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IOBE's Yannis Stournaras: Optimistic, but cautious

## Optimism PASOK can get economy back on track

Amid a worsening economic climate and a host of mounting fiscal problems looming large, compounded by warnings from the European Commission and downgrades from some of the world's leading international credit ratings agencies, *Business File's* editor-in-chief Philip Pangalos discussed many of the key issues facing Greece's economy in an exclusive interview with Yannis Stournaras, Research Director of the Foundation for Economic and Industrial Research (IOBE). Apart from being a respected economist and Professor of Economics at the University of Athens, Stournaras boasts an enviable CV, with a plethora of academic and business achievements at the highest levels, despite his relatively young age. The interview was conducted on October 19, 2009.

*IOBE Research Director Yannis Stournaras sees the fiscal deficit as an absolute priority but is optimistic that the new PASOK government can eventually put the battered Greek economy back on a righteous path*

### **Q. What is your view of the current economic situation in Greece and how do you see prospects in the short-to-medium term?**

A. "The situation in Greece is, to a large extent, similar to that prevailing at the end of 1993. The economy is almost in the same situation. Political change from New Democracy to PASOK and difficult days, months and years ahead. But in that period, the fears of the pessimists have not been realized. Following rational economic policy, based on fiscal stabilization but also on specific measures for growth, the economy was brought to a path of virtue and finally made it to EMU. So the question is whether there

are forces today to repeat the same successful economic story. I'm optimistic, reasonably optimistic, but the situation is very difficult. Perhaps as difficult as in 1993."

### **Q. Do you think that the economic situation is actually worse than in 1993? I say this as the exceedingly high debt and deficit levels seem to have combined with other unfavourable characteristics, with Greece facing recession for the first time in 16 years and the so-called 'pensions time bomb' looming larger than ever.**

A. "I'm not sure. At that time, every day,

you had the fear of a devaluation – something that does not exist today because we have the umbrella of the euro. That saved us. If we did not have the euro, Greece now would be in a much worse position than Iceland is. Without the euro, and with the large current account and public sector deficits, we would have had a huge devaluation of

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the drachma and a massive reduction in growth rates and real incomes. The situation would have been very difficult, much worse than in Iceland. This is because Iceland is a very small, very rich economy. In Greece, we have many people below the poverty line, so the situation would have been very difficult without the euro. The euro protected the economy and the poor, despite what many people may think. Whatever the costs and the benefits (of joining the eurozone), the benefits are much larger than whatever costs, especially today.”

**Q. Looking at the fundamentals in Greece, after many years of strong economic growth – despite the fact that a lot of observers say there have also been many wasted opportunities, the country now seems to be slipping into negative growth with recession an inevitability. At the same time, fiscal deficits and debt levels are rising to frightening levels compared to what had been officially announced even a couple of months ago by the previous government. What do you think has to be done to deal with a series of economic ills and the country’s longstanding problems making progress with essential structural reforms? How is Greece going to curtail upwardly spiraling deficit and debt levels, tackle bureaucracy, improve transparency, and fight corruption and waste, as well as improving competitiveness and dealing with a host of other longstanding problems? George Papandreou has now been elected with a strong mandate, with fresh faces and a slimmer government that has initially received a positive response at home and abroad. Can his government really face up to the many real chal-**

#### lenges that the country faces?

A. “I am reasonably optimistic. I heard both the Prime Minister and the Minister of Finance (address parliament before winning the confidence vote that approved the new government on October 18). They gave me the impression that they are serious about the deficit. They can’t but be serious because otherwise the government is going to face problems in financial markets, the European Commission, and in the Council. The fact that Greece is ranked very low according to the OECD and the World Bank in the efficiency of markets and the efficiency of the public sector should be seen as an opportunity to take the necessary measures to improve the functioning of the economy and promote growth. Do not forget that these impediments have nothing to do with the welfare state; they are ‘corporatistic and clientelistic’ regulations imposed long ago. I’m referring to closed professions and interventions in markets, such as cabotage in cruising. Italy and Spain have abolished cabotage. We haven’t. We lose about 1 billion euros per year because of this. I think that this is much more than enough to compensate the families of seamen living from cabotage, and secure a large surplus on top. I wonder why the previous conservative government didn’t proceed with liberalising markets. PASOK now has the opportunity to do it, derive the revenue from this and the boost in growth to finance its welfare state.”

“You need at least four years to bring the deficit down to 3 per cent of GDP”

**Q. The two main parties that have ruled Greece in recent decades appear to have come closer in their economic ideologies, but as New Democracy faced opposition to certain reforms, do you not think that PASOK will also face resistance, especially as it made certain pre-election promises that may be hard to fulfill in these challenging fiscal times when things are very difficult and there are so many demands and expectations at a time when there is little money to spare?**

A. “Beyond any doubt, the absolute priority is the fiscal deficit. They (PASOK) will understand this very quickly, because if they don’t present a credible budget, then the punishment from markets will be very harsh. But I am sure

they will take the necessary measures. That’s my impression from talking to people (within PASOK) right from the beginning.”

**Q. Greece is not the only European country facing large fiscal deficits. How confident are you that the European Commission will give Greece more time to get its economic house in order? Greece seems to be indicating that it needs 3-4 years to hopefully get its deficit below 3 per cent of GDP. How feasible is this?**

A. “Realistically, you can’t talk about one or two, or even three years. You need at least four years to bring the deficit down to 3 per cent of GDP. It’s inconceivable that the Commission might insist on something less than this. Of course, it will impose its own terms according to the Treaty, but Greece for one more time has fallen short of its promises and targets.”

**Q. To what extent has Greece’s credibility been undermined or damaged by the fiscal audit undertaken by the previous New Democracy government and the fact that Greece has so often fallen short of previously announced targets that it has said it will meet and later revised for the worse. What will it take to regain this credibility and do you feel that there is any real danger that a future Greek bond issue could fail or that there could be a sell-off of Greek bonds or whether yield spreads could again spike compared to benchmark German bunds?**

A. “The sort of fiscal audit undertaken by the previous New Democracy government was, in my view, a serious mistake, without any moral or even political basis, and destroyed Greece’s image abroad. I do not fear a sell-off of government bonds, provided a credible budget and medium-term programme are presented. If this occurs, I think spreads will go down. If markets judge that measures are not credible, then spreads will go up. We’ll have to wait and see, but I’m optimistic.”

**Q. What do you see the main priorities as far as structural reforms are concerned?**

A. “The opening-up of markets, professions, the elimination of cabotage, the liberalization of the system of transport licences. We have the same number of licences as we had in the early 1990s. Since then GDP has more than doubled, so you can imagine how costly

transport is now with the same number of lorries. We are also facing a huge cost of bureaucracy - almost 7 per cent of GDP every year. A company needs to fill an incredible number of applications in its dealings with the state. This stands for ordinary citizens as well. This government can simplify procedures and thus reduce the burden of administration. What are the administrative steps that are needed? We must simplify legislation. It's a nightmare today. There's a long queue of pending issues that can be tackled and, hence, reduce costs. But we need time for this. We need at least three to four years to see the first results coming through. In IOBE, we have studied the structural and fiscal measures that need to be taken and presented them to the public last June."

**Q. Do you think the time is right now or are the circumstances there to allow for such changes? Do you think that ordinary Greeks understand this, especially those within the public sector, and will they be willing to go along with these changes? Will there be resistance, is there a danger of social unrest or strike action?**

A. "The government has said from the beginning that it will pursue these changes. The public is optimistic that the new government has come in with fresh people and ideas and will take the necessary measures to enhance economic performance. I don't think that small resistance groups are able to put impediments to these efforts."

**Q. What effect will efforts to streamline the public sector have on unemployment in Greece at a time when unemployment appears to be on already upward trend and the country appears to have been lagging other European countries in terms of the impact of the slowdown in economic growth?**

A. "Modernising the public sector will be good for employment. This is so because the main problems in the economy definitely lie with the public sector. This is the 'great patient', so efforts should start with curing the public sector: Modernizing, simplifying procedures, reducing expenditure, collecting taxes. I would call first on defence spending. Mr Papandreou seems to be very able in negotiating in the international arena for peace. He should try to achieve a mutual reduction in defence expenditure with Turkey. That would allow him to channel money elsewhere in the welfare state, mainly into education and alleviating



Modern thinker: IOBE's Yannis Stournaras

**"We must simplify legislation. It's a nightmare today"**

poverty. Health is a second area where spending cuts should be made. Thirdly, tackle tax evasion. We don't need to discover the wheel. Let's see what our partners in the European Union have done."

**Q. But everyone is aware of many of these problems and they have been talked about in the past. Many of these problems, such as bureaucracy and tax evasion, are embedded in many parts of Greek society. How easy will it be to make real progress now?**

A. "It will not be easy. But, if the beginning is credible and the government takes credible measures, as it happened in 1994, then the situation will improve very quickly. So the beginning is very crucial."

**Q. How confident are you that Mr Papandreou will meet many of the pledges he made about the first 100 days? I say this in relation to what recently happened with the Piraeus Port Authority and the 18-day strike by Piraeus port workers opposed to the proposed takeover by China's COSCO that has just ended and many say has damaged Greece's reputation internationally. What was behind this?**

A. "Yes, initial mistakes are sometimes unavoidable. However, only those who do not

act do not make mistakes! As you said, the strike is now over. That was a good example, as reality is sometimes different from what you thought or what you dreamt of when you were in opposition."

**Q. What do you think needs to be done to deal with Greece's beleaguered pensions system and the huge deficits that it faces amid worsening demographics with an ageing population and falling birth rates?**

A. "That's a big problem. The biggest challenge for Greece. I hope, that last night's (parliamentary addresses before the vote of confidence on the new PASOK government) pledge to take back (former labour minister)

Mrs Petralia's pension legislation will be withdrawn, since this legislation has many positive elements. The population is ageing quickly, so there is no way but to adjust the average retirement age limits. There's no way out of it."

**Q. Do you think that retirement ages will inevitably have to be raised?**

A. "On average, yes."

**Q. For everybody?**

A. "I think that the first step is for every Pension Fund to approach the parameters which are valid for IKA (Greece's largest Social Security Fund). Exemptions should be eliminated and everybody should face IKA's actuarial parameters. Let us test the system under this provision and if this turns out not to be enough, we should adjust the age limit for retirement appropriately."

**Q. Do you think that some form of supplementary private pension system, possibly aided by tax breaks, may be needed as some observers say?**

A. "I don't think that the question is moving from a pay-as-you-go to a fully-funded system. It has been shown that this has serious limits worldwide. What we should do is to rationalize the pay-as-you-go system that we have now and make it more efficient and viable. I don't think that moving from a pay-as-you-go to a fully-funded system will give us anything other than trouble. At best, it will be useless, at worst, it will be dangerous, because we don't have the sort of private sector insurance companies that can bear the burden that IKA or OGA (Agricultural Social Security Organisation) or other State Pension Funds are bearing. So, we

## Yannis Stournaras CV

Yannis Stournaras was born in Athens on December 10th, 1956. He graduated from the Department of Economics, University of Athens in 1978. He obtained his post-graduate degrees (MPhil 1980, DPhil 1982) from Oxford University, specializing in Economic Theory and Policy. He was Research Fellow and Lecturer at St. Catherine's College, Oxford University, from 1982 to 1986. At the same time he worked at the Oxford Institute for Energy Studies, specializing in the petroleum market and the consequences of petroleum crises on the global economy. Stournaras is Professor of Economics at the Department of Economics, University of Athens, which he joined in 1989. He teaches Macroeconomics and Economic Policy.

From 1994 to July 2000 he was Chairman of the Council of Economic Advisors at the Ministry of Economy and Finance. From 1994 to 1997 he was Vice Chairman of the Public Gas Corporation and a member of the Board of Directors of the Public Debt Management Office (from 1998 until July 2000).

From 2000 to 2004 he was Chairman and Chief Executive Officer of Emporiki Bank and Vice-Chairman of the Association of Greek Banks.

From 2005 to August 2008 he was managing director of Kappa Securities. In 2005 he was elected a Trustee of Gennadius Library.

Since September 2008, he is Research Director of the Foundation for Economic and Industrial Research (IOBE).

should be very careful. There are other useful in-between ways, such as the Swedish system of notional private accounts.”

**Q. Do you think that pensions should be linked to the contributions that individuals have made throughout the course of their working lives?**

A. “Yes, this is one of the necessary measures. We should also make sure that the average pension should rise by less than the average wage on which it is based, because the de-

pendency ratio, that is the ratio of those aged 65 and above to the working population, is rising very fast.”

**Q. Coming back to the fiscal deficit and the likely fact that it will take a long time to get deficits and the economy back on track, what more needs to be done to attract foreign direct investment back to Greece?**

A. “First of all, transparency, tackling corruption and less bureaucracy.”

**Q. Can you be more specific and give me some examples?**

A. “Yes. First, we should establish a genuine one-stop-shop doing all the necessary work (required by a foreigner looking to invest in Greece). Secondly, tax administration: There should be more centralized auditing other than being at the hands of every ‘DOY’ (local tax office) director, following the example of other countries regarding the way they audit the books of foreign (or even domestic) companies.”

**Q. Are you concerned following talk about the likely taxation of dividends and any negative effects this may have on investment?**

A. “Dividends should be taxed, as in other countries, as normal income. Today, they are not taxed as normal income, though, of course they are taxed at source with the tax rate on profits. The effort should be for all incomes, irrespective of their source, to be taxed in the same way, with few exceptions such as interest on deposits, since we need to encourage savings. The rule should be that all incomes, irrespective of source, should be taxed in the same way, according to the tax scale, taking of course all precautions to avoid taxing incomes twice. Today about 50 per cent of incomes in this country are not taxed according to the normal tax scale and this is one of the main reasons explaining why we don't have enough (tax) revenue.”

**Q. Staying with taxation and the mixed messages that were sent to international investors after the previous administration initially announced tax breaks and later went back this. How damaging is this kind of action as far as trying to attract foreign investment in Greece at a time of tight fiscal constraints and could it happen again?**

A. “Tax announcements are very important as international markets and international in-

vestors are following developments in Greece very closely, taking also into account that Greece needs foreign capital, especially direct investment. So the new government should be very careful in its first budget and the measures it is going to announce.”

**Q. In the banking sector and recent press reports, what are your views about a possible merger between some of the state-controlled banks, though this has been initially denied?**

A’ “I think this denial was very useful and proper. I see no obvious reason why state banks should merge among themselves. This is not a priority. What we need is more competition, better auditing, more transparency of books, an independent Capital Markets Committee and enhanced supervision by the Bank of Greece. Also, don't forget that international rules will become tougher: Banks will need more capital, and supervision will become more careful in order to avoid the kind of problems that we had up to now. We have to be more careful about the risks of various assets that banks have in their portfolios. Supervisors will check things more carefully from now on and the Bank of Greece should perhaps devote more people to supervision. We don't only need to check banks in Greece but also their subsidiaries in the Balkans. The situation there is still precarious.”

**Q. How concerned are you about Greek banks' exposure to the Balkans?**

A. “I'm relatively concerned, but I'm calmer now because international organisations stepped in and helped these countries. The situation has improved dramatically, but the Bank of Greece and the government should remain vigilant as to what's happening there and in making sure that banks have enough capital.”

**Q. Do you think Greek banks should maintain their exposure in the Balkans?**

A. “Yes, definitely. We should not pull out. These are countries with a large growth potential. We should not pull out because of today's risks, but we should be careful and have enough capital to cushion any potential trouble.”

**Q. Finally, on a personal note, have you been approached to take on anything else, beyond your current position at IOBE and the university?**

A. “I'm very happy with the position I have. I can combine research on economic policy at IOBE and teaching macroeconomics at the University of Athens. This cannot be superseded easily!” ✖