Greece Debt Crisis

Greece needs a new deal with its European partners

It is time to strike the right balance between reforms and debt relief, writes Yannis Stournaras

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Greece (http://www.ft.com/indepth/greece-debt-crisis) is the only country in Europe that still remains under an adjustment programme. The Greek political system failed the country in the second half of the previous decade. Successive Greek governments promised to fix the tax collection system, uproot the deeply entrenched vested interests and implement ambitious reforms and privatisations. But, with few exceptions, they did not deliver.

At the same time, our European partners have yet to deliver on their commitment to provide further debt relief (http://next.ft.com/content/5e309f0c-21b2-11e6-aa98-db1e01fabc0c). They agreed to it in November 2012 and it should have occurred in 2014 after Greece achieved, with considerable pain, a primary surplus of €1.5bn in 2013. It never happened. The decision was delayed due to the domestic electoral cycle of various European countries. The same happened on May 24 this year when the eurogroup of

finance ministers yet again postponed the relevant decision, to 2018, despite the fact that it explicitly recognised the need to keep the Greek government's gross financing needs at manageable levels and the ratio of debt to gross domestic product at a declining trend.

It should be stressed that the eurogroup postponed the decision for debt relief in spite of the following: first, that the Greek government had honoured its commitments; and second, that current market interest rates are very favourable to debt relief decisions for both borrower and lenders. In addition, the threat of Grexit, used against Greece by a number of eurozone politicians whenever negotiations seemed to stall, weighed heavily on sentiment, further fuelling uncertainty and negatively affecting the economic and social climate in Greece.

It is now time to strike the right balance between reforms and relief. Since 2010, Greece has undergone a monumental fiscal adjustment (http://next.ft.com/content/9452f446-2c01-11e6-a18d-a96ab29e3c95), on a scale no other country has experienced since the Great Depression. Despite the delays, the costs and the mis-steps, there have been several unheralded successes — maintaining fiscal discipline (http://next.ft.com/content/78343842-2058-11e6-9d4d-c11776a5124d), labour and product market liberalisation and improving unit labour cost competitiveness by more than 25 per cent since 2009.

Now Greece needs a new deal (http://next.ft.com/content/11435d1a-23f6-11e6-9d4d-c11776a5124d) with its partners and lenders in order to move forward. It is unrealistic, and socially unattainable, to demand that Greece achieve a general government primary surplus of 3.5 per cent of GDP from 2018 and beyond. This should be lowered to 2 per cent, allowing for a more balanced economic policy mix, with the emphasis on reducing taxation, encouraging private investment and contributing to sustainable growth rates.

Scenarios explored at the Bank of Greece show that debt sustainability is achievable with a 2 per cent final primary surplus target and a rather moderate debt relief that does not inflict losses on lenders. This would involve the extension of loan maturities by 20 years and repayment of capitalised deferred interest in equal instalments over a 20-year period.

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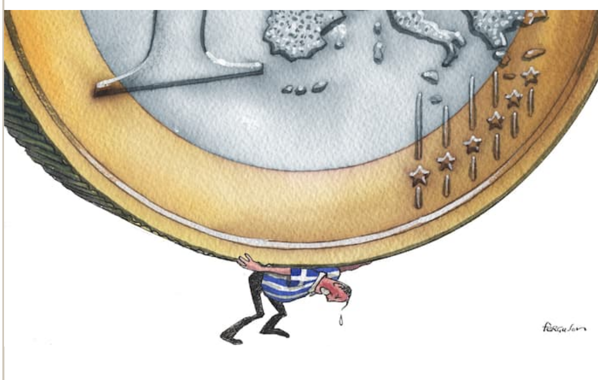

Furthermore, the government, the Bank of Greece and banks must tackle the most serious threat to financial stability: non-performing loans (NPLs). This is mainly the result of a seven-year recession that has reduced GDP by more than 25 per cent. Greek banks, following successive (and successful) recapitalisations amid difficult conditions, now have enough capital, provisions and collateral and are thus able to take initiatives

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The IMF now acknowledges that the programme agreed in 2010 was wildly unrealistic

to tackle NPLs. The recent favourable amendments to legislation, and the more benign conditions in the Greek economy following the eurogroup in May, makes these initiatives easier to undertake.

Greece has weathered a perfect storm, caught between the debt and financial crisis and an influx of refugees that has overwhelmed an already overstretched state. Tough decisions have been made. Only recently the Greek parliament voted through an ambitious pension reform that imposes further cuts on already reduced pensions, and a fiscal package exceeding 3 per cent of GDP, completing the gigantic fiscal adjustment begun in 2010. This adjustment has resulted in an improvement in the general government structural primary balance of more than 20 per cent of GDP. The current account has also improved accordingly.

Lower final fiscal targets and debt relief are the incentives that will keep the Greek economy and society going. Reforms, privatisations, public real estate development, enhanced tax collection and NPL reduction are the actions that Greek politicians should take — with determination and in the spirit of national unity in order to achieve high and sustainable growth.

The writer is governor of the Bank of Greece

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