Yannis Stournaras: Greece in Europe - reasons for optimism

Speech by Mr Yannis Stournaras, Governor of the Bank of Greece, at the Annual Stavros Niarchos Foundation Lecture, Yale University, New Haven CT, USA, 19 September 2019.

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Ladies and gentlemen,

It is a great honour for me to be invited to deliver the Annual Stavros Niarchos Foundation Lecture. The Hellenic Studies Program at the Yale Macmillan Center does an excellent job in studying and promoting contemporary Greek culture and history. In my talk today, I will first present the lessons to be drawn from the Greek crisis. I will then discuss the progress made in recent years and the outlook for the Greek economy, and highlight the crisis legacies and the challenges that lie ahead, both for Greece and the euro area. Finally, I will put forward policy proposals for addressing these challenges.

1. Overview and lessons from the Greek crisis

From 2000 to 2007, Greece experienced benign macroeconomic conditions characterised by high rates of GDP growth (well above the euro area average), relatively stable consumer price inflation and a gradually decreasing unemployment rate. The expansion was driven by rapid credit growth and low borrowing costs following financial liberalisation and Greece's EMU entry in 2001.

The Maastricht criteria for joining EMU were based solely on nominal convergence, and therefore failed to incentivise the structural reforms in the product and labour markets and in the functioning of the public sector needed to enhance real convergence, raise potential growth and safeguard the sustainability of public finances. On the contrary, employer and employee interest groups opposed reforms that would have increased competitiveness. Although Greece's GDP per capita increased during the boom period, approaching the EU average, the institutional gap relative to the euro area did not narrow. Thus, Greece continued to lag significantly behind its euro area partners in various indicators of governance and structural competitiveness.

The sharp deterioration of the fiscal and macroeconomic environment in 2008 and 2009, and the subsequent downgrades of sovereign debt and rising sovereign spreads, cut off the Greek sovereign and banks from international capital and money markets. Substantial deposit withdrawals and extremely tight liquidity conditions put strain on the banking sector. An EU-IMF financed economic adjustment programme was initiated in 2010, aiming to correct the imbalances.

The crisis has taken a heavy toll on output, incomes and wealth. Between 2008 and 2016, Greece lost over one fourth of its GDP at constant prices, and the unemployment rate rose by nearly 16 percentage points. Furthermore, GDP per capita at purchasing power parity declined to 67.4% of the EU average in 2018, down from 93.3% in 2008. To this, one must add the large increase of non-performing loans (NPL) ratio to about 50%, the large brain drain and massive underinvestment, with their immeasurable economic and social consequences.

The slide of the GDP growth rate into negative territory raised the debt-to-GDP ratio to unsustainable levels despite the fiscal consolidation, and caused debt-servicing problems for households and businesses. This was the main, but not the exclusive, reason why NPLs rose dramatically, weakening banks' asset quality, thus making it difficult for banks to finance the real economy. It took no less than eight years, three economic adjustment programmes, major debt restructuring and three rounds of bank recapitalisation to resolve the Greek crisis.

The length and depth of the Greek crisis can be explained by seven factors:

- First, the size and speed of fiscal consolidation were unprecedented. This primarily had to do with the fact that the initial fiscal and external imbalances were much higher in Greece than in other Member States under financial stress. In addition, emphasis has, on average, been placed, over the three adjustment programmes, more on tax hikes rather than expenditure cuts, growth-enhancing reforms and privatisations.

- Second, the fiscal multipliers turned out to be higher than initially anticipated, and the economy was soon caught in a vicious circle of austerity and recession.

- Third, the sequencing of structural reforms led to real wages declining more than initially expected, exacerbating the recession. In other words, the reform effort focused much more on the labour market than on the goods and services markets. Hence, nominal wages declined faster and more strongly than prices. Households experienced a massive drop in purchasing power, which, in turn, constrained personal consumption and deepened the recession.

- Fourth, the non-performing loans (NPL) problem proved very difficult to manage. Mainly the result of economic contraction, it was further exacerbated by legislative changes such as the blanket moratorium on primary residence auctions and the abuse of foreclosure protection, as well as several other legal and judicial impediments. With the benefit of hindsight, it could be said that a more dynamic response during the first years of the crisis, implementing the necessary legislative changes much earlier and introducing a systemic solution via a centralised Asset Management Company for NPLs as other Member States had done, could have reduced the problem we face today.

- Fifth, certain reforms fell behind the agreed time schedule on account of a number of factors, including: insufficient ownership of the necessary reforms; populist rhetoric, political rivalry; and the resistance of various vested interests to reform. This had serious consequences: the signing of a third economic adjustment programme, the introduction of capital controls mainly to stem the outflow of bank deposits, another bank recapitalisation round and two years of economic stagnation.

- Sixth, political deliberations in the euro area also played their part in delaying the recovery of the Greek economy. The Eurogroup decision of November 2012 to grant further debt relief was put off for several years and was only implemented in June 2018. This undermined the growth prospects of the Greek economy and prolonged the crisis. Had this form of debt relief been given at the beginning of the first economic adjustment programme, alongside the implementation of ambitious growth-enhancing structural reforms and an Asset Management Company to deal with NPLs, it would have had a more positive impact on the economy, possibly limiting output and employment losses.

- Seventh**,** when the Greek crisis broke out, EMU lacked the tools to prevent or contain the crisis. The Stability and Growth Pact (SGP) failed to control the build-up of public debt in the pre-crisis period. There was insufficient monitoring and control over macroeconomic imbalances, such as the evolution of the current account and private debt. The sovereign-bank “doom loop” amplified the financial crisis and the recession. Euro area crisis management and resolution tools were poor or non-existent on account of highly exaggerated concerns about moral hazard, and due to the lack of an appropriate institutional setting. There was no provision for risk-sharing in the initial EMU architecture. It was the ECB’s response, especially after mid-2012, which provided the time required for euro area governments to take the actions necessary to safeguard the stability of the financial system and strengthen EMU.

2. Progress since the beginning of the crisis

Despite the missteps, occasional backsliding and delays, significant progress has been made since the beginning of the sovereign debt crisis in 2010. The implementation of economic adjustment programmes has eliminated the root causes of the Greek crisis. More specifically:

· The achieved fiscal adjustment was unprecedented, turning a primary deficit of 10.1% of GDP in 2009 into a primary surplus of 4.3% of GDP in 2018 (according to the enhanced surveillance definition). The primary surplus in 2018 exceeded the programme target for the fourth year in a row.

· The current account deficit has been reduced by 12 percentage points of GDP since the beginning of the crisis.

· Labour cost competitiveness has been fully restored, and price competitiveness has recorded substantial gains since 2009.

· A bold programme of structural reforms was implemented, covering such areas as the pension and healthcare systems, goods and services markets, the business environment, the tax system, the budgetary framework and public sector transparency.

· The banking system has been restructured. Today only four systemic banks control over 95% of the market, as more than ten other banks were merged or liquidated. The role of the Bank of Greece was pivotal in the restructuring and recapitalisation of the banking system, the enhancement of its corporate governance and the provision of liquidity all over Greece during the crisis. Today, banks' capital adequacy ratios stand at satisfactory levels, and their loan-loss provisions are sufficient to address potential credit risks.

A number of important reforms have been implemented, aiming to provide banks with an array of tools for tackling the problem of non-performing loans (NPLs), including a strengthening of the supervisory framework, by setting operational targets for NPL reduction, the creation of a secondary NPL market and the removal of various legal, judicial and administrative barriers to the management of NPLs.

These actions have started to bear fruit, as shown by the continued reduction of the NPL stock in line with the targets set. Non-performing loans amounted to €75.4 billion at the end of June 2019, down by €31.9 billion from their peak in March 2016. However, the NPL ratio remains high, at 43.6% in June 2019.

As a result of the reforms implemented since the beginning of the crisis and the effort of enterprises to make up for declining domestic demand by exporting to new markets, openness has increased substantially and the economy has started to rebalance towards tradable, export-oriented sectors.

· The share of total exports in GDP increased from 19.0% in 2009 to 36% in 2018. Exports of goods and services, excluding the shipping sector, have increased in real terms by 60% since their trough in 2009, outperforming euro area exports as a whole.

· The volume of tradable goods and services in the economy increased cumulatively between 2010 and 2017 by approximately 14% relative to non-tradables in terms of gross value added.

3. The outlook for the Greek economy

Following the stagnation of 2015–2016, GDP growth returned to positive territory in 2017 (1.5%) and picked up to 1.9% in 2018. Recent real GDP data point to continued expansion in the second quarter of 2019 (1.9% y-o-y). Thanks to the improved economic conditions and to the reforms implemented since 2010, the unemployment rate, though still high, fell to 16.9% in the second quarter of 2019, from 27.8% at the end of 2013. Looking forward, the Bank of Greece expects that economic activity will remain on a positive growth trajectory, expanding by 1.9% in 2019 (that is by 2.3% year-on-year in the second semester of 2019) and above 2% in 2020.

The outlook is subject to downside risks, related both to the external and the domestic environment. The global growth and trade slowdown due to the imminent trade war could affect export growth more markedly, while the disorderly Brexit, geopolitical tensions and the recent increase in oil prices are further significant downside risks. A possible sharp correction in global capital and financial markets could increase the cost and reduce the availability of funding, particularly for the private sector. There are also downside risks on the fiscal front, associated with ongoing court rulings on pension cuts, which could weigh on debt sustainability. In addition, an exacerbation of the refugee crisis could hurt tourism and trade. However, there are also domestic opportunities, relating to a rapid implementation of structural reforms in Greece and the reduction (both direct and indirect) of the primary surplus fiscal targets. The fact that Greece still lags behind its peers and competitors in almost all indices of structural competitiveness, is a huge opportunity for a rapid catch-up which should be exploited.

4. Future challenges

Despite the progress made so far, major short- and medium- to long-term challenges and crisis-related legacies remain.

A) Medium- to long-term challenges

The main medium- to long-term challenges are the following:

· The high public debt (whose sustainability improved sign ificantly in the medium term with the measures adopted by the Eurogroup from 2012 to 2018) creates uncertainty about Greece's ability to service its debt in the long term, raising the cost of borrowing both for the public and the private sector, and hampering growth prospects.

· Greece's negative current account balance and large negative net international investment position.

· The high long-term unemployment rate, which generates inequalities threatening social cohesion and increases the risk of human capital erosion.

· The projected demographic decline (due to population ageing and outward migration), which exerts downward pressure on potential growth and puts at risk the long-term sustainability of the pension system.

· The slow digital transformation of the economy. Based on the Digital Economy and Society Index of the European Commission, Greece for the year 2019 ranks 26th among the 28 EU countries, which implies a high risk of technological lag and digital illiteracy.

· The multi-year recession has left an investment gap and risks permanently impairing the productive capacity of the Greek economy through a hysteresis effect. In more detail, gross fixed capital formation (at current prices) fell from 26% of GDP in 2007 to 11.1% of GDP in 2018. The largest proportion of this decline (10.1 out of 14.9 percentage points) is due to shrinking residential investment, which fell from 10.8% of GDP in 2007 to 0.7% of GDP in 2018.

· Fixed capital investment net of depreciation has been negative since 2011. Specifically, in 2018, net fixed capital investment amounted to roughly -€8.8 billion or –4.8% of nominal GDP. Positive net investment is a prerequisite, if the capital stock and thus the potential output of the Greek economy are to increase.

· Estimates by the Bank of Greece indicate that the net capital stock of the Greek economy (at constant 2010 prices) declined by €67.4 billion in the period 2010–2016, to €622.2 billion in 2016. In order to raise the net capital stock over the next decade to pre-crisis levels, gross fixed capital formation at constant prices needs to increase by about 10% per year. Excluding residential investment, which accounts for about 50% of the capital stock, gross fixed capital formation at constant prices needs to increase by about 5% per year by 2029. Although a business investment growth rate of 5% per year over the next decade is high, it is deemed achievable for the Greek economy based on historical experience, so long as suitable investment and business-friendly policies are pursued.

· Investments need to accelerate in order to bridge the investment gap in a timely manner and avoid the so-called hysteresis effect. As recently pointed out by the European Commission, Greece needs additional public and private investment in transport, solid waste and industrial sewage treatment, water supply, infrastructure and energy network connectivity, mainly between island regions and mainland Greece, in information and communication technology (ICT), and in innovation, education and training.

· Many of the above investments would align Greece's environmental protection standards with those of the rest of the EU, something particularly important given the risks of climate change. Addressing the challenge of climate change calls for coordinated efforts. Incidentally, the Bank of Greece has been playing an active role in this area through its Climate Change Impacts Study Committee (CCISC) and its various publications on the topic. Moreover, the Bank participates in the Central Banks and Supervisors Network for Greening the Financial System (NGFS), aiming to enhance the role of the financial system in managing climate and environmental risks, analyse the macro-financial impact of climate change and strengthen the global response to the threat of climate change.

B) Short-term challenges

Apart from the medium- to long-term challenges, the Greek economy also faces major challenges in the immediate future, which need to be dealt with as a matter of urgency:

· Greek government bonds have yet to regain investment grade status, despite the substantial decline in their yields after the new government took office and the recent successful issuance of a new 7-year Greek government bond at a yield of 1.9% with significant participation from foreign institutional investors. Recently, Greek 10-year government bond yields fell below 1.4%, and, what is even more important, the corresponding spread fell below 200 basis points. It is estimated that investment grade status could cut further the spread by 60 basis points.

· The Greek economy continues to face very tight fiscal and monetary conditions compared to all the other Member States of the euro area, which negatively affects its growth prospects and overall competitiveness.

- Primary surpluses in recent years have been very large. The high primary surplus targets and their systematic overachievement in recent years through the curtailment of public investment spending and high taxes have dampened the growth dynamics of the economy, reduced the competitiveness of Greek businesses, created a disincentive to work and invest, and caused tax fatigue, leading to a contraction of the tax base and an exhaustion of taxpaying capacity.

- The monetary policy easing by the ECB has indirectly benefited Greek businesses and households, but not to the extent that it would have, if Greek government bonds had been eligible for the Asset Purchase Programme (APP). The fact that all the other Member States enjoy much more favourable financing conditions for their businesses has an indirect negative effect on Greece's overall competitiveness.

- The high stock of non-performing loans (NPLs) impairs banks' lending capacity and increases lending costs. This is yet another reason, on top of the previous one, why Greek businesses continue to face higher financing costs than their European counterparts, which undermine their competitive position, despite the significant drop in unit labour costs following the wide range of reforms that were implemented in recent years. It is indicative that, according to the most recently available data, the average bank lending rate for businesses in Greece is still slightly below 5%, compared to slightly above 2% in the euro area.

· Up to now, the business environment had not been considered investment-friendly and in fact discouraged investment. Non-price competitiveness, so-called structural competitiveness, is low compared to Greece's EU partners. This is mainly due to high tax rates, weak public sector efficiency and delays in court proceedings and rulings. Here are some numbers:

- According to the World Economic Forum (October 2018)[1] Greece ranked 103rd out of 140 countries in Checks and Balances (which refers to budget transparency, judicial independence, efficiency of legal framework in challenging regulations and freedom of the press), 115th in Public Sector Performance (which refers to the burden of government regulation, efficiency of legal framework in settling disputes, e-Participation index, future orientation of government), 119th in Property Rights Protection (which refers to property rights, intellectual property protection and quality of land administration), and 119th as regards the Strength of Auditing and Reporting Standards.

- According to the World Bank's Doing Business Report for 2019, Greece ranks 132nd out of 190 countries in terms of Enforcing Contracts. Specifically, it takes 1,580 days for a case to be heard by the competent court of first instance and for the ruling to be enforced, compared to 582.4 days in the OECD high-income economies. Resolving insolvency takes 3.5 years, compared to 1.7 years in the OECD high-income economies. Thus, the recovery rate is 33.2% in Greece against 70.5% in the OECD high-income economies.

5. Policy actions to address short- and medium- to long-term challenges

The reformist policy agenda of the new Greek government, elected last July, is viewed positively by the international financial markets, as indicated by the rapid decline in Greek government bond yields, which, as already said, currently stand at below 1.4%. The government is swiftly implementing its planned investment and growth-friendly policies, which involve lowering business taxes and placing more emphasis on reforms and privatisations, as a means to address short- and long-term challenges and reinforce the credibility of economic policy. Meanwhile, the substantial improvement in budget execution, according to recently published Bank of Greece cash data, between end-June and end-August 2019, indicate that the primary surplus fiscal target for 2019 will be met. This should support the efforts of the Greek government to achieve an upgrade of government bonds to investment grade status by international credit rating agencies. Should this happen, Greek bonds would then be allowed to participate in the ECB's recently-enhanced Asset Purchase Programme (APP), and, therefore, to reap substantial benefits in terms of lower borrowing costs for the Greek economy.

To this end, economic policy should follow a three-pronged approach, aimed at:

(a) achieving the agreed fiscal targets;

(b) drastically reducing NPLs; and

(c) stepping up the pace of structural **reforms and privatisations.**

(a) Achieving the agreed fiscal targets

The fact that the new government immediately announced that it will respect the agreed fiscal targets is a welcome development. At the same time, in line with what the Bank of Greece has repeatedly stressed in recent years, the government is negotiating a reduction (both direct and indirect) of the primary surplus target with the institutions.

A lower, more realistic, primary surplus target compared to the current one of 3.5% of GDP through 2022, if combined with more reforms and privatisations, would probably imply lower, rather than higher public debt. This is so because, with a public debt-to-GDP ratio of 180%, a one percentage point-higher growth rate (likely to materialise if the lower primary surplus target is achieved through lower taxes and social contributions, combined with more privatisations and reforms) and/or 100 basis points-lower borrowing costs (already materialised, relative to the European Commission's baseline scenario) are 1.8 times more effective in reducing the debt ratio than an additional GDP percentage point of primary surplus.

The fact that government borrowing costs today are much lower than under the baseline scenario in the European Commission's debt sustainability analysis, provides leeway for easing the fiscal targets without compromising debt sustainability. Moreover, the Stability and Growth Pact allows for fiscal flexibility so long as additional reforms increase potential growth.

In a nutshell, there appear to be sufficient grounds for lowering the primary surplus targets and ample room for a compromise solution. In such a solution, primary surpluses could be lowered in exchange for an acceleration of reforms. The outcome will be a win-win situation for Greece, as well as for its EU partners, given that Greece will be able to return faster to a high growth path that safeguards fiscal sustainability and the repayment of bailout funds. Downside risks related to external factors also justify a reduction of the primary surplus fiscal target.

(b) Drastically reducing NPLs

Priority must continue to be given to reducing the high stock of non-performing loans (NPLs), which impairs banks' profitability and lending capacity and delays the recovery of investment and economic activity. As I mentioned earlier, the ratio of NPLs to total loans remains very high (43.6% in June 2019). According to the operational targets for NPL reduction, the aim is to bring the NPL ratio down to 35% by end-2019 and to below 20% by end-2021. Overall, despite the progress in this regard, the pace of NPL reduction has not been fast enough to bring the Greek NPL ratio close to the European average of 3.1% as of March 2019.

The activation of a truly systemic solution to the NPL problem, which resembles an Asset Management Company (AMC), would — alongside the banks' own efforts — be key for cleaning up the balance sheets of banks, for bank lending to increase and for investment to recover. After all, similar solutions have been implemented in almost all Member States under financial stress.

(c) Stepping up the pace of structural reforms and privatisations

Foreign direct investment (FDI) is necessary, as domestic savings are insufficient to match the investments needed for high growth rates. If Greece is to attract more FDI, it must speed up privatisations, which mobilise additional private investment, promote private-public partnerships in various sectors and focus on removing major disincentives, such as red tape; the lack of a clear and stable legislative and regulatory framework; an unpredictable tax system; weaknesses in property rights protection; limited access to financing and high borrowing costs, and delays in legal dispute resolution. The lifting of capital controls on September 1st is an important step towards attracting foreign direct investment.

In addition to helping reduce the investment gap, FDI promotes closer trade links with countries and companies with state-of-the-art technologies and facilitates participation in global value chains. This would increase openness and improve both the quantity and quality of Greek exports.

Greater emphasis must also be placed on improving public sector efficiency through the modernisation and digitisation of public administration and state-owned enterprises, with a redesigning of procedures and responsibilities, and the evaluation and development of staff capacities and infrastructures.

Legal certainty and clarity and a stable legal framework as well as the speedy and reliable resolution of legal disputes would be fundamental to strengthening the rule of law, improving the investment climate and accelerating economic growth.

Moreover, international experience has shown that robust economic growth is achieved by countries with good governance and strong, independent institutions.

Finally, it is necessary to strengthen the "knowledge triangle" (education, research and innovation) through policies and reforms that promote research, technology diffusion, entrepreneurship and foster closer ties between businesses, research centres and universities. Strengthening the knowledge triangle and ICT would lead to the digital transformation of the economy, an increase in the stock of knowledge and productive capital, the development of outward-oriented sectors and, more generally, to a knowledge economy and society.

6. The need to strengthen EMU

(a) Progress and remaining challenges

Greece belongs to the euro area and is directly affected by its economic and financial conditions. Hence, Greece has a very strong interest in promoting and supporting policies that strengthen the euro area economy. Policy makers around the world have learned their lessons from the Great Depression: a financial system in distress requires active central bank intervention. Thus, when the need arose, and in the absence of an appropriate policy response by the governments, the ECB stepped in decisively to restore market confidence, contain the sovereign debt crisis and support the euro area economy, by safeguarding price and financial stability. The ECB used the asset side of its balance sheet, as well as other tools such as forward guidance, in addition to its standard and non-standard interest rate policies. Given the success of these policies, some of these instruments will be permanently included in the new standard framework, as the effective lower bound will likely continue to be a binding constraint on interest rate policy in a low inflation, low interest rate environment. Indeed, earlier this month, following subdued inflation, a downward revision of inflation forecasts and weakening euro area growth, the Governing Council of the ECB decided to adopt an even more accommodative monetary policy with an even lower deposit facility rate, a new net Asset Purchase Programme (APP), more favourable terms for TLTRO-III and a new forward guidance.

Euro area governments took a number of necessary actions to safeguard the stability of the financial system and to strengthen EMU. Policy actions have focused on addressing institutional weaknesses, structural fragilities and excessive risk-taking that led to the sovereign debt crisis and the negative feedback loop between sovereigns and banks, which in turn undermined euro area stability. Other steps taken involved not only more effective regulation, but also higher capital and liquidity buffers for banks, early warning systems and the development of macro-prudential tools to increase resilience to potential shocks.

The eruption of the Greek crisis as well as the crisis in other Member States acted as a catalyst for key initiatives such as the provision of intergovernmental loans to Greece; the establishment of the EFSF (European Financial Stability Facility), and its successor the ESM (European Stability Mechanism). Other initiatives, which stemmed mainly from the world banking crisis, included: the creation of the Banking Union with the Single Supervisory Mechanism, the Single Resolution Mechanism and the – yet to be created – European Deposit Insurance Scheme; the introduction of stricter rules on banking regulation and supervision as well as the establishment of the European Systemic Risk Board (ESRB). Finally, the European Commission proceeded with the development of appropriate macro-prudential tools, which allowed for greater emphasis on identifying and addressing system-wide risks; the strengthening of the Stability and Growth Pact; the initiation of the Macroeconomic Imbalance Procedure and the European Semester.

As a result of the above initiatives, all Member States that had received EU-IMF assistance are now back on their feet, macroeconomic imbalances have been corrected to a large extent, and growth has been restored. Economic expansion in the euro area as a whole continues, albeit at a slower pace, and EU banks have become more resilient to financial shocks over the past two years, as reflected in the results of the EU-wide stress tests. Moreover, four additional Member States were admitted to EMU during the crisis years.

Despite the progress achieved so far, the euro area faces several challenges ahead. The recovery of the euro area from the financial crisis lags behind the recovery of its global competitors. This reflects weak productivity performance and a lagging behind in innovation and digital technologies. Population ageing and climate change raise serious concerns about the longer-term outlook of the euro area economy. Post-crisis, we have seen a halt in financial integration, which weakens private risk-sharing in the euro area. According to a recent IMF discussion note, and in accordance to what has already been said, businesses in Greece pay a 2.5 percent higher rate of interest on their debt than similar businesses in the same industry in France. Moreover, for every one percentage point drop in national GDP growth, consumption drops by 0.75 percentage points, on average, in the euro area Member States, compared to only 0.18 percentage points, on average, in the United States. Economic convergence in terms of real GDP per capita among the 12 old euro area countries (EA12) has stopped since 2010. Only the new euro area Member States have showed sustained convergence. Divergence has widened also in terms of unemployment rates and income inequality indicators.

b) Further policy steps to deepen EMU

Bold steps need to be taken to strengthen the euro area. In the financial sector, it is a priority to complete the Banking Union by creating the European Deposit Insurance Scheme (EDIS). The Banking Union will help to create a better integrated, more efficient and well-capitalised European banking sector. Coupled with the completion of the Capital Markets Union, a single rulebook for banks and capital markets, convergence in taxation frameworks, in capital market supervision, in insolvency procedures and with EU rules allowing pension funds and insurance companies to participate in long-term market investments, it can be expected to support the single market and to fund investment and growth. More developed and integrated capital and banking markets will reduce funding costs, improve the financing of the real economy by diversifying the sources of financing and facilitate private risk-sharing through the capital and credit channels. For example, as recently flagged by the IMF, if Greece were to improve its insolvency practices to best-in-class standards, it could reduce its businesses' average debt funding costs by about 50 basis points. More developed and integrated capital and banking markets will also support the international role of the euro through the creation of more integrated and liquid capital markets. However, we need to make sure that the expansion of the non-bank sector does not endanger financial stability.

Increased risk-sharing is highly desirable, but we should not forget that greater public risk-sharing is only possible with less, and not more, sovereignty. Risk-sharing, whether in the form of a safe asset, a central fiscal stabilisation tool, a fund to insure against unemployment, or a truly European deposit insurance scheme, should proceed simultaneously with risk reduction, such as the reduction of non-performing loans or national discretions in supervisory and resolution rules for banks. It is only in this way that we can transform what is in effect today in the euro area a non-cooperative zero-sum game into a cooperative, win-win one.

In addition, in a monetary union such as the euro area, the adjustment of current account imbalances should be as symmetric as possible. Not only Member States with excessive current account deficits, but also Member States with excessive current account surpluses should adjust.

Monetary policy alone cannot stabilise the economy. Fiscal policy should also be active in those Member States where fiscal space exists and public debt remains sustainable. In particular, the euro area urgently needs investment in new technologies in order to catch up with its competitors and investment necessary to face the challenges of climate change. Part of this investment will be public or in the form of private-public partnerships. Moreover, euro area Member States need to step up structural reform efforts in the labour and product markets to make them more flexible, which is necessary in a single currency area, and boost productivity, and to make public finances more robust. However, the sequencing of domestic structural policies is important: for instance, goods and services market flexibility is best achieved before, or simultaneously with, labour market flexibility. Otherwise, large real wage reductions might occur, which are unnecessary and undesirable both from an economic and a social perspective.

In the context of economic policy coordination and with a view to fostering real convergence, improvements should be made in institutional quality and good governance across euro area Member States.

7. Conclusions

Despite some missteps and delays in the implementation of the required reforms, Greece has made notable progress since the start of the crisis in 2010. The implementation of economic adjustment programmes has eliminated several macroeconomic imbalances. The economy is now recovering and has started to rebalance towards the tradable, export-oriented sectors. The Bank of Greece expects that economic activity will remain on a positive growth trajectory, expanding by 1.9% in 2019 (that is by 2.3% year-on-year in the second semester of 2019) and above 2% in 2020. The catching-up effect from a long depression is projected to counterbalance the negative effect of a global slowdown. However, significant challenges and crisis-related legacies remain (e.g. a high public debt ratio, a high NPL ratio and high long-term unemployment), while the brain drain and underinvestment weigh on the long-term growth potential.

In order to contain future risks and address the remaining challenges and crisis legacies, the government should implement its reform agenda as soon as possible. Moreover, the continuation of reforms is an obligation to which Greece is bound in the context of enhanced surveillance, as well as a precondition for the activation of the medium-term debt relief measures. Increased policy credibility through the implementation of reforms, the speeding up of privatisations and unblocking already approved investment plans will increase market confidence in the growth prospects of the Greek economy. An acceleration of NPL reduction through the adoption of a truly systemic solution will improve financing conditions for businesses and households as well as market confidence, and will accelerate investment and GDP growth.

The conditions described above will facilitate Greek government bonds regaining investment grade status, thus paving the way to the inclusion of Greek bonds in the ECB's recently-enhanced Asset Purchase Programme (APP). This, in turn, would further lower borrowing costs for the Greek economy, thereby boosting growth and improving debt sustainability. In such a benign scenario, growth rates higher than currently projected, above 3%, could be achieved through increased investment.

Last but not least, in order to enhance real convergence and strengthen the international role of the euro, we must take steps to deepen EMU. The only realistic way forward is to simultaneously promote risk-sharing and risk-reduction measures, to improve policy coordination and to make sure that economic rebalancing operates symmetrically.

I am optimistic that Greece, despite occasional failures and backtracking, having survived an acute and long economic crisis once more in its history, and contrary to almost all pessimistic forecasts, has now a great opportunity to close the institutional, investment and structural competitiveness gap with its peers and competitors, and catch up fast. My optimism is not based on technocratic arguments only, but, also, on historical ones. Please allow me to conclude by quoting the historian Roderick Beaton in his great book: “Greece: A biography of a Modern Nation”:

“Two hundred years ago, during the 1820s, Greeks were the pioneers who first mapped out the route that would lead from the old Europe of great empires to the Europe of nation states that we know today. No one should take it for granted that Greece and Greeks in future will always align with the values, traditions and politics that we tend to lump together and call ‘Western’. Geography, and to some extent also history, may pull the other way. But as they prepare to celebrate the two-hundredth birthday of the Greek nation state in 2021, Greeks can take pride in an achievement that by its very nature, and from the very beginning, has been won not through isolation, but in partnership, every difficult step of the way, with other Europeans. It could not be otherwise. Because ‘Greece’, however understood, or misunderstood, has always been part of the modern identity of Europe too.”

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1 A similar picture in terms of weak government efficiency is painted by IMD's 2019 World Competitiveness Ranking, where out of 63 countries Greece ranks 60th in public finance and tax policy, 57th in institutional framework, 52nd in business legislation and 51st in societal framework.