Time to get real and step back from the brink of disaster

IOBE Director General Yiannis Stournaras talks about the government's delayed privatisation plans, persistent talk of a debt restructuring and warns of the disastrous effects that would result from an unlikely return to the drachma

To sum up

Just one year after being forced to go to the European Union and International Monetary Fund for an emergency 110 billion euro bailout loan in order to avoid a sovereign default, Greece once again needs to convince its international partners to provide fresh funds. In an exclusive interview on May 24, the day after the government announced the long-awaited first wave of privatisations that may help restore confidence, *Business File's* Editor-in-chief *Philip Pangalos* spoke to Yiannis Stournaras, Director General at the Foundation for Economic and Industrial Research (IOBE), about many of the key issues facing Greece.

Greece is facing some of the biggest challenges in recent history as it teeters perilously close to the brink of bankruptcy. A string of harsh austerity measures and tax hikes have put the squeeze on most ordinary Greeks, while fiscal targets promised by the government in exchange for last year's EU/IMF emergency bailout loan have been missed and a return to international capital markets remains a distant dream. The government now hopes to convince its European peers that it deserves further financial assistance and more time to implement essential reforms after finally unveiling the first phase of an ambitious 50 billion euro privatisation and asset sale plan. *Business File* spoke to Yiannis Stournaras, Director General at the Foundation for Economic and Industrial Research (IOBE) and a Professor of Economics at the Athens University, about some of the key issues facing Greece and whether the country can do what is needed – even at the eleventh hour - to save itself from even more misery and eventually return to better days.

What do you think of the government's latest privatisation and stake sales measures that have just been announced? Are they too little too late and what do you say to those who argue that selling state assets now is equivalent to a fire sale as they will be sold at a very low level?

Privatisation measures have been announced with a delay. They should have been taken before, when the government realised that there

No alternative: Yiannis Stournaras says there is no real alternative for the government other than to implement essential reforms, as the alternative is the very real prospect of bankruptcy

was going to be a fiscal deviation, as early as February. And also, as far as privatisation is concerned, there isn't a single privatisation, despite the targets, until this month (May), which created the impression abroad and among our peers and in markets that Greece is not going to make it. There has now been an effort to recover lost ground, I hope this will continue. These measures are going to restore part of the lost credibility, not all of it, because the deficit will still not fall to 7.4 per cent of GDP this year as previously predicted. Our estimate is that it is going to be around 8.5 per cent of GDP, but it will still be better than last year. Without the measures, the deficit was going to be at about the same level as last year.

On the second part of your question, those arguments that say that assets being sold now have a very low value don't take into account that debt also has a low value in the second-

Eternal optimist: Yiannis Stournaras, Director General at the Foundation for Economic and Industrial Research (IOBE), says that Greece can make up for lost ground, tackle deficits and eventually return to sustainable economic growth

ary market. So, if Greece sells assets to buy back debt in the secondary market, it's a balancing act.

How confident are you that the government will be able to make progress on the privatisation and stake sale measures that have been announced given that there has been no real progress up until now? Also, do you expect opposition from within PASOK, as well as the opposition parties and the unions, who have so far strongly resisted these changes?

There are not many options left. The alternative is bankruptcy, so I suppose society understands that. So far, there has been the assumption that there is an alternative to these measures, but there isn't any, unfortunately. But I think rationality will prevail. If implemented, these measures will have an effect on this year's measures, but not enough to bring us back to the original target. So we will deviate from the original targets, but we will not fail completely, as that would be the case without the measures.

There has been a lot of talk from many leading economists and experts around the world that Greece's debt dynamics are unsustainable and some kind of debt restructuring cannot be avoided down the line. Do you agree? Can a restructuring be avoided?

There is no doubt that without assistance we would have already been bankrupt. So we wouldn't be talking about restructuring but outright default. Fortunately, we have the cohesion of the eurozone and the very strong position taken by the European Central Bank that no haircut and no restructuring will be allowed for bonds which are used as collateral by commercial banks financed by the ECB. So the only rational solution on the part of the eurozone is some form of Brady Bonds (named after former US Treasury secretary Nicholas Brady and were originally dollar-denominated bonds issued mainly to Latin American countries in the 1980s to convert loans into tradable new bonds after defaults), which means triple-A countries giving either guarantees or liquidity to the EFSF or the countries to outright buy back their debt. This is what we call a market-friendly restructuring. Any other restructuring has the risk of creating serious trouble for the banking system.

How concerned are you about the fact that there is growing resistance from many within the EU, especially Germany, as well as a tussle between the ECB and eurozone members?

I am very concerned, but this goes beyond Greece. This is related to the very existence of the eurozone. Greece is a small case. Suppose Greece goes bankrupt, who says the situation will stop there. There's going to be a huge domino effect that will start in the periphery of the European south, but then it is going to affect the core countries and even everyone else.

How about talk by some that Greece may be forced out of the eurozone?

That's rubbish. No one can force us to commit hara-kiri.

But what would happen, theoretically, if Greece did reintroduce the drachma?

It can't happen. Even the latest opinion polls show that more than 70 per cent of the Greek people are in favour of the euro. Those who want the drachma back simply don't know the consequences. Firstly, the financial sector would see public debt increase by the amount of devaluation because it is denominated in euros. Secondly, banks are going to find themselves with a big hole between assets and liabilities, so banks' capital would evaporate within seconds. This would be outright default and Greece would be shut out of international markets for a very long time. So any theoretical benefits from improved competitiveness from reintroducing the drachma would disappear long before that as the country would be bankrupt long before that.

Bearing in mind Greece's debt dynamics and the need for primary surpluses, do you fear that more austerity measures may deepen and prolong the recession and lead to even greater unemployment?

The initial forecast incorporated measures to be taken at this stage. They specified the targets but not the measures. The forecast on recession has turned out to be only slightly worse than initially predicted. Also, if you compare Greece with Ireland or Lithuania or Estonia, Greece didn't have the deep recession that these countries experienced. The problem with the revenue is not the problem of recession but is the problem of the mechanism of the Ministry of Finance.

Profile

Yannis Stournaras was born in Athens on December 10, 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, specialising 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 has been with the Foundation for Economic and Industrial Research (IOBE), initially as Research Director before stepping up to become Director General.

Here, at IOBE, we don't think the recession will be as deep as last year. So instead of -4.5 per cent last year, we think the decline in economic output will be around -3.5 per cent this year and a slight recovery in 2012. We see a sustained recovery, more than 1.5 per cent growth, after 2013.

Where do you see positive economic developments, such as from the tourism sector or exports, or benefits from the memorandum?

Exports and tourism have recovered. We've seen a reduction in consumption and in unit labour costs, which means improved competitiveness. Again, comparing Greece with Ireland, recession is very mild in Greece.

How concerned are you about social unrest in the future, especially as unemployment is above 15 per cent and youth unemployment is above 40 per cent?

I'm not very concerned, as so far people have shown responsibility. Unemployment is high and I don't disregard this, but given the huge magnitude of the problem of the real economy, this is not as bad as in Ireland or Spain, or the GDP fall in Ireland or Estonia, or in Argentina a decade ago, which went bankrupt because it had no financial assistance.

What needs to be done to deal with the still-bloated public sector?

I don't agree with layoffs. I would firstly cut bonuses and supplementary payments, as well as certain types of social expenditure, for example for people with substantial property assets who still get a lot of cash. But low income groups and pensioners should be excluded from further cuts.

What did you think of New Democracy's proposals at Zappeion II?

Definitely much more responsible than PASOK's proposal when PASOK was in opposition, but still falling below what is necessary.

Do you think there is any real hope of consensus between the two main parties?

I hope so. The country is just a step before bankruptcy.

What would early elections mean for the country?

We don't have time for elections. Time will be lost and money will be lost as well. It is better for the government to go on, even with resistance. The best thing is to have political consensus, at least on a platform of ten points that we have suggested in an article in last Sunday's *Kathimerini*, such as on the economy, education. There should be a minimum consensus between the two large parties.

If you were advising the government on what to do, what are the three most important things you would say to them?

Continue with privatisations and with the money earned you buy back debt from the secondary market. Negotiate, with the assistance of Samaras, to get the Community Support Framework's unabsorbed money and to frontload it and to backload the national participation. Thirdly, make a deal with New Democracy for universities to have elections of chancellors and chairmen of departments without the participation of students and create prototype schools using the old model in neglected areas with poor people. Reform education to build for the future.

> **"Those who want the drachma back simply don't know the consequences"**

How confident are you about the future of the eurozone, bearing in mind contagion has begun? Has it gone too far?

No, it hasn't yet, but it might go even further. But I believe in the rationality of the central banks and governments to use all weapons necessary to counterbalance this effect. That means use the EFSF, use the ECB, to buy back bonds and avoid bankruptcies.

Do you think that European voters and taxpayers are ready to give the additional support that will be needed?

If it is explained properly, that a negation to do that would imply the demise of the euro, I'm sure they will.

What implications would there be on the global economy from an unravelling or collapse of the euro?

There's going to be the drachma, the Portuguese escudo will get out, the D-Mark will appreciate, but there's going to be havoc in the banking system.

Would this be worse than the collapse of Lehman Brothers?

Definitely. It would be worse than Lehmans. The real economy would be affected dearly and it would take years before growth resumed in Europe.

Do you think that some kind of logic will prevail, even at the eleventh hour, among the powers that be, including the United States, to hammer out some kind of deal?

Yes, but we must show logic as well, not only our peers.