The FT Lets Itself Down Again: Francesco Giavazzi on Greece

Karl Whelan
Professor of Economics at University College Dublin

Is this Italy's answer to Hans-Werner Sinn?


Francesco tells Greece to take a hike.

With regular opinion pieces from the likes of Hans-Werner Sinn and Niall Ferguson, the Financial Times op-ed page is developing an unfortunate reputation for publishing rubbish on economics. [This](#) new article on Greece from Italian professor, Francesco Giavazzi, ("Greeks chose poverty, let them have their way") perhaps tops the lot with its combination of inaccuracy and unfortunate national stereotyping.

Giavazzi reckons that after "*Five years of negotiations that have achieved virtually nothing*" the EU would be better off without Greece. He argues that the EU's focus on Greece has distracted from other issues and concludes

"But the euro cannot be a substitute for further political integration. Indeed, without such integration, the euro cannot survive—and today, Greece stands in the way of it."

I want to offer a few comments on Giavazzi's piece, starting with his claim about few reforms being achieved in the past five years.

No Progress in Five Years? Public Employment

Giavazzi's analysis of the past few years in Greece is as follows:

"Five years of negotiations that have achieved virtually nothing (the few reforms that had been adopted, like a small reduction in the inflated number of public sector employees, have since been reversed by the Syriza-lead coalition). It is pretty clear that the Greeks have no appetite for modernising their society. They worry too little about an economy ruined by patronage."

Let's first examine the one specific claim in Giavazzi's article, that the reduction in public sector employees was small and has been reversed. The European Commission's report on Greece from last year contains the following table on Greek public employment.

Table 7. Greece - employment in public sector (number of persons)

	2009	2010	2011	2012	2013	2014	2015	2016
General Government				**707,609**	**653,746**	**635,227**	**623,219**	**606,170**
Ordinary staff	692,907	667,374	646,657	629,114	599,207	581,886	570,271	553,619
Other staff	175,550	132,877	72,333	56,588	36,372	36,037	36,037	36,037
Chapter A entities	n.a	n.a	n.a	20,446	16,587	15,723	15,330	14,933
Chapter A fixed term contracts	n.a	n.a	n.a	1,461	1,580	1,580	1,580	1,580
Memorandum items								
Chapter A entities not classified as GG	n.a	n.a	n.a	18,603	17,365	16,491	16,093	15,691
Chapter A entities in the public sector (all contracts)	38,894	34,254	28,366	40,510	35,532	33,794	33,003	32,204
Total public sector (excluding ESPA and self financed other staff)	**907,351**	**834,505**	**747,356**	**726,212**	**671,111**	**651,717**	**639,311**	**621,860**
ESPA and self-financed other staff				15,343	47,570	44,946	44,946	44,946

Total public sector employment declined from 907,351 in 2009 to 651,717 in 2014, a decline of over 255,000. That is a drop of over 25%. Can this really be said to be a "small reduction"?

And the reversal under Syriza? Reports on the new government's rehiring plan say it may hire "as many as 15,000" workers, a tiny figure compared to previous reductions. Either Giavazzi doesn't know the figures or he is playing fast and loose with them.

No Progress in Five Years? Fiscal Deficits

A theme that runs through commentary such as Giavazzi's is the Greek people have no stomach for hard decisions. One has to wonder whether people who think this are conscious of even the basic facts about the scale of fiscal adjustment experienced in Greece. See below for a table from the OECD showing public deficits around the world. Greece has reduced its fiscal deficit from 15.6 percent of GDP in 2009 to 2.5 percent in 2014, a scale of deficit reduction not seen anywhere else in the world.

This reduction involved massive cuts to public expenditure and was achieved against the background of a steadily shrinking economy. Professor Giavazzi is associated with the idea that severe fiscal contractions can be expansionary. Well the experiences of Greece and other countries have firmly discredited that idea. The Greek people have had to endure an extraordinarily harsh number of years and its governments have taken many tough decisions. They deserve better than to be trolled in the opinion pages of the FT.

Government deficit / surplus as a percentage of GDP

General government financial balance, surplus (+), deficit (-)

	2008	2009	2010	2011	2012	2013	2014	2015
Australia	-0.6	-4.7	-5.1	-3.6	-2.9	-1.4	-2.5	-1.4
Austria	-1.0	-4.1	-4.5	-2.4	-2.6	-1.5	-2.8	-1.3
Belgium	-1.1	-5.6	-4.0	-4.0	-4.1	-2.7	-2.1	-1.2
Canada	-0.3	-4.5	-4.9	-3.7	-3.4	-3.0	-2.1	-1.2
Czech Republic	-2.2	-5.8	-4.7	-3.2	-4.2	-1.5	-2.1	-2.6
Denmark	3.3	-2.8	-2.7	-2.0	-3.9	-0.9	-1.5	-3.0
Estonia	-3.0	-2.0	0.2	1.1	-0.2	-0.2	-0.2	-0.1
Finland	4.3	-2.7	-2.8	-1.0	-2.2	-2.5	-2.2	-0.9
France	-3.3	-7.5	-7.0	-5.2	-4.9	-4.3	-3.8	-3.1
Germany	-0.1	-3.1	-4.2	-0.8	0.1	0.0	-0.2	0.2
Greece	-9.9	-15.6	-11.0	-9.6	-8.9	-12.7	-2.5	-1.4
Hungary	-3.7	-4.5	-4.4	4.2	-2.2	-2.3	-2.9	-2.9
Iceland	-13.5	-9.9	-10.1	-5.6	-3.8	-2.1	-2.0	-2.1
Ireland	-7.4	-13.7	-30.6	-13.0	-8.1	-7.0	-4.7	-3.1
Israel [1]	-3.3	-6.2	-4.6	-3.9	-5.1	-4.3	-3.9	-3.6
Italy	-2.7	-5.4	-4.4	-3.6	-2.9	-2.8	-2.7	-2.1
Japan	-1.9	-8.8	-8.3	-8.8	-8.7	-9.3	-8.4	-6.7
Korea	2.9	-1.0	1.0	1.0	1.0	-0.4	0.1	0.5
Luxembourg	3.2	-0.7	-0.8	0.2	0.0	0.1	0.3	-0.9
Netherlands	0.5	-5.6	-5.0	-4.3	-4.0	-2.4	-2.7	-2.0
New Zealand	0.4	-2.7	-7.4	-4.4	-2.1	-0.3	0.1	0.7
Norway	18.8	10.5	11.1	13.6	13.9	11.1	10.7	10.2
Poland	-3.7	-7.5	-7.8	-5.1	-3.9	-4.3	5.6	-2.9
Portugal	-3.7	-10.2	-9.9	-4.3	-6.5	-5.0	-4.0	-2.4
Slovak Republic	-2.1	-8.0	-7.5	-4.8	-4.5	-2.8	-2.7	-2.6
Slovenia	-1.9	-6.3	-5.9	-6.4	-4.0	-14.7	-4.1	-2.6
Spain	-4.5	-11.1	-9.6	-9.6	-10.6	-7.1	-5.5	-4.5
Sweden	2.2	-1.0	0.0	0.0	-0.7	-1.3	-1.5	-0.8
Switzerland	2.0	0.8	0.3	0.7	-0.2	0.1	0.1	0.3
United Kingdom	-5.1	-11.2	-10.0	-7.9	-8.3	-5.9	-5.3	-4.1
United States	-7.2	-12.8	-12.2	-10.7	-9.3	-6.4	-5.8	-4.6
Euro area (15 countries)	-2.1	-6.3	-6.2	-4.1	-3.7	-3.0	-2.5	-1.8

No Progress in Five Years? Structural Reforms

Ah yes, but what about the all-important "structural reforms" beloved of every Eurocrat? Greece is famous for its anti-business red tape promoted by vested interests. Presumably nothing has been done about this. Well, Prof. Giavazzi may believe almost nothing has happened but there is concrete evidence that the Greek government has undertaken reforms in this area that will help to promote growth. The 2010 Doing Business report ranked Greece as the 109th best country in the world in which to do business, an extremely low ranking. The 2015 report ranked Greece 61st, a rise of 48 places.

This still leaves Greece near the very back of the pack of European countries and there are many areas where there are opportunities for improvement. But to say there has been no improvement at all is simply incorrect.

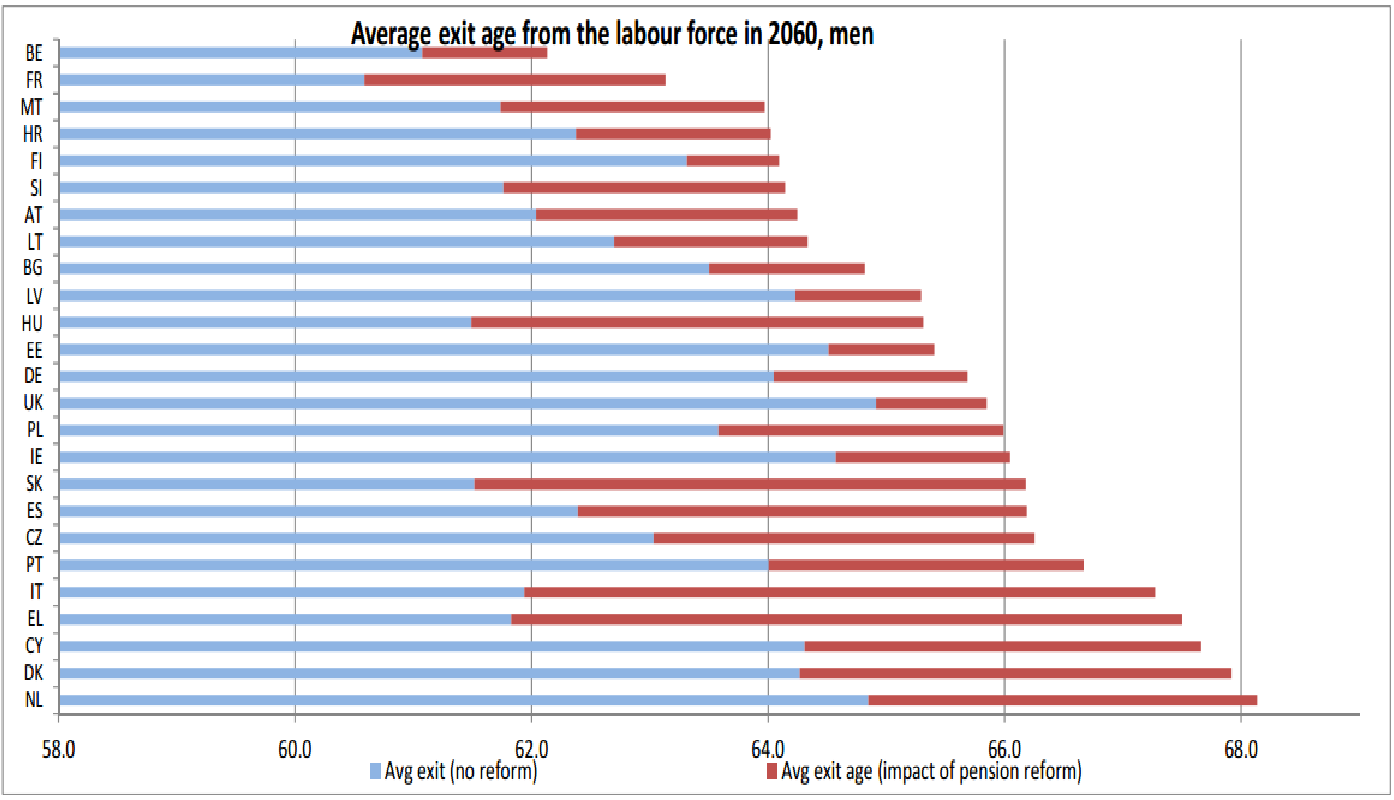
No Progress in Five Years? Pension Reforms

What about pensions? Stories about Greeks retiring early appear to have had a major impact on the hard-line attitude of the German public towards Greece over the past few years. Pension reform is still a focus of the current negotiations between Greece and its creditors but this is another area where the widespread perception that there has been no reform is untrue.

Greek governments have introduced a number of long-term reforms to their pension system in recent years. See pages 39 to 40 of the European Commission's 2015 Ageing Report for a description of these reforms.

The report also explains the long-run impact of pension reforms that have been legislated throughout the EU. The graph below is taken from the report. The blue line shows the average age of retirement in 2060 if there were no pension reforms and the red line shows the average age at retirement under current legislated systems. Greece (marked as EL) goes from one of the lowest average retirement ages under no reform to one of the highest after the reform. In this sense, Greece has undertaken the most significant pension reform in Europe (and it has not been repealed by the courts, as happened in Italy to pension reforms passed by Mario Monti's government.)

Graph I.2.1: **Impact of pension reforms on the average effective retirement age from the labour force**



Again, this is an area where more reforms are almost certainly in the wider interest. Whatever about the longer run, current activity rates among older age groups in Greece are very low and steps need to be taken to adjust pension entitlements to address this issue. But the idea that no substantive reforms have taken place is false.

Indeed, overall, you can credibly argue that Greece's governments have achieved more substantive reform in recent years than the post-Berlusconi governments have managed in Italy or Mariano Rajoy has managed in Spain.

Greece as a Political Problem

Giavazzi suggests that the European Union may be better off without Greece partly because it causes serious political problems. But the political problems he cites seem fairly odd.

The first is that Greece has been a distraction.

"European leaders, instead of devoting their summits to the question of how to best defend our economic and military interests, agonise over what to do about Greece."

This is the can't-walk-and-chew-gum-at-the-same-time school of political thought. Can anyone honestly argue that the EU's enormous foreign policy and military structures would have come up with a better approach to Putin's Russia or ISIS if only they had squeezed Greece off the agenda at some EU summits?

The second is that Greece "stands in the way" of required further European political union. I'm not sure how it's doing that. But even if it was, there are far larger obstacles to greater European political union, like the fact that most European citizens have no interest in more treaties bringing ever-closer union. The euro area is not, and probably never will be, anything close to an opimal currency area and blaming feckless Greeks for the euro's problems is delusional.

Worth noting as a counterpoint is that given Greece's neighbourhood of the world (close to Macedonia, Albania, Kosovo, Turkey, Cyprus, North Africa and the Middle East) I'm pretty sure international affairs boffins could think of some good reasons to keep the country in the EU.

Giavazzi's Offer to Greece: All Carrot and No Stick

The strangest part of Giavazzi's article is his proposed offer to Greece. It's a carrot and stick approach that turns out to be all carrot.

Giavazzi recognises that Greek debts to the EU are unsustainable and (as best I can tell) seems to call for a complete write-off:

"Since Athens joined the monetary union, we have lent Greece €400bn, 1.7 times the country's gross domestic product in 2013. It is time for a reality check: they will never be repaid. And it is an illusion to imagine, as the Finns sometimes do, that we could

receive compensation in kind by acquiring a few Greek islands. The age when the British empire would do that is, luckily, over. Bygones are bygones. The sooner we accept this and forget those loans the better."

Ok, so let's imagine that happens. The Eurozone governments write off their loans to Greece. Given that the vast majority of Greece's public debt is owed to these governments, this would slash its debt-GDP ratio to well below the Eurozone average.

This is why Giavazzi's stick doesn't make sense. Having written off most of Greece's debt, his stick is the following.

"But it is not for the rest of Europe to impose reforms on Greece. It should merely make crystal clear that without serious reforms, new official loans are over. The only way for Athens to borrow will be to convince the markets that it will pay its own bills."

Giavazzi may imagine that a country that has just had most of its debts written off and that is close to having a primary balance won't have any takers in the sovereign bond market because they are not doing enough reforms. But this isn't how the world works. If bond markets will lend in large quantities to the likes of Brazil and Mexico, a post-write-off Greece should have no problem borrowing.

So Giavazzi is wrong that "*European leaders should stop treating the Greek problem as if it were merely a financial issue*." Write off Greece's debt and there will be no more programmes, no more demands for reform, no Grexit and no more time taken up at EU summits. In the context of EU GDP, the price to pay for this is fairly small. But it's not a price European leaders are willing to pay, partly because of the precedent it may set.

This is very much a financial issue, albeit one where politics now largely prevents cold-eyed economic calculation from deciding what needs to be done.

Grexit Complacency

Albeit that his grand plan to get Greece to leave the euro (offer to write off all their debts and then demand reforms …) wouldn't actually achieve its goal, Giavazzi's complancency about the prospect of Greece leaving the euro (and possibly the EU—nobody really knows how this stuff would work) is a telling indication of the state of mind of much of Europe's policy commentariat. He reckons that

"thanks to the actions of the European Central Bank, monetary union today is resilient enough to withstand Grexit."

Which actions of the ECB? The never-used never-tested OMT? Bank stress tests? The "whatever it takes to preserve the euro" commitment? Well, when Cyprus had its crisis in 2013, whatever-it-takes did not go as far as ensuring that free movement of capital was maintained within the euro area. And if whatever-it-takes doesn't prevent a Greek exit, there would be serious questions about what kind of euro the ECB was actually willing to bother preserving. If Greece could leave, then so could any country if the conditions were right.

Someone told me on Twitter last night that nobody in financial markets was worried about Greece leaving the euro causing any contagion. That made me feel so much better because financial markets are never wrong or change their mind, right?

A useful datapoint to conclude with: Francesco Giavazzi was very enthusiastic about the decision to let Lehman Brothers go bankrupt. If he liked that so much, I suspect he'll love Grexit