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The Greek Economy:

Development and Economic Policy after exiting the Adjustment Programme

Synopsis

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Foreword

From 2009 to 2018, the Greek economy accomplished an unprecedented fiscal adjustment of €31.9 billion, due mostly to a €36.4 billion reduction in public spending, while public revenues fell by €4.5 billion. The result was the transformation of a primary deficit of -10.1% of GDP in 2009 into a primary surplus of +4.3% of GDP in 2018. Perhaps an even more important adjustment occurred in the Goods-and-Services (G&S) trade deficit, which fell from €24.3 billion (-10.2% of GDP) in 2009 to €2.5 billion (-1.3% of GDP) in 2018; this adjustment was not only due to the €4.5 billion fall in imports of G&S, but mostly to the impressive €17.3 increase of G&S exports (+36%) that more than covered losses from shipping foreign exchange inflows, following the imposition of capital controls in July 2015.

The Greek economy has been in moderate recovery since 2014, while at the same time going through a period of fiscal adjustment that, on the one hand, saw the achievement of a General Government Primary Surplus (GGPS) significantly higher than required and, on the other hand, the completion of vital structural reforms legislated and implemented in the country after 2009. Incoming tourism has been a key contributor to mitigating the recession and boosting recovery, pumping some €125 billion into the Greek economy in the ten years from 2009 to 2018. But in view of the downturn that has been seen in demand for tourism services from our traditional markets, it is important to stress the need to restore the tax-related competitiveness of the tourism product and rationalise regulation of short-term rentals, in tandem with planning and implementation of a consistent, organized and effective National Strategic Plan for Tourism. The projections for contraction of the growth dynamic of the eurozone and our most important markets are trending in the same direction.

It is obvious that any economic growth from 2014 to 2018, as well as that expected from 2019 to 2023, is due to the impressive fiscal adjustment and the substantial improvement Greece accomplished in its international competitiveness, through globally unprecedented structural reforms carried out from 2010 to 2018. The fiscal adjustment and the achievement of primary-surplus targets were the most catalytic factors in the substantial boosting of confidence in Greece among domestic and foreign entrepreneurs, investors and consumers, as they halted the downward spiral and contributed to the significant rise in domestic economic activity that is seen mainly in the major increase in imports of G&S and, to a lesser extent, the increase in recorded GDP, albeit to levels lower than expected. Domestic demand may have fallen by 2.5-3.0 billion euros due to the GGPSs, but it is increasing by 5.0-15.0 billion euros annually due to higher income and net influxes of capital, resulting from increased credibility.

Our forecast for the country's fiscal prospects following the new government's policy statements, as analysed in this report, is that – under certain conditions – the GGPS will be very close to, and perhaps even exceed, the target of 3.5% in 2019. In 2020, if the implementation of additional measures brings an increase in nominal GDP (to 3.8%, rather than the projected 3.3%) and, at the

same time, we see an increase in collectability of revenues and reined-in Primary Spending of the General Government (1.2% rather than the projected 1.8%), the GGPS will again be near the target of 3.5% of GDP.

INSETE's annual reports on the Greek economy systematically express the view that the country's fiscal stability is of critical importance, along with the honouring of its international obligations, in the effort towards a new sustainable growth course following the major debt and credibility crisis the country has gone through. With regard to the calls that GGPS targets are reduced to 2.5% of GDP, starting in 2020, our view is that the key condition for the feasibility and sustainability of this target – without jeopardising what the country has achieved so far – is an improvement in the parameters of the sustainability analysis of the Greek debt, and mainly the estimated cost of borrowing and the targeted rate of economic growth in the long term. Growth requires investments, which, due to the extremely low national savings, presuppose the fastest possible upgrading of the Greek economy to a rating that will lead institutional and other investors to make investments in the country, bringing to the country considerably larger amounts of capital than those deprived by the high GGPSs.

It is imperative to stress that, for an economy like that of Greece, which essentially has no national savings and a very high debt, achieving the "required" fiscal surplus – at the levels agreed upon with the lenders – is tantamount to a commitment not to increase the state debt by even a single euro. This express commitment – that we will do whatever it takes to pay off our debts on schedule – can be seen as the hard core of a long-term sustainable national policy for our country's economic growth. At the end of the day, this commitment is the key to our international credibility, our creditworthiness and the comfortable funding of our economy in the coming decade. The country's ability, in other words, to achieve steady economic growth based on its international competitiveness, against the necessary backdrop of primary surpluses based on the truly vast structural reforms it carried out over the past eight years, will be the result of the sacrifices of the unemployed, of workers and their families, and the efforts of healthy enterprises.

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Greece emerged from the strict surveillance of the Adjustment Programme about a year ago, having achieved ...

- ... a remarkable fiscal adjustment that is a necessary condition for restoring the country's international credibility,
- ... restoration of its competitiveness, which is a necessary condition for the economic survival and prosperity of its citizens.

The recent (17 July 2019) issue of a seven-year Bond by the Greek State, the return on which is around 2%, which was accompanied by a supply of funds five times the amount of demand (€13 billion as compared to €2.5 billion) attests to the fact that the Greek economy's prospects continue to be positive.

On the other hand, this adjustment was achieved with great difficulty, significantly burdening the economic conditions for the most of the Greek population.

Tourism, having achieved remarkable growth during the crisis, contributed to a very large extent to limiting the impact of the recession and, subsequently, to the Greek economy's return to positive growth rates. This return to growth was accompanied by a corresponding increase in employment. Indicatively:

- Incoming tourism in the decade 2009-2018 generated some €125 billion for the Greek economy, while the vast majority of the 230 million visitors had positive experiences at a time when our country was an "easy target" for the news media.
- Revenues from incoming tourism increased by about 50% from 2012 to 2018.
- Employment in the tourism sector increased by 12.7% between 2009 and 2018, in contrast to other sectors of the economy, where employment fell by -18.2% during the same period.

As a result of its dynamism, in 2018 Greek tourism:

- contributed directly to the creation of 11.7% of the country's GDP with €21.6 billion, while its total contribution (direct and indirect) is estimated at up to 30.9% of GDP (€57.1 billion),
- in the high season (Q3), tourism – through employment at tourist accommodations and in the restaurant industry (411,000 jobs) – accounted for 16.7% of employment and some 40% of total (direct and direct) employment, and it is a key tool for reducing unemployment, particularly among women and the young,
- the tourism sector saw significant investment activity in the amount of €5.0 billion, of which €1.9 billion was domestic value added,
- tourism is chiefly an international-market activity, as over 90% of tourism revenues come from abroad. These revenues, including receipts from cruises, air transport and sea transport, come to €18.2 billion and increased by +11,3% or +€1.8 billion as compared with 2017.

Recent studies carried out by the Institute have shown that this success is due to the fact that Greece is now seen by the market as a mature destination competing mainly with major European destinations such as Spain, Italy, Portugal and France, and to a lesser extent with destinations such as Turkey and the countries of North Africa. In fact, in many of the criteria visitors use to choose

their holiday destination, Greece ranks significantly higher than the competition. These criteria include friendly and hospitable treatment of visitors, the sense of security felt by visitors, the high level of accommodation facilities, gastronomy, as well as the beaches and the beautiful landscapes in our country. In contrast, the criteria where Greece lags behind the competition concern infrastructure, cleanliness and enrichment of the product through appropriate synergies to make the visitor want to return to Greece.

Thus, if tourism is to continue to play a positive role in the Greek economy and Greek society, it will have to consolidate its position among the major European destinations. A necessary condition for achieving this goal is active Destination Management, with emphasis on improving infrastructure and public-private synergies. The need for active Destination Management is even greater now, when the economic climate is deteriorating in our markets, leading to a fall in consumer confidence and, consequently, to limiting of the travel expenditures of these markets' residents, who are our potential visitors.

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Disclaimer

This study contains estimates of various values about the Greek economy. Although due diligence has been exercised in vetting the data used and the estimates put forward, the SETE Institute (INSETE) and the authors of this study cannot guarantee their accuracy.

The opinions, statements and conclusions included in this study do not necessarily reflect the positions of SETE (the Greek Tourism Confederation), nor are they necessarily binding for SETE.

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Summary

The Greek economy has been in moderate recovery since 2014 and moderate growth in 2017 and 2018, while at the same time going through a period of fiscal adjustment that saw the achievement of a General Government Primary Surpluses (GGPSs) significantly higher than those required by the 3rd Memorandum of the Adjustment Programme, as well as the completion of vital structural reforms legislated and implemented in the country, mainly from 2010 to 2016.

However, the increase in recorded GDP with an average annual growth rate (AAGR) of 0.7% in the period 2014-2018 (1.51% in 2017, 1.93% in 2018 and 0.9% in Q1 2019) was much lower than expected. This is due to the following two reasons:

1. The increase in Fixed-Capital (FC) formations and particularly of FC investments by entities of the General Government from 2014 to 2018 was much lower than expected, ending up in 2018 at lower levels than in 2013.
2. 2. ELSTAT's projected small increase in domestic final expenditure (DFE) in the economy, and more specifically in private consumption and investments in inventory, are highly inconsistent with the extremely high rates of increase during this time in imports and exports of goods and services (G&S). It is striking that imports of G&S, and especially imports of goods (which are based on real administrative data and not on estimates) increased significantly in the period 2014-2018, and in particular in 2017, 2018 and Q1 of 2019, in spite of the estimated drop in FC investment, which was accompanied by projections for a large drop in inventory and only a slight increase in private consumption.

The lower-than-expected increase in recorded GDP from 2014 to 2018 was not due to a negative impact from attainment of GGPSs in excess of targets:

- First, these high and increasing GGPSs over five consecutive years indicate that the increase in the country's real GDP during this period was much higher that the increase in recorded GDP, as the latter is estimated by ELSTAT.
- It is obvious that any economic growth from 2014 to 2018, as well as that expected from 2019 to 2023, is due exclusively to the impressive fiscal adjustment – in other words, the high GGPSs – and the substantial improvement Greece achieved of its international competitiveness through vital structural reforms carried out from 2010 to 2018.
- More specifically, the high GGPSs and the systemic/structural nature of these primary surpluses contributed decisively to boosting the confidence of domestic and foreign entrepreneurs, investors and consumers in Greece. They halted the economy's downslide and contributed to the rise in domestic economic activity that was largely manifested in the dynamic increase in imports and exports of G&S and, to a lesser extent, the increase in recorded GDP.
- Domestic demand may have fallen by 2.5-3.0 billion euros due to the high GGPSs, but it is increasing by 5.0-15.0 billion euros annually due to higher income and net influxes of capital resulting from increased credibility, which is due exclusively to the high GGPSs.
- Moreover, the high GGPSs did not cause the very low rate of increase in domestic final expenditure (DFE = consumption + investments in equipment and inventory) in the economy during the aforementioned period. If this were the case – if the primary surpluses had contributed to limiting domestic demand for consumption and for investments in fixed assets and inventory – they would also have contributed to the

lowering average annual growth rate (AAGR) of imports of G&S. But the AAGR of G&S imports was 3.9% for the period 2014-2018 and, more specifically for the recent years, 7.1% in 2017, 4.2% in 2018 and 4.6% in Q1 2019.

There is, therefore, a need for a new economic policy package, for implementation from 2019 to 2021, that includes a set of measures for reducing overtaxation in a rational manner and increasing development and social spending, in combination with a necessary reduction in tax-free income levels (e.g. to the tune of € 1.5 billion for the whole package). If this package is implemented, we will likely see growth exceed 3.0% in 2020 (4.2% at nominal values) and the revenues of the General Government increase by more than 2.3%, in spite of the significant reduction in overtaxation. This development would lead with certainty to a 2020 GGPS that is again higher than 3.6% of GDP, even with a significant increase of FC investments of General Government entities and with an increase in social spending that would lead to a 2.2% increase in General Government Primary Expenditures in 2020. Additionally, the GGPS can continue to exceed 3.5% of GDP from 2020 to 2023 and 3.0% of GDP from 2024-2030, provided the AAGR of nominal GDP exceeds 3.57% from 2020 to 2030 and the AAGR of General Government revenues and expenditure exceeds 1.85%. In this case, with the anticipated significant upgrades of the Greek economy's rating, it can be anticipated that confidence in the economic policy being followed and in the stable growth of the Greek economy will be steadily growing. Increased confidence in the prospect of fiscal stability and growth with a rationalised tax system will help attract the investments needed for further improvement of the economy's productivity and international competitiveness, in a new boosting of growth, a drastic reduction in unemployment and a substantial increase in domestic incomes.

The country's fiscal prospects following the new government's policy statements

Based on the execution of the 2019 Budget (B2019) in the first half of 2019, and without additional measures, it is estimated that there will be an increase of 3.1% in revenues of the General Government and a 4.6% increase in expenditure. As a result, the General Government Primary Surplus (GGPS) is forecast to be close to 3.7% of GDP.

The implementation of the 22% weighted average reduction in the ENFIA property tax and some other tax cuts starting in 2019 may cause a €0.7 billion fall in General Government revenues, which corresponds to -0.35% of GDP. With this reduction, the GGPS may end marginally lower than the target of 3.5%. But there is room to limit this reduction due to the increase in collectability of taxes, and, at the same time, the government is trying to reduce Primary Public Expenditure by €0.5 billion. If these estimates are borne out, the GGPS will be close to or possibly higher than 3.5% for 2019.

For 2020, without implementation of other additional measures and based on the execution of B2019 during the first half of 2019, we estimate that the GGPS will be around 3.7% of GDP, which will result from a 2.2% increase in revenues and a 1.8% increase in expenditures of the General Government.

The implementation of additional measures – such as reduction of VAT rates, the tax on corporate profits, the lowest and marginal natural person income tax rates, the solidarity contribution and, starting in 2020, social security contributions – means an immediate €1.6 billion fall in tax revenues, which corresponds to about 0.8% of GDP.

On the other hand, the implementation of all these measures starting in 2020 could bring an increase in nominal GDP of 3.8%, up from the projected 3.3%, and at the same time significantly increase the collectability of revenues, which would mean a €0.6 billion increase in government revenues from these sources. Moreover, one of the government's main goals is to contain Primary Expenditure of the General Government, which may lead to an increase in expenditure of only 1.2%, as opposed to the projected 1.8%. In this case, it is estimated that the GGPS for 2020 will be very close to the target of 3.5% of GDP.

In conclusion – and for as long as the given GGPS targets remain the same – an effort must be made to adhere strictly to these targets in order to avoid any possibility that doubts are again raised in the markets as to the credibility of the Greek government and the sustainability of the Greek Sovereign Debt; such a possibility may be used in 2020 to delay the anticipated and necessary upward revisions of the Greek economy's credit rating, which are vital to attracting institutional and other investors to Greece.

From 2021 on, if the most important tax-burden reduction measures have been taken in 2019 and 2020, and with nominal GDP increasing at a rate of over 3.5%, the revenue increase rates will be over 2.5% and the GGPS can be maintained at levels above 3.5%, even with an Average Annual Growth Rate of General Government Primary Spending at around 2.5%.

Consequently:

- Ensuring achievement of the fiscal goals arising from last year's Eurogroup communique on Greece's exit from the 3rd Memorandum of the Adjustment Programme may entail that measures for the reduction of overtaxation are distributed over a longer period of time, at least as long as the terms of this particular agreement are in effect.
- The central objective of the country's economic policy must remain the achievement of the necessary General Government Primary Surpluses that will ensure the sustain-

ability of the Sovereign Debt. Until there is an improvement in the parameters of the sustainability analysis of the Greek debt, and mainly the estimated cost of borrowing and the targeted rate of economic growth in the long term, Greece must consistently meet its international obligations. This is the only way to accelerate the upgrading of the Greek economy to a rating that will lead institutional and other investors to make investments in the country, bringing the country considerably larger amounts of capital than those deprived by the high GGPSs.

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Με τη συγχρηματοδότηση της Ελλάδας και της Ευρωπαϊκής Ένωσης

ΕΚΤ

ΕΣΠΑ 2014-2020