Jörg Asmussen: Exchange of views on the economic and social crisis in Greece

Introductory statement by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, to the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 27 March 2012.

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Responses to written questions on the economic and social crisis in Greece by several political groups within the European Parliament can be found on the ECB's website.

Dear Chairwomen,

Honourable Members of the European Parliament,

The organisation of this hearing once again illustrates to what extent the launch of the euro has brought about *economic* interconnectedness: in view of the strong implications for the stability of the euro area as a whole, putting Greece back on its feet is in the very interest of all of us. *Political* interconnectedness could also hardly be better demonstrated than today. Domestic policies have become European – which fully justifies to discuss them at European level, both in executive and parliamentary fora.

Why the Greek adjustment programme is unavoidable

The Greek economic adjustment and its social implications are painful: there is no doubt about this. The question, however, is: how did Greece get in such a situation and does it have any alternative? The major effort of adjustment reflects the severity of the macroeconomic imbalances that have accumulated over years in Greece. Misguided economic and fiscal policies, lack of structural reforms: all these policies undermined the sustainability of public debt and created a very large competitiveness gap. It is not the adjustment programme which is causing the recent decline in GDP. The current economic depression is an unavoidable correction of the substantial positive output gap that has built up until 2009.

Is there any alternative to the current adjustment? We do not help Greece by creating false expectations. Calls for loosening the fiscal stance are illusory. Greece could hardly face larger financial constraints than at the moment: it has lost market access and can only draw on a fixed envelope for official support. There is only one way forward: restoring fiscal sustainability and competitiveness, which will, in turn, bring back sustained growth. This requires perseverance: perseverance in carrying out fiscal consolidation; perseverance in implementing comprehensive structural reforms; and perseverance in addressing the weaknesses of the Greek banking sector.

The efforts undertaken by the Greek government and the sacrifices the Greek public endured so far have been substantial. But there is still a long way to go.

It is no secret that the programme is subject to exceptionally high implementation risks. The debt exchange operation has been successful, official financing has been scaled up. This has improved debt sustainability prospects: the estimated debt-to-GDP ratio could be brought to about 116½% in 2020. But this all depends on one key condition, namely that Greece fully implements the programme. Debt dynamics are extremely sensitive to implementation slippages. Delayed fiscal consolidation, lower privatisation proceeds or slower structural reforms: such scenarios would translate into weaker economic growth and worsen again debt sustainability. Without a regime-change in policy implementation and a much broader political consensus in favour of painful, but necessary reforms, there is a high risk that the programme derails. Therefore, political courage is more needed than ever.

Let me now comment in some more detail on three key areas: fiscal adjustment, competitiveness gains and financial sector issues.

Fiscal adjustment

The Greek authorities and the Greek people deserve recognition for the significant fiscal adjustment they have achieved over the last two years: despite the deep recession, the general government deficit was reduced by around 6½% of GDP since 2009 (from 15¾% to 9¼%). This broadly corresponds to the deficit reduction that was initially envisaged under the programme, *i.e.* before the 2009 deficit outcome was revised upwards (by 2.2% of GDP). This is a remarkable achievement.

Nevertheless, the size of the government is still too large compared to Greece's capacity to generate and collect fiscal revenues.

Moreover, the quality of the fiscal adjustment was mixed. On the one hand, important reforms have started to address Greece's high level of public wages and employment and the previously unsustainable pension system. On the other hand, fiscal adjustment has so far excessively relied on an increase in tax rates and across-the-board expenditure cuts.

Looking ahead, further progress in fiscal consolidation requires the implementation of difficult structural fiscal reforms. Closing the large fiscal gap for 2013–14 (5½% of GDP) will be a litmus test for the government's commitment to the programme: without the government's willingness and ability to design and implement the difficult structural fiscal reforms, such a large adjustment cannot be achieved.

I call on Greece's political class to push through these difficult reforms by confronting vested interests. Otherwise the critical mass of structural fiscal reforms necessary to close the medium-term fiscal gap may not be reached.

Finally, how can we make sure that the economic adjustment burden is being fairly distributed? I know that this is an important concern of the European Parliament. One essential avenue is the tax administration reform. Progress in this regard has been rather disappointing so far: in many cases, wealthy Greeks still contribute less than possible to the overall adjustment effort, partly on account of tax evasion. Strengthening revenue administration and fighting tax evasion are crucial. Not only are they needed to increase revenue; they could also improve the social acceptability of the adjustment programme.

Competitiveness

There has been some improvement in competitiveness under the first programme, but it fell short of what is needed: Greece still faces a substantial competitiveness gap. This largely reflects delays in the implementation of labour market and other structural reforms. Closing this gap, while remaining in the euro area, will require a more pronounced internal devaluation. How can it be achieved? How can we reverse the dramatic increase in unemployment? Reducing minimum wages in the private sector, removing rigidities in the wage-setting system: these are key elements of the strategy for accelerating the internal devaluation. They may not be popular, but there is no way around it if we want to create the basis for renewed competitiveness and employment growth.

This is not the only area where decisive action is needed. Labour market reforms must be complemented by a liberalisation of product and services markets, for example in closed professions. Political willingness is a key ingredient to overcome the resistance of vested interests in these areas.

Bank recapitalisation

Last but not least, Greece needs to address the situation of its banking sector. As a consequence of the debt exchange, most Greek banks are heavily undercapitalised. The programme envisages that banks deemed viable by the Bank of Greece will be recapitalised. Banks that are unable to raise capital in the market will be recapitalised with programme resources through the Hellenic Financial Stability Fund (HFSF). In contrast, banks that are deemed non-viable will be resolved. It is crucial that the €25 billion earmarked for these purpose as part of the first disbursement be used for the *swift* injection of capital into Greek banks (the overall envelope for bank recapitalisation and resolution amounts to €50 billion).

The recapitalisation strategy was designed to maximise private sector participation, while preserving the State's interests. The banks' shares acquired by the State in the recapitalisation process will have limited voting rights, but may still allow for upside returns to be shared between the State and private shareholders. Whenever possible, the private management of banks will be safeguarded.

The governance structure of the recapitalisation and resolution processes will be significantly enhanced. This became necessary owing to the very substantial amount of official financing that will be channelled through the existing Greek institutions, in particular the Hellenic Financial Stability Fund.

Conclusion

Let me conclude with a message of hope. Yes, the medicine is bitter, but the patient can and will recover if he follows the prescription. Looking at successful past experiences of fiscal adjustment in other European countries shows that this is not a lost battle. However, an absolute prerequisite for the adjustment to succeed is strong political ownership. The Greek people are not reforming their economy and their state to please the troika; they are not carrying out sacrifices to please country X or Y in the euro area. They are going through this adjustment process for their own good. Maximum political ownership should therefore be expected and is key.