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Greece: Hellas is not lost yet

by Michael Heise
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The marathon as embodiment of endurance and toughness was invented by the Greeks – but now they are threatening to give up shortly before the finishing line. That would be a further act in the Greek tragedy. Reneging on its commitments and its promise to consolidate would be bound to trigger a euro exit. It would not mean the end of austerity, as some politicians misleadingly suggest, but only the beginning, and in far more drastic form than we are seeing today.

A new weak currency – whether it be the drachma or some form of parallel currency – would slash people's incomes. There would be a run on banks and capital would rush for the exit. The economy and employment would shrink further. The outcry among the population and the political chaos does not bear thinking about. It would therefore be tragic if, after so many years of adjustment, Greece was to lose heart and perseverance now. The cuts already carried out in the public and private sector, the relief provided by the debt haircut and drop in interest rates as well as the significant external trade adjustment will gradually generate light at the end of the tunnel.

There are indeed early signs that the tough medicine is starting to work. Seasonally adjusted gross domestic product rose slightly in the first quarter of 2012. In the first four months of this year the public sector deficit was almost EUR 2bn lower than planned, putting the full-year deficit on course to be well below the 7.3% of GDP agreed with the Troika. The government of experts led by Papademos evidently managed in the space of just a few months to achieve substantial cuts, especially in public spending. Finally, the yawning current account deficit, which peaked in 2008 at a staggering 14.9% of GDP, is set to decline to an estimated 7% in 2012. A correction here is unavoidable, and significant progress has already been made as wages, consumption and gross domestic product shrink. Sadly there is no magic potion to eliminate such an external deficit swiftly and without side effects, and certainly not in Greece with its small export sector. The adjustment is taking place largely via domestic demand: previously credit-fueled demand is being displaced and imports are falling – in Greece's case by some 25% since 2008.

Further wage cuts and tax hikes need not be the order of the day, rather priority should be given to the implementation of structural reforms: more efficiency in the public sector, more competition in the economy, privatization, tackling croneyism and tax evasion, more legal security are needed to push up growth in the medium term. Greece could be supported by a growth initiative – a kind of Marshall Plan – with existing EU funds being used to stimulate public and preferably also private investment and create better opportunities for the young unemployed. However, even a growth plan will only be effective if structural reforms are implemented.

It would be tragic on several counts to abandon the reform and consolidation course now. Marathon runners are well familiar with the need to conquer the man with the hammer at around kilometer 35. This is probably the point Greece has now reached – stamina is still required, but the adjustments evident on the macroeconomic front suggest that Greece will soon be able to harvest the fruits of its efforts. It is not unrealistic that the Greek economy could start recording modest growth again as early as next year. The mood would then shift, the country would have reached its goal, exhausted, but brimming with pride and alive.