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An Assessment of the Implementation of Greek Economic Policy in the Context of the Euro Crisis

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1. Aim

This paper outlines the causes of the severe imbalances and high debt loads of the government of Greece, which have become a threat to the country's solvence and the stability and possible survival of the European Monetary Union. Then, it reviews the adjustment measures in Greece to the Euro crisis. Some negative lessons from public sector adjustment in Greece are drawn and positive policy measures are proposed.

2. The causes of the economic crisis in Greece

It is essential to understand what caused the crisis in Greece. It is important to deal with the often heard argument that Greece's problems are due to its membership in the European currency union and the use of the Euro. This argument is false. The fundamental cause of the fiscal crisis has been the tendency of its politicians to spend consistently more money than they raised through taxes so that they ran fiscal deficits that had to be financed by selling bonds.

This deficit spending had its roots in the politicians' practice of buying votes through the provision of benefits to interest groups while avoiding the loss of votes by passing on the cost to future generations unable to vote in current elections rather than rasing income through higher taxation and/or more efficient tax-collection here and now. This process is a well known one in public choice theory.

The adoption of the Euro in 2001 was expected to end deficit spending and with it these political cycles since the politicians could no longer order its central bank to buy its bonds with newly printed money. The low interest rates brought by the Euro may actually have encouraged it. This unexpected development is explained by the failure of financial markets to demand a higher risk premium on Greek bonds. One explanation of this puzzle is that the world's credit rating agencies failed to down-grade Greek debt as they were expected to do in the light of Greece's deficits and debt. As a result, lenders using the information about Greece's credit worthiness in deciding to buy the country bonds continued to demand interest rates that were too low in light of the risks they carried. Why did this happen? The answer to this question was that the prevalent belief that European countries would never let one of its neighbours go bankrupt and provide all needed assistance to prevent such an event.

In 2009 the budget deficit exceeded 15 per cent of GDP. Greece became both illiquid and insolvent. However, the initial adjustment programme in 2010 treated Greece mainly as illiquid, that is, unable to meet its current debt repayment obligations. It did not treat (as it should) Greece as insolvent, that is, unable to repay its debt in the long run. The “long run” came as early as within a year (by the end of 2011), by which time the adjustment programme was “re-adjusted”. The financial markets kept panicking despite attempts to “ringfence” Greece. An immediate consequence of the events of the recent years was the record fall in consumer confidence. There was a sharp decline in the number of applications for new consumer loans. In 2008, new loans to consumers amounted to some 800,000 (a total of 9 billion Euros). In 2009 new loans dropped to 380,000 (some 3.6 billion Euros) to reach an all –time low of 50,000 loans with a value of approximately only 0.5 billion Euros in 2011. The most generous debt forgiveness package in world history that followed in February 2012 seems to have averted a European crisis though the final outcome is still uncertain amidst emerging concerns for Spain and Italy (Tzannatos, 2012).

3. The structure and evolution of the public sector

Employment in the public sector increased from 264,000 in 1970 to 824,000 by 2009, equivalent to 4 per cent per annum. The Greek public sector has undoubtedly been over staffed. During that four decade period, employment in the private sector increased, from 3 million to 3.8 million - an annual growth of less than 1 per cent. Self employment remained practically unchanged at around 1.7 million. Greece was at the top among OECD countries in terms of employment growth in the public sector.

The uncontrolled expansion of employment in the public sector had implications for its internal structure, which was transformed to satisfy personal ambitions more than operational needs. Compensation of government employees as a percentage of GDP was practically the same in Greece in 2001 as in the Euroarea, at around 10.5 per cent. By 2009 the Greek share had gone up to 13.4 per cent, while it remained practically unchanged in the Euroarea.

4. Public sector reforms and their effects

The scope of the adjustment programme has left untouched practically no area of economic, labour and broader social policy. Practically all ministries and agencies have reduced wages and employment in an attempt to bring the public wage bill from 13.4 per cent of GDP in 2009 closer to 9 per cent in 2012 (The First Adjustment Programme for Greece, 2010). This has to be done through various measures, including the following:

•the reforms aimed to bring the wage and benefit structure in the public sector closer to the private sector.

•increase in the working week from 37.5 to 40 hours and reductions in overtime payments;

•introduction of part-time public sector employment and unpaid leave;

•reduction in benefits for various activities;

•the total reduction in public sector employment should be 150,000 employees by 2016 or 26 per cent of total employment in public sector.

•introduction of a "one hiring for 10 departures" rule for 2011 and "one hiring for every five departures" for 2012-2016;

•transfer of excess staff to a labour reserve paid on average at 60 per cent of their wage;

•reduction in benefits for state-owned companies;

5. Pensions

There are about 2.9 million pensioners in Greece in 2012 (against an employed labour force of around 4 million). Of them 2.3 million were previously workers in the private sector. The number of pensioners who were former civilian workers in the public sector comes to nearly 600,000 in November 2011. In 2001 the ratio of active civil servants to pensioners was 4:1; in 2011 this ratio was down to almost 2:1.

Pensions and broader social security related payments absorb 24 per cent of the government budget (2010) of which one-third (8 per cent of the budget) goes to pensions paid to former civil servants. Public pensions are on average 2.6 times higher than private pensions. The pension reforms include:

•immediate reductions in pension levels for current beneficiaries;

•increase in pensionable age, less generous determination of pension levels;

•reductions in pension among those who voluntarily retired early;

•the retirement age was raised to 67 years. The required years of contribution for a full pension were raised from 37 to 40 years.

The ability of the pension funds to meet future payments has been adversely affected by the recent Private Sector Involvement (PSI) in public debt restructuring. The haircut resulted in a significant loss to the social security funds of 54 per cent of the 24-30 billion euros they held in government bonds.

6. Designed reform programmes in health care

The health sector was among the most prominent of those included in the adjustment programme. The programme included cost reductions in the area of pharmaceuticals and many institutional changes. The adjustment programme aims to create savings of more than 2 billion euros by 2015 (The First Adjustment Programme for Greece, May 2010).

7. Unemployment, social protection

Unemployment has grown massively as a consequence of the recession.The total number of unemployed has increased by more than 600,000, reaching nearly 1.2 million that corresponds roughly to 25 per cent of labour force at the end of 2012 compared to less than 8 per cent in 2008.

The Bank of Greece (2012) is reported that the 13.4 per cent of GDP spending on pensions contributes to 19.3 per cent to poverty reduction while the 14.5 per cent dedicated to all other forms of social spending contributed to reduce poverty by only 3 per cent.

As part of the 2nd adjustment programme of February 2012 the government reduced the gross monthly minimum wage in the private sector that had been collectively agreed between employers and workers organizations in July 2010 (that is, after the initial adjustment programme was agreed between the Government and the Troika).

8. Concluding remarks and policy implications

Understanding the causes of Greece's fiscal problems is essential for the design of policies that will enable other members of the Euro-zone from experiencing the same problems in the future. One cause was the failure of credit rating agencies to down-grade their ratings and the willingness of private buyers of Greek bonds to accept low interest rates. These failures of rating agencies and lenders are attributable also to the general euphoria about financial and economic conditions and a very strong global economic boom that existed for several years before 2008.

Although Greece has been labelled a "special case" among policymakers in Europe, its case may become "general" as the need for bailouts and adjustments may well be repeated (and soon) in some other countries located along the Mediterranean coast or among the more recent members of the enlarged EU that have economic and institutional characteristics similar to those of Greece.[1]

Politicians were either certain that cutting spending would eventually help the economy recover, or they had no idea of what to do to bring about recovery. But the answer lies in their own errors. Deregulation and the lack of effective competition policy created giant corporations which lobbied government and coerced political leaders into decisions that were beneficial mainly to big business. So policy had come to be formulated not by political representatives, or by their advisers or by experts, but instead, by corporate executives or their advisers.

The negative lessons from public sector adjustment in Greece, reflect a situation that needs to be transformed in accordance with the positive messages such as: employment adjustment should be based on competencies and needs, wage adjustment should be progressive, reforms should be decided after social dialogue, social services and poverty reduction measures should be preserved, public sector adjustment should not call into question the role of the public sector, (especially in productive investments), a social safety floor should be established for the protection of the poor and most vulnerable especially in times of distress and a long-term horizon should be adopted.

[1] Tzannatos (2012).

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