligations towards international creditors will continue to focus attention on the magnitude of this double challenge. The accumulated debt burden chokes off any optimistic assumptions of an economic recovery in the near term. Three successive financial assistance programmes for Greece have »turned an unmanageable private debt into an unpayable institutional debt« (Parker, 2015).

Given this point of departure, maintaining the existing repayment burden on Greek sovereign debt deprives the real economy of urgently needed liquidity, investment capacity and innovative potential. Continuing to lecture Greece that it has to »deliver« or finish its »homework« only perpetuates a five-year cycle of self-reinforcing economic decline.

21. TINA stands for »there is no alternative«, an expression used on many occasions by Margaret Thatcher and used again by German Chancellor Angela Merkel in the Bundestag when arguing in favour of adopting the second financial assistance package for Greece (the German version is »Es gibt keine Alternative«).

It also increases political instability and leads to enormous social costs among Greeks. Citizens on both sides of the bailout debate have suffered severe economic and social hardship. They are both wrestling with the consequences of this »homework« demand.

As for the recovery prospects of the recession-ravaged economy, any outlook beyond 2015 is currently extremely difficult to identify, let alone project. The task of defining a new reform agenda in Greece will not work in a Grexit scenario. Nor will it have any chance of succeeding if the focus remains on near-term fiscal tightening, illusionary primary surplus targets and Greece remaining in a sovereign debt trap.

The debate about alternative macroeconomic approaches is in full swing in Athens, but has yielded little in terms of substance and light at the end of the tunnel. Against this disillusioning background, the conclusion of a third macroeconomic adjustment programme for Greece in August 2015 underlines the degree to which the country remains in intensive care and thus on financial life support for the foreseeable future. The price Greece has been paying since 2010 to remain in the euro is enormous and rising in economic, social and political terms.

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About the author

Jens Bastian is an economic analyst with Macropolis (www.macropolis.gr). Between 2011 and the end of 2013 he was a member of the European Commission Task Force for Greece based in Athens.

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Friedrich-Ebert-Stiftung
Athens Office
Od. Neofytou Vamva 4 | 10674 Athens | Greece

Responsible:
Nicole Katsioulis, Christos Katsioulis
Directors

Phone: +30 210 72 44 670 | Fax: +30 210 72 44 676
www.fes-athens.org

Email:
info@fes-athens.org

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