# John Iannis Mourmouras: The EU crisis – EMU, Brexit, the migrant crisis, and Greece

Intervention by Professor John Iannis Mourmouras, Deputy Governor of the Bank of Greece, at a Panel Discussion with former Fed Chairman Paul Volcker on the euro crisis, organized by OMFIF, Washington DC, 18 April 2016.

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*Views expressed here are personal views and do not necessarily reflect those of the Bank of Greece.*

Let me begin by saying how delighted and honoured I am to participate in such a gathering of distinguished central bankers and policymakers here at the Metropolitan Club in Washington DC, most pre-eminently among them, former Chairman of the Federal Reserve Paul Volcker, a giant in the world of central banking and public affairs over the last forty years. For this, I would like to thank David Marsh and the OMFIF Advisory Board for inviting me.

## A. On Europe

### *1. On the incomplete architecture of EMU*

I will restrict my comments today to the incomplete architecture of EMU, Brexit and the migrant crisis and I will refrain from remarks on current European monetary policy since the ECB's quiet period – as I was told last week – applies to deputy governors too; and coming Thursday (21/4/2016) the ECB Governing Council meets in Frankfurt.

Partly as a result of the crisis in the euro area and Europe's relative global decline, the EU is currently finding it difficult to manage events even in its own neighbourhood (see the unfolding migrant crisis). The fog of uncertainty has become thicker on the other side of the little pond, also due to the migrant crisis and the British referendum. The time has now come for the European Union to take bold action.

A plethora of policies and reports have been put forward to propose solutions to the euro crisis, from the Europe 2020 Strategy, the European Semester, the Six-Pack, the recently established "Structural Reform Support Service" specialised in technical assistance for Member States to assist them with implementing growth-enhancing administrative and structural reforms, the introduction of national Competitiveness Boards or even an advisory European Fiscal Board and, last but not least, the Five Presidents' Report for completing Europe's Economic and Monetary Union. Of course, these are all very nice acronyms and welcome ideas and proposals, but have yet to be tested in practice.

All these initiatives reflect a shift towards more burden-sharing and this is undoubtedly very important and welcome news to me as a pro-European. The question of course remains how quickly Europe will complete its Economic and Monetary Union (EMU) – before it is really too late – and move, for instance, towards a common Deposit Guarantee Scheme, some form of sovereign debt mutualisation, or indeed put in place a Capital Markets Union. I would also like to see the ESM mutated to a truly European Monetary Fund in charge, among other things, of future debt restructurings in eurozone member countries.

There is not much time left. The time has come for change, and I mean the full completion of EMU. "Nothing endures but change" to quote Heraclitus, a 4th century BC Greek philosopher. As long as Europe adapts, it will survive. There is an old saying in Brussels that the European project only advances in times of crisis, and Europe's leaders have a tried-and-tested method of coming up with policy fixes only when asked to cope with emergency situations. I am pretty confident that this generalised crisis will not lead to Europe's unbundling, but will inspire it to introduce long-term changes to the foundations of the European integration project.

### *2. On Brexit and the migrant crisis*

A very brief comment on the migrant crisis and Brexit – the two hot topics in Europe today – that both have been addressed separately by panellists earlier. In my intervention I will explain how these two issues could be linked to create a real nightmare scenario. The migrant crisis has triggered a debate about security that may reshape the European Union. Following last month's terrorist attacks at Brussels airport which have hit the main arteries of the capital of the European Union (its airport and metro system), we see that the security threat is real if the integration of refugees and immigrants in the Western societies which host them is not successful. There are now mounting concerns and growing scepticism in host countries about the global terrorism threat (human shields) and how far this could go. For instance, an unexpected event might tilt the vote in the British referendum towards the 'Leave' camp, turning it into a single-issue referendum (that of security) and possibly leading to Brexit. Two shocks of this scale would be unbearable indeed. Coming at a time like this, Brexit could have disastrous effects for the European construction.

## B. On Greece

### *1. On what went wrong in Greece*

Taking over from Athanasios Orphanides and his earlier remarks on what went wrong in Greece, I would like to say a few words on that myself.

The dramatic rise in the unemployment ratio, which almost tripled from 9% in 2008 to 26% today, due to the free-fall in output (more than 25% loss of GDP, comparable only to the US Great Depression of 1929), the dramatic fall in living standards and valuations of assets (real and financial), the accumulation of another mountain of debt (private debt of €200 billion in just 5 years), the ongoing exclusion from the international capital markets and hence the need for a 3rd Memorandum – currently under way – makes it evident even to the layman that adjustment programmes in the case of Greece have failed, at least so far (Ireland, Cyprus, Portugal all needed only one MoU and recently successfully exited from it).

There are several reasons for that and I am quite certain that dozens of PhD dissertations will be written in future about the causes of Greece's Great Recession. I name a few: the initial-point argument (a huge deficit that required a bold adjustment effort); errors in the design of the programme that include the mix of adjustment measures (a greater reliance on tax increases than public spending cuts), the value of fiscal multipliers, etc.; the slow pace of implementation of structural reforms (due to a lack of programme ownership on behalf of Greek authorities, and this is our European lenders' view); the fact that Greece is a relatively closed economy and, hence, internal devaluation may contribute negatively, in net terms, to economic activity; and finally, the fact that debt restructuring in 2012 should have occurred much sooner, i.e. at the beginning of the first MoU in 2010 (the IMF view), etc.

On top of the above five reasons which are more or less commonly accepted, I would add a couple of extra – rather technical and more subtle – reasons on what went wrong in Greece. Firstly, as we know, fiscal consolidation took place through the targeting of a nominal variable, that of the overall fiscal deficit which is cyclical. Taking permanent austerity measures to reduce the cyclical deficit only deepens and prolongs a recession, it results in excessive austerity and over-taxation which is self-defeating (it raises less government revenues). Instead, the structural deficit should be the appropriate target variable, and the cyclical deficit would correct itself through the economy's automatic fiscal stabilisers, provided that growth-enhancing measures supplement fiscal consolidation {this is my FT article, January 2012}. Secondly, there is a certain misperception in the MoUs about how reforms would work in the economy. I identify three grey areas here: *Firstly*, reforms take time to unlock their growth potential and their results are also country-specific. A recent study by the OECD (2014) indicates that the above time period may extend to five years or more. *Secondly*, structural reforms work better and quicker when there is investment to take advantage of them and, more generally, demand in the economy, because the more the recession lingers on, the harder it is to get positive results by implementing structural reforms {see my WSJ article, March 2012}. An illustrative example from the recent Greek experience is the liberalisation in the freight transport industry in 2012. Despite the opening of the market which resulted in reduced freight transport charges, the industry did not grow as analysts had expected because of the recession and lack of demand in the economy. By contrast, the removal of cabotage restrictions in 2013 had a particularly positive impact on cruise-ship tourism in following years, because of strong foreign demand in this particular sector. *Last but not least*, as regards the sequencing of reforms, the appropriate strategy is: product market reforms come first and are then followed by labour market reforms (whereas in the case of Greek MoUs the exact opposite took place). {In my latest two-volume book "The Double Sovereign Debt – Banking Crisis", 2015) I explain all the above in more detail.}

## *2. On how to revive the Greek economy*

In response to Paul Volcker's earlier remark that Greece is a relatively small country and it wouldn't be difficult to achieve a turnaround of its economy, I would like to say a few words. Indeed, Greece is a small country, only accounting for 1.76% of the euro area's GDP [and just 0.38% of the world's GDP]. My own personal view on how to revive the Greek economy from its current stalemate is the following:

Firstly, it is imperative to stabilise expectations as soon as possible. Given the directionless economic governance of last year and the resultant huge cost of the economy's backtracking (capital controls, etc.), this could be achieved through the timely completion of the first review of the 3rd MoU, if possible yesterday! Then this could pave the way for the following benign steps, a sort of roadmap:

- Reinstatement of the waiver: that will release at least €5 billion from the current ELA programme (at 1.5% interest rate) to be channelled towards standard monetary policy operations (MRO) with zero interest charge, contributing to Greek banks' profitability.
- Debt relief negotiations from either of the two options on the table: the ESM plan or the IMF plan.
- The country then will be getting the "certificate" of the DSA, which will open the door to credit rating upgrades for Greek sovereign bonds, bringing closer the date of Greece's inclusion into the ECB's QE programme which will help towards a lowering of spreads for GGBs and the gradual return to international capital markets.

Secondly, an equal focus should be given to short- and medium-term growth prospects of the economy because there is evidence that by now recession in Greece has the characteristics of *hysteresis*, namely a persistent and long-lasting recession (and this is the long-run downside risk for the Greek economy). Let me explain. The initial, non-permanent (cyclical) effects of the recession have shifted into permanent, structural problems (lack of new physical capital due to disinvestment, depreciation of human capital due to both the skills deterioration of the long-term unemployed and the brain drain). To give you only one figure: in 2007, investment was 27% of GDP, whereas last year it was 12% of GDP, the lowest level since 1960. So very few would disagree that right now the country needs an investment shock within a new growth paradigm centred around the expansion of its export-oriented output base, aiming at internationally tradable goods and services with high value added.