CHAPTER 1

Policies for Immediate Action
and Medium-Term Policies

1.1 INTRODUCTION

The Greek economy during the years of 2008 crisis experienced a significant decline in its production and deterioration in almost all of its macroeconomic variables. From 2008 to 2016, GDP decreased by 66.29 billion euros, as throughout this period (with the exception of the year 2014) the growth rate was negative. The major effort to restore the economy from 2017 to 2019 (growth rate from 1.5 to 1.9% per year), was violently halted by the emergence of the Covid-19 pandemic and its significant impact on the economy due to the measures taken to limit its spread in Greek society (lockdown of the economy).

The planning of the next day should, anywise, have been careful for the Greek economy, while the existing effects of the pandemic make this planning even more compelling. The Greek economy enters a decade that is expected to be particularly critical to its recovery.

When the political mandate is given to implement a new economic policy, there are two levels of action: the first one has urgent direct character. This usually involves policies being put directly into practice, having results before long. The second includes policies that are being directly implemented, with the results occurring in the medium-term.

The first category includes handlings related to the closure of the output gap and effective demand. The second includes handlings related
to fiscal policy, the reorganization of the banking sector and the effective management of the productive potential of the wider public sector.

This chapter focuses on the presentation of a series of actions and policies for immediate action or for action in the medium-term for the Greek economy. More specifically, Sect. 1.2 presents issues related to the output gap of the Greek economy and the importance of its management for the implementation of economic policy in the Greek economy. The following Sect. (1.3) presents economic policy guidelines for the revitalization of the financial sector. Next (Sect. 1.4), the medium-term fiscal strategy for the Greek economy is being presented and finally, Sect. 1.5 presents the critical—for various sectors of the economy—issue of the efficiency of the public property’s management and privatization.

1.2 The Output Gap

The factors of production of an economy (physical capital, labor, human capital) are given at any point of time and they determine its maximum production capacity. When these factors are used effectively, then the level of potential product of this economy is also determined.

One of the main questions that concerns economies is whether or not the utilization of the productivity factors is fully effective. In other words, whether the produced product (GDP) is above or below the potential product (potential GDP). Potential GDP is essentially an indicator summarizing the economy’s capacity for long-term, sustainable, and non-inflationary economic growth. Thus, the output gap of an economy is calculated, as the difference between its actual product and its potential product. This is an indication of the degree of over-using or under-utilization of productive resources in relation to potential GDP.

The potential product and the output gap are two important tools of the economic science in order to evaluate the production capacity of an economy and determine its position in the economic cycle. These concepts are now an essential component of the budgetary surveillance process, as derived from the Stability and Growth Pact, as well as in assessing the effectiveness of the structural reform program, pursued in the context of the priorities for long-term economic growth.

The output gap can be either positive or negative. Negative output gap means that the actual produced product is below the full production potential of the economy. A significant disadvantage of the prevailing views on the output gap (Borio, Piti, & Mikael, 2013), is about how it
is measured, since ignoring the possible economic conditions that determine fluctuations in economic activity can lead to less accurate estimates about the potential product.

For example, an output gap of $-10\%$ means that the economy in question can produce $10\%$ higher GDP than the actual, by incorporating in the production process the inactive production factors up to the levels taken as a hypothesis for calculating the gap. In other words, the output gap is an indicator of potential productivity that exists but is not being realized. When the output gap has positive values it turns into a surplus of production, meaning that the economy is over-using resources, it’s reaching its limits, that is, full employment levels, which is a non-sustainable situation in the medium to long term. A typical example of an economy with positive value is Germany. German economy has an extremely low unemployment rate of $4\%$, well below the historical averages used by the OECD to calculate the output gap. In other words, German economy has been producing higher GDP in recent years than if the employment indicators of the productivity factors were at their medium- to long-term equilibrium levels. The reason is that the German economy serves the demand of other economies than the domestic demand, in a way that is quite profitable judging by the monstrous surpluses in its current account over the last years.

The important issue arising from the debate on the output gap of an economy, is that the phase in which an economy is determines the type of economic analysis that is applicable and the economic policy that should be followed in order to get the economy out of the output gap regardless of whether it operates below or above its productive potential. In theory, as long as an economy is at the point where it has not exhausted the available margins of economic production potential, the theoretical and political analysis of growth will belong to the field of macroeconomic analysis and when it is above its potential it will belong to the field of development analysis and policy. So basically we accept a more general logic that argues that short-term problems cannot be addressed unless they are placed in a broader long-term context.

However, the analysis should be multi-dimensional regarding the choice of theoretical and applicable policy. The period after the Great Recession of 2008 or the crisis of Covid-19 are good examples where demands for macroeconomic analysis and growth analysis coexist for both situations after economies have been operating at a level below their potential for a long time.
Hence, macroeconomic analysis and policy should be used when the economy is operating at a level below its potential. In other words, if the economy is at the point where it has not exhausted the available margins of economic productive capacity we are in areas where theories of macro-economics are being applied. Typically, during a recession or during an external shock, a negative output gap is generated since the economy produces less than it could. In such a case, a government could use monetary policy in order to strengthen economic growth (e.g., through lowering interest rates) or fiscal policy (e.g., expansionary fiscal policy in order to increase government spending).

On the contrary, if an economy has exhausted the available margins of economic capacity and the question of growth for the production capacity arises, then it is in areas where growth theories apply and development analysis and policy are implemented. A typical example in such a case is the implementation of structural reforms.

Regarding Greek economy, from 1980 to the present day, the output gap has negative values for most years. As shown in Fig. 1.1 presenting the percentage ratio of actual product and potential product, only in the years 1980, 1989 to 1992, and 2002 to 2009 the output gap recorder positive values. Of course, the recent global financial crisis highlighted the structural weaknesses of the Greek economy, resulting in the output gap falling to significantly negative prices and has remained in them until

![Fig. 1.1 Output gap in the Greek economy (%)](Source: Oxford Economics [Global Economic Model] and authors’ own creation)
Today. Indeed, the crisis of the Covid-19 pandemic seems to bring the real output of the economy to an even lower level than its potential output since the 2010 crisis.

However, the next decade should be a period of recovery for the output gap of the Greek economy. Based on the above discussion, three types of macroeconomic policies can be implemented to fill the output gap:

- The first relates to monetary policy by adopting the theoretical-positive relationship between the functioning of the financial sector and the productive sector of the economy. As for Greece, this policy is limited to the issues of reorganization of the banking system (see Sect. 1.3) due to accession to the Eurozone, since the issues about quantitative easing and interest rates belong to the European Central Bank (ECB).
- The second relates to fiscal policy and the management of the budgetary area (see Sect. 1.4). The higher the fiscal space, the less the need for Central Banks intervention through unconventional policies. The use of fiscal space is one that will be able to increase limited demand and lead to sustainable growth in the Greek economy.
- Finally there is a third version related to the creation of growth expectations. This is an interesting prospect and refers to the creation of a “growth environment“ based on the reduction of tax burden and to enhance creative motivations.

1.3 Revitalizing the Financial Sector

The way the financial system is organized and the relative importance of the intermediary process in relation to arm’s length transactions has a number of advantages, but at the same time, under certain circumstances, it also raises important questions about the smooth functioning of economic activity (Petrakis, 2011).

As Petrakis (2011) points out, in economies where the intermediary process of the banking system is the main source of financing for the business sector, cooperation between intermediaries and enterprises provides the productive units of the economy with financing at the time when they most need it, during economic turbulence and financial crises. In these
periods, financing through the market mechanism (for example issuing and distributing new securities) is only possible for robust companies (which are likely to be able to finance their investments in other ways, e.g., by retained earnings, etc.) because of the negative psychology of investors and their refusal to take higher levels of risk. After all, even those companies that retain the ability to have access to financing from the market mechanism in times of instability and uncertainty, do so by paying significantly higher costs. Because of all of the above, economies that rely to a lesser extent on the decentralized market mechanism, experience less force of turbulences.

On the other hand, economies that rely to a greater extent on the "invisible hand" of the money market, are in a better position to respond to serious technological changes and adopt the innovations that appear. In these cases, investors can, much more easily, be freed from sectors of the economy with an uncertain future (with whatever political, social, and other consequences this attitude may involve), while offering funding to the sectors with the highest growth rates. Typically, these economies are more dynamic and record higher growth rates, precisely because of their ability to invest in the most promising technologies and to adopt innovations, changing more often the structure of their productive activity.

The organization of the financial system, in addition to the business world, can greatly affect the consumption of households. In general, in economies in which most of the financing is carried out through the mediation of the banking system, consumers are most affected by income shocks. On the contrary, the ability to carry out arm’s length transactions allows households to normalize their consumption level (for it allows them to borrow using their property as collateral, taking advantage of periods of euphoria of the real estate market). However, at the same time, in these economies there is a greater dependence of the wealth of individuals on assets in their possession that are freely traded in markets. In this way, the wealth of households is directly related to the conditions in the respective markets and—thus—their well-being is exposed to sharp changes in asset prices.

From the above it can be concluded that no form of financing of economic activity is a necessary and sufficient condition for the growth of the economy (Levine, 2001; Rajan & Zingales, 1998).

However, in the Greek economy, the problem of the underfunctionality of the financial system outside of systematic banks widened
with the crisis of 2010, while it is obvious that policy measures should be adopted for four areas of economic policy. The first relates to the banking system consisting of the four systemic banks. The second is associated to cooperative banks, the third to the shadow finance system and the fourth to the development banking sector and development finance.

Until the appearance of Covid-19 the data was quite promising for the 4 systemic banks. Greek banks zeroed their dependence on ELA, deposits were returning, capital controls were effectively abolished and banks were returning to normalcy, improved operational profitability was observed, capital adequacy was maintained at a satisfactory level, the recovery of credit growth to non-financial corporations continued and the reserve of non-performing loans (NPLs) was further reduced on the banks’ balance sheets (although remains particularly high). However, the Covid-19 pandemic is expected to significantly affect both the banking industry and the progress it had started to make.

In Greece systemic banks face three serious issues: (a) the requirements for their operational and capital reorganization, (b) the liquidity problem, and (c) the issue of non-performing loans which has serious problems.

The liquidity problem is evident from a report by the European Banking Authority (2019), which analyzes the resilience of banking systems in the Eurozone by calculating the Liquidity Coverage Ratio (LCR) which examines the adequacy of high-quality reserves of liquid assets to meet short-term liquidity needs under a specific scenario of difficult conditions (stress) over a period of 30 days. It’s being recorded that the Greek banking system is the only one in the EU that has a Liquidity Coverage Ratio below 100%, while in most countries the ratio is between 100% and 200% (145% in the EU-28). Of course, the Greek banking system is a special case. The intense debt crisis forced Greek banks to monetize the liquidity cushion, and, as a result, LCR index plunged to very low levels.

At the end of December 2019 NPLs remained at a high level and amounted to 40.3% of total loans (68 billion euros), compared to 3.4% of the European average at the end of September 2019. Of course it should be noted that there was a significant decrease, by 13.8 billion euros compared to the end of December 2018 and by 39.2 billion euros compared to March 2016, when the highest level of NPLs was recorded. This is mainly due to loan sales of 8.1 billion euros and write-offs of 4.3 billion euros during 2019. With regard to the operational targets for the reduction of NPLs, the targeting of banks is that the NPL index
should have reached levels below 20% by the end of 2021 (e.g., through the “Hercules” plan). Also, a major issue concerning the management of NPLs is whether the Greek banking system will be operational with a medium-term period of management of the NPLs or whether it will proceed to the creation of a Bad Bank. But this issue requires special attention and analysis and is associated with profound social perceptions.

But all this is under review in the extraordinary circumstances and the conditions of great uncertainty caused by Covid-19 under which the banking system, as well as the real economy, is called to operate today. In other words, it is expected that the path to achieving the target of a significant reduction in the rate of NPLs will be adversely affected in the next period, but not the final target.

Regarding cooperative banks, it is an institution that in recent years is losing its momentum in the Greek banking system, while at an average European level cooperative banks cover even up to 20% of the total market. While the number of partner banks was double-digit by 2016 it has now fallen to 7 + 2 financial institutions. These institutions have a significant presence more at the regional than at the national level, numbering 110 stores in Greece with a total of 907 employees in 2019, constitute an important factor in the development of the region, financing 15% of small and medium-sized enterprises in the country, as their loan portfolio focuses by 85% on companies of this category. Overall, cooperative banks in Greece show positive credit expansion, as opposed to the systemic banks that has a negative pace. With equity at 17.5 billion, assets at 2.6 billion, loans at 2 billion and deposits at 2.1 billion, the cooperative sector has to manage two very serious obstacles: one concerns the “mountain” of non-performing loans and their coverage, as they exceed 45% of total lending (above the average of systemic groups). The second is related to their balance sheets.

Over the past few decades, the global trend shows that the financial intermediation services offer new and more complex investment products. All intermediaries other than banking institutions (Other Financial Intermediaries, OFIS) operating under the supervision of the audit authorities constitute the shadow banking system (McCulley, 2007). A key factor in the observed growth of the shadow banking market (mainly until 2007 when the global financial crisis started) is the application of increasingly binding conditions in the formal market, which gives the incentive to many banking institutions to transfer part of their activities to the informal sector. Basel III is expected to provide banks higher motives to invest
in non-banking institutions with a higher degree of leverage to avoid commitments to hold a certain percentage of capital requirements.

The shadow banking system is an expanded entity and therefore there is no specific definition that can be provided to describe it. It refers to all activities involving the provision of credit, liquidity and short-term capital to finance long-term investments outside the regulatory framework of the banking system (European Commission, 2012; FSB, 2012). Its main components are securitization activity through special purpose vehicles, and in terms of financing Money Market Funds (MMFs), repo market agreements, and hedge funds.

Measuring the size of the shadow banking market is a difficult task, at least for Europe, as there is no data available and so quantification is approximate. The most recent data from the Financial Stability Board concerning the year 2016 speak of a global shadow banking system that after the international financial crisis develops faster than the banking industry. With an annual growth rate of 8%, the assets of the international shadow banking sector are estimated at 36.5 trillion euros and accounts for 13% of the funds of the financial sector, while the total financial assets are valued at 275 trillion euros. The wider ecosystem of non-banking institutions is estimated to have 129 trillion euro assets.

In addition, there should be further expansion of the development banking sector and development finance in Greece. The establishment of the Hellenic Development Bank in 2019 and the effective beginning of its operation in early 2020 was a very important step in this direction; Greece was the only country in the European Union that does not have so far, an institution with such a key role for the development process. This deficit was particularly felt at the development level, with negative consequences in terms of sustainability and the broader characteristics of the Greek economy. The objective of this bank is to provide a lever to stimulate economic development, support businesses, and promote investments with strategic planning.

In the direction of development finance, actions are also proposed to support the strengthening of the private sector. This can be realized after adopting a growth model that would be export oriented, focusing in supporting the stability of the financial sector to ensure access to finance and support for the private sector.
1.4 The Medium-Term Fiscal Strategy

The fiscal policy applied to the Greek economy during the period of the crisis of 2008 and especially in the period after 2015 was directed to the smoothing of various structural fiscal imbalances and to the promotion of the credibility of economic policy, with the ultimate goal of regaining confidence for the Greek economy and the return of the economy to international markets.

The result of the implementation of the medium-term fiscal strategy program in the Greek economy from 2015 to 2018 outweighed the primary surplus targets, the fiscal surplus for the General Government, the exit of the economy from the excessive deficit process of the European Union and the increase of the credibility of the economy in international markets (reduction of borrowing costs, credit rating upgrade, reduction of economic uncertainty and return to positive growth rate).

Following the effects of the Covid-19 pandemic in 2020 on the Greek economy, an effective fiscal strategy program is imperative. The medium-and long-term budgetary strategy of the Greek economy up to 2030 should be directed to: (a) the creation of fiscal space through the restructuring of the public finances are being organized, (b) to maintain a program of gradually reducing fiscal surpluses in the medium term, (c) the improvement of the effectiveness of the mechanism of tax revenues, (d) changing the fiscal policy mix and the strengthening of sustainable development and (e) the protection of the fiscal credibility of the economy.

The issue of the fiscal space, which is critical for both the medium- and long-term horizon of the Greek economy, as it is committed to the permanent reduction of tax burdens, insurance contributions, and the targeted support of specific categories of primary expenditure. It is about the flexibility of a government in relation to spending options and, more generally, the economic well-being of a government (Roy & Heuty, 2009). Heller (2005) defined fiscal space as “the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government’s financial position.” However, there are different views on how to measure it as it is difficult to identify a country’s current, future and potential liabilities.

The fiscal space can be calculated either as a loss of access to markets, or as achievement of long-term viability. Both of these approaches are intertwined. On the one hand there is uncertainty about a country’s
ability to pass on debt. Fiscal space can be seen as the difference between the current level of debt and the debt limit at which the government would lose access to markets. On the other hand, the fiscal space can be defined in relation to long-term fiscal sustainability (Botev, Fournier, & Mourougane, 2016). A simple way of creating fiscal space is by reducing the liabilities of primary surpluses which pay off budgetary obligations. But why is fiscal space so important? The higher it is, the less the need for Central Banks intervention through unconventional policies. The QE program of ECB helped the fall of sovereign bonds and debt servicing costs after the crisis occurred. However, it is the use of fiscal space that will be able to increase limited demand and lead to sustainable growth.

History has shown that the emergence of high primary surpluses (more than 5% of GDP) over a long period of time (e.g., a decade) is not common. That is why a program of gradually decreasing fiscal surpluses should be observed for the medium-term future of the Greek economy. In particular, Eichengreen and Panizza (2014) using a sample of 34 developed and developing countries for the period 1973–2013 try to identify the factors associated with the occurrence over time of high primary surpluses. As they note, there are only three cases where high primary surpluses have occurred over many years. These are Belgium, Norway, and Singapore. All three are small and “special” cases. Belgium’s case is linked to the convergence criteria of the Maastricht Treaty, while Norway’s is linked to the oil in the North Sea. The authors also try to identify the economic and political factors associated with the existence of long-term high surpluses. As they note, 1% GDP growth leads to a 7.5% increase in the likelihood of long-term high surpluses.

Improving the efficiency of the tax revenue mechanism is imperative since tax rates in the Greek economy are higher than those of OECD and EU-27 countries, while at the same time tax receipts are smaller (OECD, 2018). More specifically, personal income tax rates are 33.25% for Greece and 25.74% for OECD-EU countries, corporate income tax rates are 29.00% for Greece and 23.64% for OECD-EU countries and the VAT rate is 23.00% for Greece, and 21.73% for OECD-EU countries. On the other hand, in terms of tax revenue, tax revenues from direct taxes on households are 6.5% for Greece and 9.2% for OECD-EU countries, direct taxes on business are 3.9% for Greece and 2.9% for OECD-EU countries, and tax revenues on imports are 24.6% in Greece and 27.2% for OECD-EU countries (OECD, 2018).
In addition, a change in the fiscal mix must be achieved in order state budgets over the next decade to ensure support for household disposable income, protection, and reinforcement of social care and the fight against poverty and especially child poverty. Of course these actions should be carried out together with support—in a safe manner—for the sustainable recovery of the economy.

The international environment in which the Greek economy is now moving—and in which it is expected to move over the next decade—is characterized by increased volatility in the bond markets of the countries of the European periphery but also by significant risks arising from the shock of uncertainty accompanying the emergence of Covid-19, the accelerated change in the direction of monetary policy of the United States and changes in the status of international trade. In this context, the fiscal strategy of the Greek economy should be such as to protect fiscal credibility and the inclusion of the Greek economy to international capital markets should be permanent, secure, and sustainable.

1.5 Effective Public Entities Management and Privatizations

It is necessary to activate the production potential located in the periphery of the public sector, mainly through the action of entities such as the Hellenic Corporation of Assets and Participations S.A. (HCAP).

The new, for the Greek economy, HCAP institution has the characteristics of a holding company, and this includes the Hellenic Financial Stability fund (HFSF), the Hellenic Republic Asset Development Fund (HRADF), the Public Properties Company (ETAD), while a subsidiary is established under the name Hellenic Corporation of Assets and Participations in order to manage the Treasury portfolio in public enterprises. In this way, a new body is created, the aim of which is the concentration of public property in a single body and to manage it as a whole, in order to capitalize on it.

In order to be able to take advantage of the idle capacity of the Greek economy, the use of HCAP as a pole of attraction for foreign capital should be planned. In the event of an increase in its borrowing, Greece’s private debt would increase, not the public debt. The case of Ireland, where there has been a severe shift in public debt to the “private sector,” is typical, with very good overall economic performance.
According to the relevant provisions, HCAP manages and utilizes the assets of the State in order to contribute resources for the implementation of the country’s investment policy and for the realization of investments that contribute to the growth of the Greek economy and contribute to debt reduction.

HRADF and its assets are absorbed by the “Hellenic Holdings and Property Company.” In essence, HRDHR was an institution that is identified and fully oriented to the privatization of all assets that have passed into its possession. The new institution that replaces HRDH is not exclusively committed to privatization and its goal is to use the property. It is an institution based on French standards. The corresponding French institution manages the entire value system available to the French State, companies, stocks, real estate, bank participation, etc.

Thus, the assets belonging to the HRDH portfolio, all the movable and immovable assets managed by the Public Properties Company (ETAD), the share capital of the banks that are owned by the State, through the HFSF, as well as the portfolio in public utilities.

In contrast to HRDH, whose revenues were attributed only to debt repayment, revenues from the operation of the new company will be paid 50% as a dividend to the Greek State and will be used to service the country’s international obligations and the remaining 50% will be used for the company’s growth and investment. The choice of investments will be made in the public interest.

Any privatization proposed by the company’s governing bodies must be approved by the Minister of Finance. This also applies to Public Utility Organizations that are included in the Fund as the participation of the State in PPC, EYDAP, EYATH, OSE, Attiko Metro, Building Infrastructure, OASA, OSY & STASY, OAKA (Olympic Stadium), Athens International Airport, Hellenic Saltworks, ELTA, ETVA VIPE, AEDIK (Corinth canal), OKAA (Central Market of Athens), KATH (Central Market of Thessaloniki), HELEXPO, ELVO, and KAE (Hellenic Duty Free).

Of course the issue of privatization is a variable that plays an important role in a number of critical areas such as the attractiveness of the economy in foreign capital, the evolution of the Balance of Payments, the primary fiscal balance, the liquidity of the economy, the introduction of innovation and more secondary investments. Therefore, a separate business plan is
needed for the developmental management of the issue of privatizations in the Greek economy.

NOTES

1. The case of the Irish “miracle” is the most blatant but tacit application of this example.
2. These are 7 regular members (Bank of Drama, Bank of Epirus, Bank of Thessaly, Bank of Karditsa, Bank of Central Macedonia, Pan-Cretan Bank and Bank of Chania) and 2 affiliated members (Aitoliki Pisti and Credit Cooperative of Voioita), with all members constitute the Association of Co-operative Banks of Greece.
3. As part of the ESM program, and in line with the Euro Summit statement of July 12, 2015, the Greek authorities established the Hellenic Corporation of Assets and Participations S.A.—HCAP.

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