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Greek reforms can yet stave off default

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Greece's default is viewed by many as a foregone conclusion. Financial markets put the probability as higher than 50 per cent that Greek bonds will become worthless over the next five years. But we believe default can be avoided through overdue reforms. These must combine deregulation and long-term investment in education to restore competitiveness, with radical pension, healthcare and tax reform to eliminate pressure on public finances and improve incentives. They will be difficult but possible – the commercial lorry drivers' strike was called off after the government stood firm.

The pessimists' argument is simple. Greece's public debt is projected to rise to 150 per cent of gross domestic product in three years. To move from the currently large primary deficit to the large primary surplus required to service the debt will require huge cuts in government expenditure which have to be impossible politically. Recent data showed Greece plunging deeper into recession and a sharp rise in the year-on-year jobless rate. Greece's low competitiveness precludes high GDP growth in the future.

One of the pessimists' main arguments is that the Greek economy is highly inefficient. But if you turn this argument on its head, it suggests the reforms will have huge returns and they do seem feasible in the current circumstances. A large majority of the population sees the need for change, as was apparent in the public disapproval of the lorry drivers' strike.

Greece has a heavily-regulated economy: its goods market is the most heavily regulated of all 30 countries in the Organisation for Economic Co-operation and Development. Most of these regulations are inefficient and a key driver of Greece's low competitiveness. But this inefficiency can also be a source of huge gain: the OECD estimates comprehensive regulatory reform will result in a one-off increase in Greece's GDP by more than 15 per cent, with potential for more.

The removal of regulatory barriers to entry in the road-transport industry, a reform already legislated, has been estimated to raise Greece's GDP by 0.5 per cent. Similar reforms are planned in other transport industries, energy, and many professions. Regulatory reform will raise growth in the medium term as well by attracting more investment. Greece has been one of the worst OECD performers in attracting foreign direct investment.

One reason is a complicated and non-transparent institutional framework, which is also a big source of corruption. A second is an inflexible labour market with restrictive firing regulations and little room for negotiating wages at a decentralised level.

Drastic reform on both fronts will bring investment and jobs. After all, Greece is perfectly located to do business in the Middle East and the Balkans. The growth that regulatory reform will generate will reduce drastically the primary surplus required to stabilise the debt-to-GDP ratio.

Large fiscal gains are possible by pension, healthcare and tax-collection reforms. While Greece's tax rates are slightly higher than the European Union average, the taxes actually collected are 7 per cent of GDP lower. Closing this gap alone by reorganising the tax-collection system will almost eliminate the current primary deficit.

Public healthcare is one of the most dysfunctional and corrupt sectors. A drastic restructuring based on mandatory private insurance with subsidies for the poor and on the management of public hospitals by the private sector will bring high-quality healthcare to all and remove an important source of tax evasion and corruption. Large gains are also possible by moving to a pension system based on individual savings, making educational institutions more autonomous and accountable and introducing performance indicators for the public sector.

Is this feasible? Austerity measures are bound to be unpopular. But there are grounds for optimism. The hardship will be softened by factors such as the low level of household debt and the high percentage of home ownership. Public awareness is growing that opposition to reforms is often an attempt to preserve privileges that benefit the few. The government's response to the lorry drivers' strike indicates its increasing assertiveness. There is no time to lose.

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For a fuller version of this argument please go to www.GreekEconomistsforReform.com

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