

The political economy of the public debt crisis in Europe and Greece*

Lessons and the Way Forward

by

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*** Disclaimer:** Views expressed here are personal views and do not necessarily reflect those of the institutions I am affiliated with.

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AGENDA

- THE EURO DEBT CRISIS
 - Lessons from a macro, political, and an accounting perspective

- EUROZONE'S ECONOMIC OUTLOOK
 - Low investment in the euro area

- WHAT MORE EUROPE NEEDS
 - The EMU's incomplete architecture

WHAT IS NEXT FOR GREECE

**“Neither a borrower,
nor a lender be”**

Polunius’ advice to his son Laertes

Shakespeare’ s Hamlet

Euro Debt Crisis Lessons: Macro Dimension

○ Lesson I

Since the introduction of the single currency, both EU officials and markets kept a wrong sense of safety, as they failed to recognise that the elimination of exchange rate risk would lead to a systemic risk caused by chronic structural problems being incorporated as credit risk premium in a country's borrowing cost. As a result, euro-denominated debt of a country would, to a large extent, be equal to an external debt expressed in quasi-foreign currency.

○ Lesson II

The euro crisis highlighted the vicious circle between banks and sovereigns. In order to cut this Gordian knot, the EU swiftly moved to establish a European Banking Union among euro area member states, in order to “create the right conditions for the financial sector to lend to the real economy, spurring economic recovery and job creation”. The first pillar of the EBU is the Single Supervisory Mechanism, the second pillar is the Single Resolution Board, and the final EBU pillar is for a pan-European deposit guarantee system.

Euro Debt Crisis Lessons: Macro Dimension

○ Lesson III

The experience of the last 6 years from adjustment programmes in the euro periphery - and more particularly Greece - has shown that there big benefits from a swift implementation of reforms and privatization.

On the other hand, there are limits to persistent austerity and to the “disarming” of automatic stabilisers.

A second vicious circle of negative expectations-recession-new measures of austerity.

➤ Undeniably, less attention has been paid to the role of recession in adjustment programmes in the eurozone , from which a growth element is missing.

Euro Debt Crisis Lessons: Political Dimension

The huge rise in unemployment due to the free fall in output and dramatic fall in the living of standards and valuations of assets (real and financial) are disintegrating apart the Greek society and give rise to political and social instability. This in turn gives rise to populist parties with eurosceptic credentials which undermine the European direction of the country with potential destabilizing effects also for the euro itself.

Euro Debt Crisis Lessons: Accounting Dimension

The "accounting" dimension
has two important technical features.

We know today, after 6 crisis years, that :

- Balance sheets **do** matter in a debt crisis
- Transparency and accountability in budget reporting **boost** confidence

Euro Debt Crisis Lessons: Accounting Dimension (cont'd)

However, what is equally important are the following two related issues:

a) who owns the debt : domestic residents, foreigners, the central bank of the country, etc. and

b) how you measure public debt: in terms of future value or present value?

In terms of gross value or in net value?

Euro Debt Crisis Lessons: Accounting Dimension (cont'd)

On the second point of measurement, again two remarks:

- future vs present value ?
- gross debt vs net debt ? (net worth)

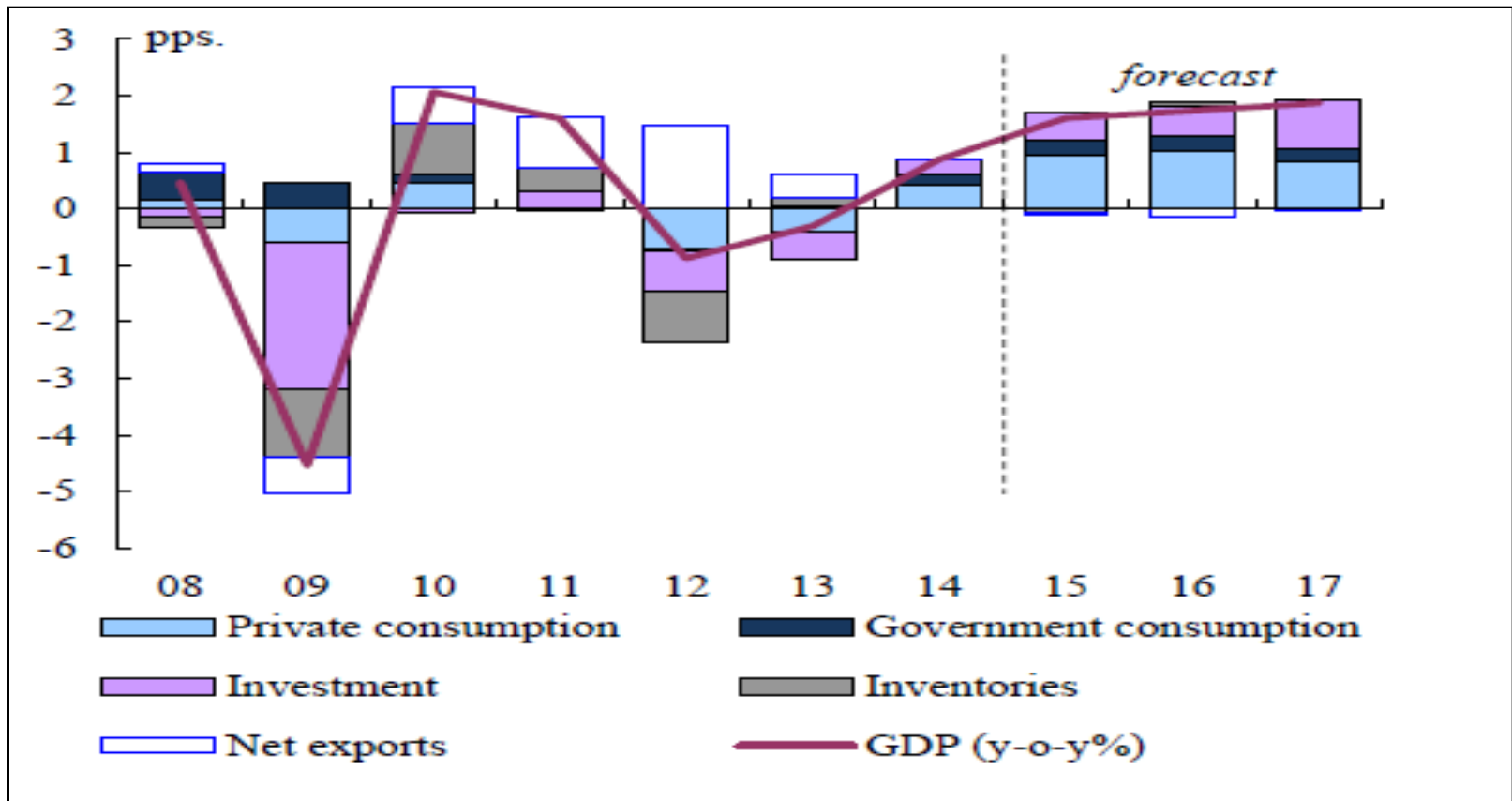
Euro Debt Crisis Lessons: Accounting Dimension (cont'd)

On the transparency and accountability of budget reporting as a booster for investor confidence :

Full use eg of the IFRS (International Financial Reporting Standards) and/or IPSAS, which is the standard global norm , adopted eg by the European Commission, the OECD, the UN and the World Bank, would help towards re-gaining the foreign investors' confidence , improve credit ratings for the country and companies, stabilize private sector's expectations and deliver jobs and growth which is the ultimate objective.

Eurozone's Economic Outlook

Euro area GDP growth and its components



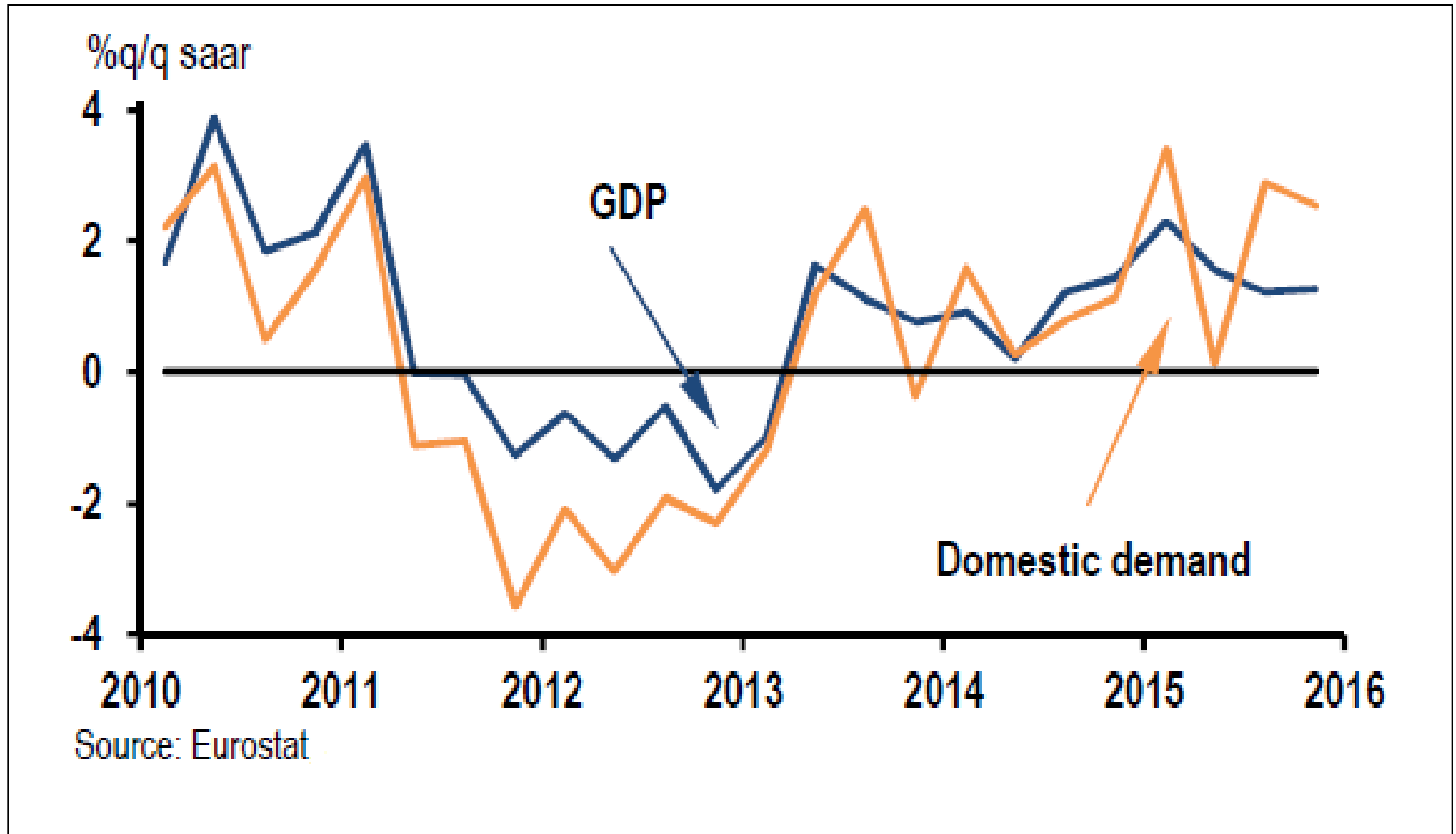
Source: European Commission

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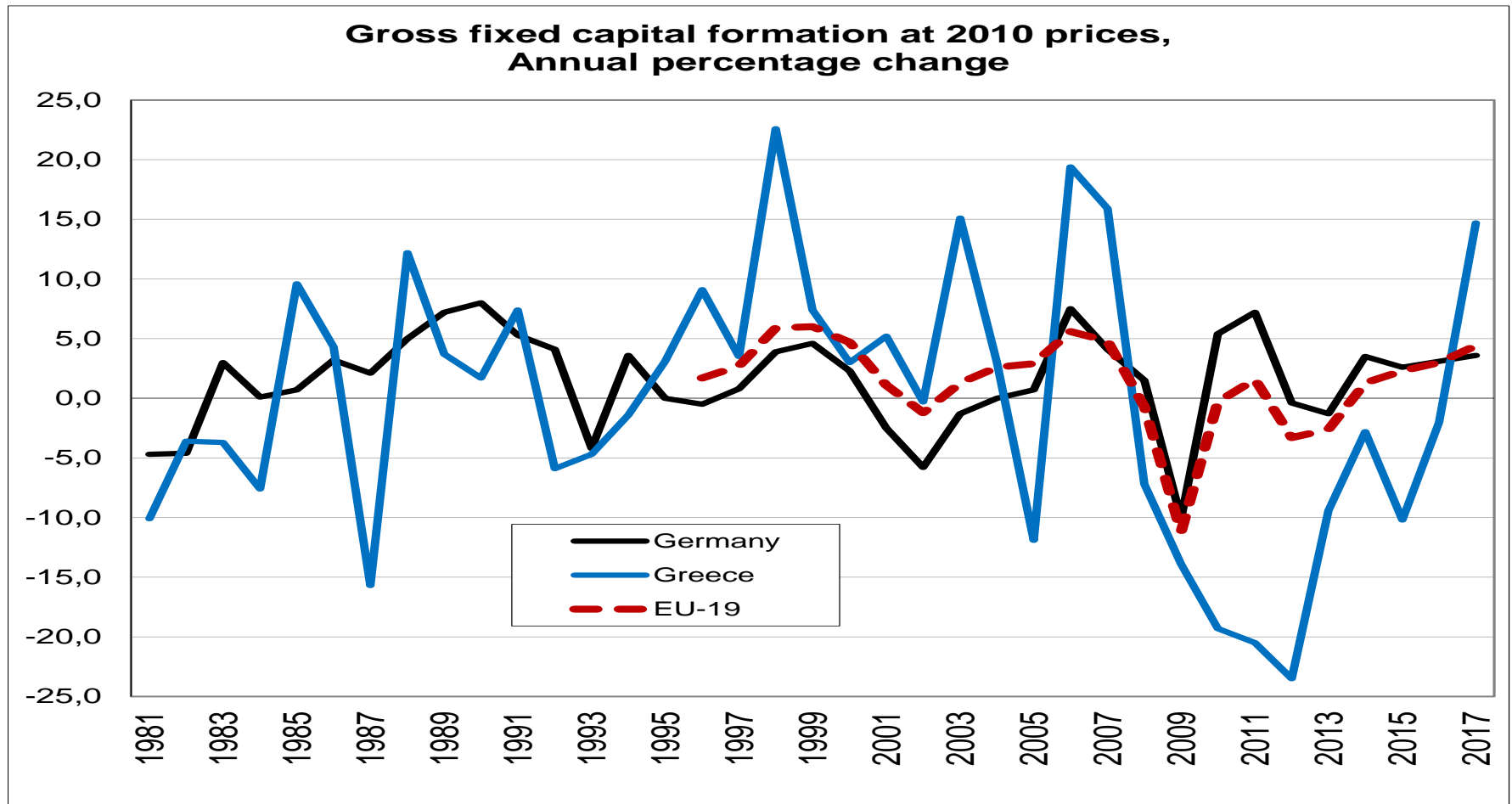
Eurozone's Economic Outlook (cont'd.)

Euro area GDP and domestic demand



Eurozone's Economic Outlook (cont'd.)

Euro area gross fixed capital formation at 2010 prices

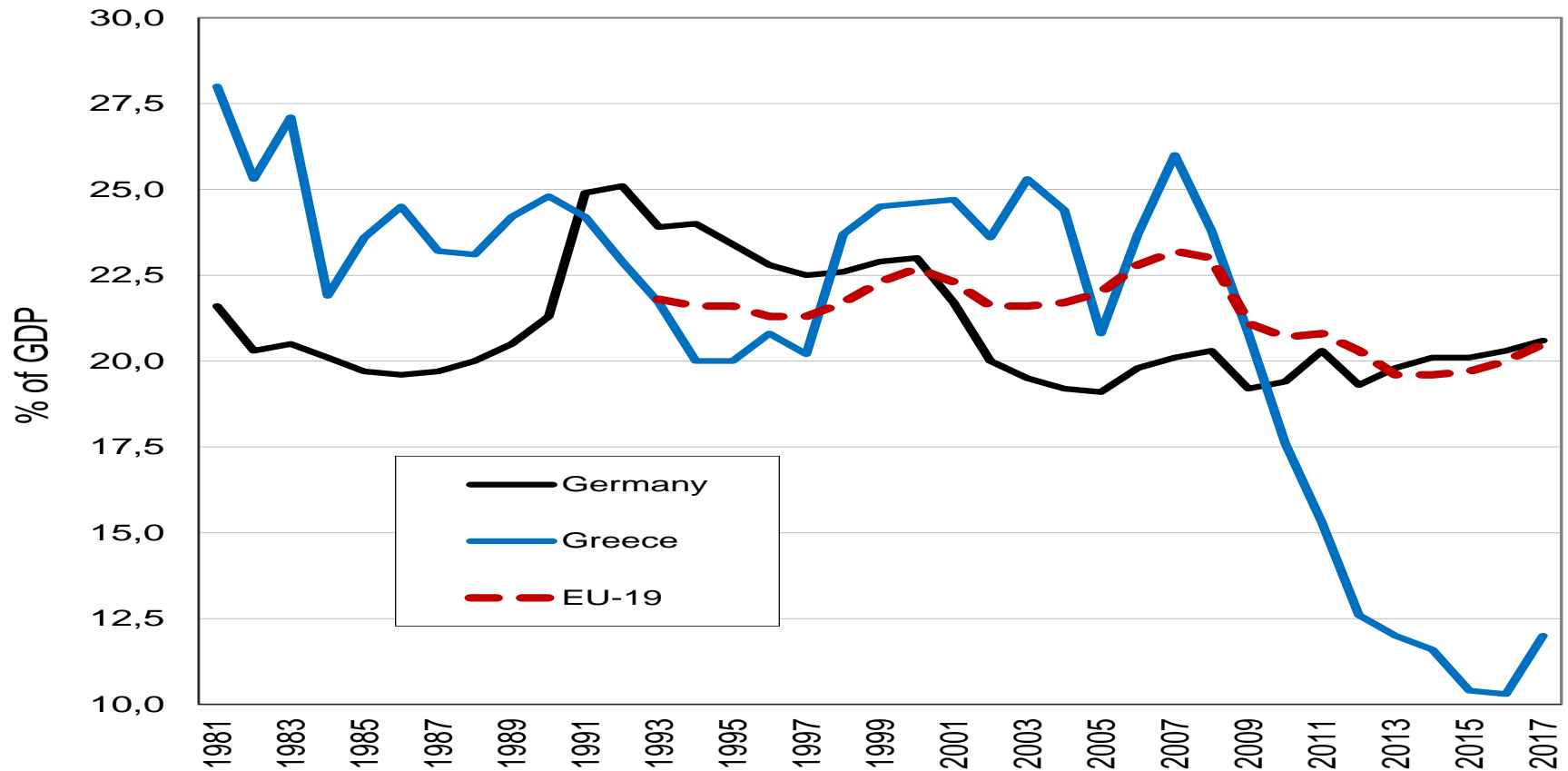


Source: European Commission

Eurozone's Economic Outlook (cont'd.)

Euro area gross fixed capital formation

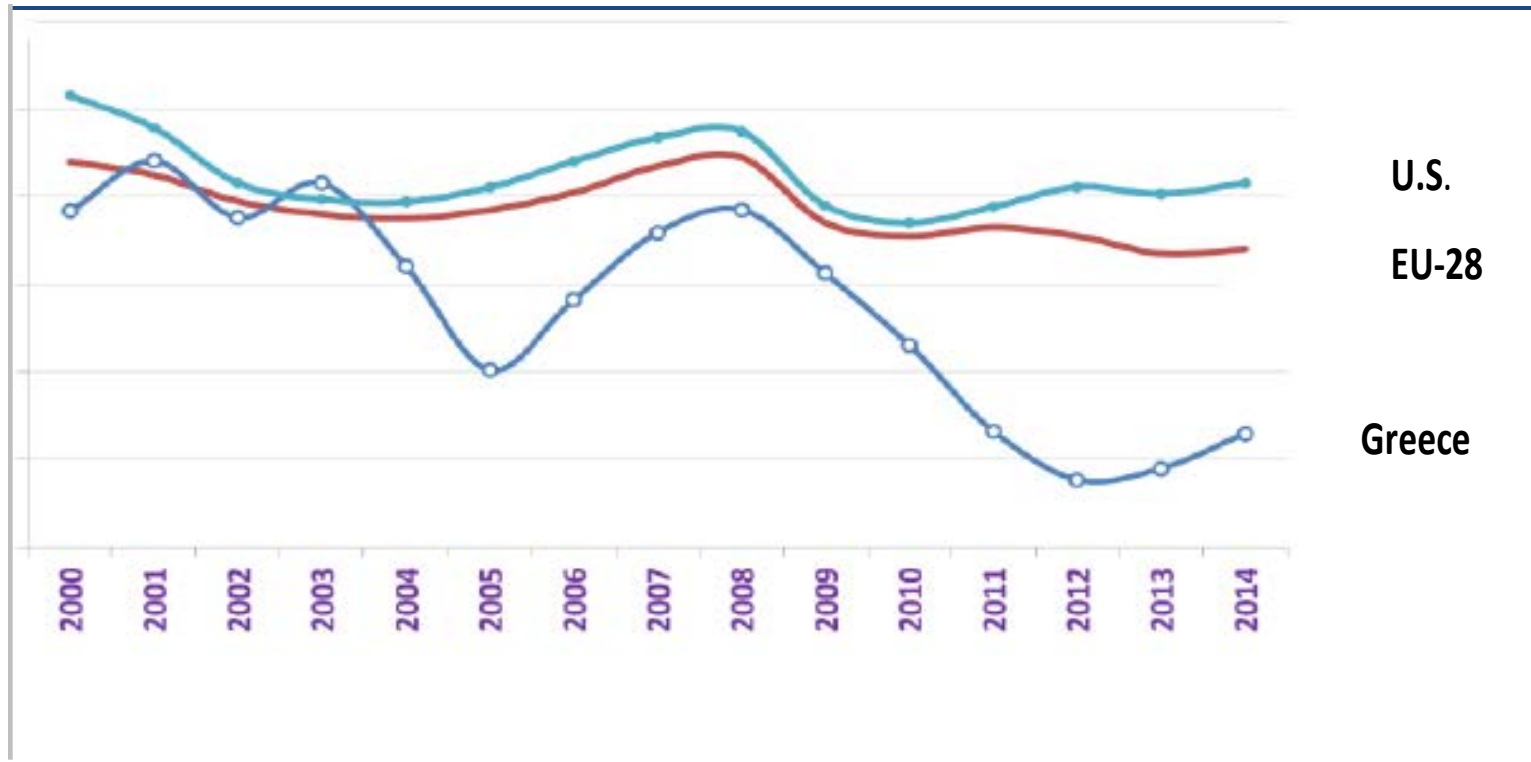
**Gross fixed capital formation at current prices
as a percent of GDP**



Source: European Commission

Eurozone's Economic Outlook (cont'd.)

Investment in the EU-28, the US and Greece
(as a percentage of GDP)



Source: AMECO 2014