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STRUCTURAL CHANGES OR POSSIBLE EXIT OF GREECE FROM THE EUROZONE?

1. Introduction

The monetary integration in its higher form requires the use of a common currency (Machlup 1979, p. 23). The cost that can result from a country's participation in a monetary union can be traced to the loss of its right to modify its exchange rate independently, the ratio between inflation and unemployment, and the loss of its ability to manage its regional economic policy as well as government revenue by issuing currency. The monetary integration brings many benefits. Among these is the elimination of exchange problems in the group of countries involved, in addition to increased influence on monetary issues and increase of monetary stability. The larger the area, the greater the benefits (Jovanovic 2002, pp. 292–302). The choice of the 16 countries of the European Union (EU), including Greece, to proceed to the creation of the EMU leads to the conclusion that these countries believed that the objectives of economic policy are achieved more easily when participating in a system of fixed exchange rates.

To be more precise, in the case of EMU, the rest of the countries forming the Eurozone have not simply decided fixed instead of floating rates, but proceeded to adopt the common currency, the euro, in order to mark their desire for a common monetary path in the future, a path that is irreversible.

2. Asymmetric disturbances and Eurozone

The Eurozone is not yet an “optimum currency area”, as it is characterized by a generally limited flexibility of prices and wages as well as low labour mobility and in particular has no system of financial transfers from a federal

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budget (Garganas 2001, p. 8). With the loss of exchange rate policy as a means of adjusting economy to international pressure, the members of Eurozone face asymmetric disturbances (Gikas 2004, pp. 183–87). What this means is that changes in the external economic environment affect differently the economies of individual Member States of the common currency area.

In the past, whenever the economy was hit by a crisis, an imbalance or external disturbance, the adjustment to international competition was achieved by means of exchange rate policy through devaluation or revaluation of the national currency. The rate of adaptation to the demands of international competition is not a real solution but a simple shift in time. To put it differently, by resorting to changes in the exchange rate in order to offset the price difference resulting from lower productivity or higher inflation,¹ we are not dealing with the problem but merely postponing it. The use of exchange rate policy may prove useful only in the short term, thus providing the time for the economy to adjust more smoothly to the demands of international competition.

In Eurozone countries with a lower level of development, the current disturbances hit important sectors of the economy and affect economic growth and employment more adversely than in the rest of the Eurozone. This uneven growth can cause considerable tension between Member States regarding the implementation of a common monetary policy, since there is no mechanism for fiscal transfers and the Eurozone is not yet an "optimum currency area".

Differences in living standards, particularly in the unemployment rate, will inevitably lead to political pressure to offset them through transfers from richer to poorer regions. At present, at the European level there is no financial mechanism to transfer funds to an individual member country being affected by a disorder. The EU budget is relatively small and its resources are mainly granted either as aids to agriculture or as structural aids, all of which represent less than 1.3% of EU GDP and only 2.5% of overall government spending for all EU countries (Garganas 2001, pp. 8–9). Fiscal policy in the Eurozone remains the exclusive competence of national authorities, unlike what happens in integrated federations such as the USA.

The adjustments between regions in the U.S.A. are facilitated by a system of implicit federal government transfers of real resources. The federal government spends a lot on lagging or inefficient States/regions and taxes them less, while in advanced States/regions it does the opposite. The EU, with its huge internal market, has not yet developed economic stabilizers to the U.S. scale in order to facilitate the adaptation of countries and regions within it. The EU has, however, developing structural funds. What the adaptation requires is not only the transfer of real resources, but also measures to increase the mobility of the factors from areas of low to areas of high productivity. In this respect, the EU has so far failed.

¹ For a further analysis, see Kapopoulos, Lazaretou 1997, pp. 33–35.

The need for direct financing of the EU budget by introducing a European tax (convergence tax) would create the conditions for establishing a system of transfers among members of EMU. This currently seems unlikely with the existing political relations. It would also create serious disputes between member countries on how they would share between themselves the burden of these new contributions. Consequently, members of the Eurozone are obliged to face asymmetric disturbances with their own forces.

3. The competitiveness of the Greek economy in the Eurozone

Participation in the Eurozone deprives Member States of the ability to adapt to the pressures of international competition through exchange policy. In the case of Greece, this issue becomes even more important if we consider that the Greek economy is characterized by low competitiveness compared with economically more developed EU countries.

Attempting to define the concept of national competitiveness, we could claim that a national economy is competitive if it maximizes the living standards of its citizens without recourse to large foreign loans which would disrupt the equilibrium of its balance of payments. In this case, the definition of competitiveness is technically complex, since its measurement should include all those factors that determine the level of prosperity such as growth rate, level of employment, income distribution, productivity, share of world market, etc.

Similarly, competitiveness can be defined as "the ability to produce products and services which meet the test of international markets, while maintaining high and sustainable levels of income". According to the definition adopted by the European Commission, a country or region should be considered competitive if its productivity improves at a rate at least comparable with that of its trading partners, while also maintaining external balance and achieving a high rate of job creation.

Although the improvement of competitiveness of a country or region depends primarily on internal factors, consideration of the competitiveness of an economy is often compared to the progress of other countries. The success of an economy to adjust promptly, flexibly and effectively to the requirements of a constantly changing international economic environment can be analyzed only by using as a benchmark the achievements of other national economies or regions. The search, therefore, for a better position in the arena of global competition is equivalent to a continuous process.

Usually in literature four structural factors are referred to as being closely related to regional differences at the level of competitiveness (Hyz 2001, pp. 434–46): the structure of economic activity, the skills of the workforce, the existing infrastructure, and the extent of innovative activity. All of the above

elements constitute "structural competitiveness" in juxtaposition to "price competitiveness", which denotes the level of prices with which domestic production competes with foreign products, either domestically or in foreign markets.

Following the adoption of the common European currency by Greece, inflation remained consistently above the average inflation in the Eurozone. The steady upward deviation of inflation in Greece from the average inflation in the Eurozone has reduced the international competitiveness of the domestic economy. In this case, the real exchange rate had increased significantly and the deviations of this magnitude cumulatively have had an impact on competitiveness, with negative effects on real incomes and employment.

Within the Eurozone, Greece, with its unfavourable structural features is required to slow the pace of economic growth to levels below those of major trading partners, namely the Member Countries of the European Union. In order to avoid such a development, Greece should improve price competitiveness. This is not a new situation, as Greece is an open economy already participating in international competition.

The changing parameter, which is going to bring significant changes in the operation of our production system, is the way in which the values of Greek products will adjust to international competition. There are four ways to adapt to the pressures of international competition: changing the exchange rate, lowering production costs, reducing profit margins and, finally, increasing labour productivity and improving the structural competitiveness of the economy.

By adopting the euro, Member States of the Eurozone are no longer able to use exchange rate policy as a way to adapt to international competition. Therefore, the remaining means to attain short-term adjustment is either the reduction of production costs or the reduction of profit margins. Improving structural competitiveness on the one hand, and increasing labour productivity at a rate exceeding the European average, on the other, appear to be the means to mid-term adjustment.

As far as short-term adjustment is concerned, an attempt is being made to achieve that at the expense of labour, namely by reducing the share of labour in the product; in other words, income redistribution at the expense of labour. While the adjustment of national economy under conditions of national currency is attained with national and fiscal policy as a tool, participation in the Eurozone has shifted all the pressure of international competition on labour pay and much less on corporate profitability.

However, neither the continuous transfer of the burden of adjustment to the world of labour nor the continuous reduction of profit margins is a long-term solution. This is because the former exacerbates labourers' standard of living severely, while the latter undermines the ability of firms to invest. For this reason, the two afore-mentioned adjustment policies are short-term or even

medium-term arrangements. The only solution is to increase labour productivity and the structural competitiveness of Greek economy. Labour productivity in Greece is at one of the lowest levels in the European Union.

In conclusion, the success of the economic and monetary union requires, firstly, creating a system of fiscal transfers for the transfer of resources to an individual member country being afflicted by an asymmetric disturbance and, secondly, other effective national policies aimed at structural changes for the increase of structural competitiveness.

4. Current situation and prospects of the Greek economy

The Greek economy faces a deep crisis, whose main characteristics are the large fiscal deficit, the huge debt and the continuous erosion of competitiveness. These problems existed before the international crisis of 2008 and it was inevitable that without bold and decisive interventions they would lead, sooner or later, to a dead end. As these interventions were not implemented, the situation deteriorated, culminating in the financial derailment in 2008 and 2009 and, subsequently, the escalating spreads between Greek and German government bonds. Furthermore, the international crisis magnified the accumulated negative effects of these chronic weaknesses and accelerated the decline of the economy.

These negative developments undermined confidence in the future of the Greek economy and caused a series of downgrades of the country's credit ability and a widening of the Greek-German government bond yield spread.

Since 2009, Greece has been subjected to excessive deficit procedure, as deficits in 2007 and 2008 were above the Treaty reference value. In 2009, the general government deficit reached 12.9% and public debt rose to 115% of GDP. The Greek economy is now engaged in a vicious circle and the only way out is the drastic reduction of its deficit and debt.

Public deficits and debt are certainly high in other countries, too. However, they are mainly financed by domestic savings – in contrast to what happens in Greece, where the gross national saving, public and private together, was slightly above 7% of GDP in 2008 and 5% in 2009: an amount entirely inadequate to finance even current investments. The shortfall in national saving is mainly due to large fiscal deficits and the rapid growth of private consumption during the recent years. In the five years 2004–2008, private consumption at constant prices grew at an average annual rate of 3.8%, while in the Eurozone the growth rate was 1.5%.

Low saving, first and foremost, does not allow public debt financing from domestic sources, thus leading to a swelling external debt and a widening current account deficit. Obviously, the problem of budget deficit is closely associated

with the problem of the external deficit and debt and the twin deficits emerge as the main factors creating a dangerous vicious circle.

The most visible aspects of this situation have been the widening of fiscal imbalances and debt, and the decline in competitiveness, reflected in the deficit on the current account. The crisis, however, is not confined to them. It adversely influences the entire economy, burdens the banking system, affects confidence, creates unprecedented uncertainty, and, ultimately, undermines social and economic behaviours and attitudes prevailing in the country during recent decades.

5. Conditions for ending the crisis and keeping Greece in the Eurozone

The drastic reduction of the fiscal deficit is a must for the survival of the Greek economy. Reducing the fiscal deficit and debt has to be achieved not only by means of broadening the tax base and combating tax evasion, but also by reducing waste and rationalizing and reducing primary spending – more specifically, personnel costs, operating costs and expenses for social security and protection.

Besides fiscal consolidation, it is clear that a recovery of competitiveness is necessary to happen, through deep and extensive structural changes, which:

First, will directly reduce the unit cost of production and will stem the loss of price and cost competitiveness.

Second, will contribute to the modernization of the production model; in other words, to an increase in productivity and to the formation of a new structure of domestic production – capable of meeting the domestic and external demand of 2015 and not 1970.

These changes should help to restore the sustainability of the current account deficit. What is required, therefore, is a policy mix that will restore macroeconomic and microeconomic stability and improve the competitiveness and productivity of the economy on a permanent basis. Due to the fact that during the long period of rapid growth the consumption patterns substantially exceeded the productive capacity of the economy, what is essential from now on – so as to avoid a permanent reduction in the level of consumption – is exactly to increase productive capacity; the "potential output" and the pace growth, in other words, which has declined significantly over the last two years.

Certainly, because of the accumulated effects of neglect or mistakes of the past but also because of the delays since the outbreak of the global crisis, there are no longer any "magic solutions" for the Greek economy; so the policy decisions taken during the recent months were in fact necessary. The ultimate impact of all fiscal policy measures that have been announced will depend on the

efficiency and speed of implementation, but also on the relative balance between the restrictive and expansionary effects of each measure and the package of measures in total. For example, the increase in the VAT rate increases public revenues, but incurs in inflation and could lead to further reduction in demand, while the restrictive income policy measures on the one hand reduce the revenues and demand, but on the other help reduce not only the public deficit but also the cost of labour per unit of product – a development that could lead to a moderation of inflation and increased competitiveness, thus ultimately encouraging investment.

At the same time, the effect of the fiscal policy implemented will also depend on the timely promotion and implementation of structural and development policies, preferably of low or zero cost and fast performance. The essential structural measures include:

- the fight against bureaucracy, by eliminating obstacles to the functioning of product and labour markets
- the rapid use of available EU funding of the National Strategic Reference Framework (NSRF) – 4th Community Support Framework
- the upgrading of education by implementing a national planning in addition to institutional changes.

These directions can contribute to an increase in rates of employment and fixed capital investments, as well as overall productivity, so as to elevate substantially the potential growth rate, which has declined significantly due to the crisis.

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(Summary)

In Eurozone countries with a lower level of development, the current disturbances hit important sectors of the economy and have a more negative impact on economic enlargement and employment than in the rest of the Eurozone countries. In this paper we try to evaluate the Greek experience in the Eurozone and highlight the problem of competitiveness, which is related with the lower level of development. Finally, we examine whether and how much the evolving exchange rates contribute to the stability of the economy or, instead, to the aggravation of its imbalances. Finally, the conditions for exit from the crisis are presented, in order for Greece to continue to participate in the Eurozone.