
POLICY PLATFORM | Policy Letter

Reforms or Bankruptcy?

A group of Greek academic economists

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Reforms or Bankruptcy?¹

Greece is at a decisive moment that will determine its future: prosperity in a dynamic European economy or poverty and isolation for decades. Holding a huge debt that it cannot service, it is faced with the dilemma of defaulting, or accepting to carry out an economic program of structural reforms, privatization, efficient tax collection, and shrinking of the public sector. Such a program has been proposed in general terms and is financed by its EU partners and the IMF.

Unilateral suspension of debt payments would be an economic catastrophe for Greeks. Because of its primary budget deficit, Greece would have to cut civil servants' wages and pensions by 25% or more. The Greek banks would go bankrupt resulting in inability to finance Greek companies and households for a number of years. Greece would be excluded from the international financial markets for some time with very adverse effects on investment, growth, and consumption. An exit from the Euro would be even more disastrous, since it could lead to hyperinflation and extremely high borrowing costs.

The proposed reforms program contains most, but not all, elements of a solution. Structural reforms, such as opening up competition in professions and guilds and liberalising labor markets are necessary for a modern European country. Privatizations of state corporations, besides reducing public debt, helps Greece by improving efficiency and reducing corruption in procurement and management; they should be accompanied by a strengthening of regulatory mechanisms to avoid monopoly behaviour and by changes in corporate governance so that companies function effectively. Reducing the size of the public sector is crucial and must be accompanied by productivity incentives, evaluation and accountability. Efficient and fair tax collection from all including salaried workers, businessmen, and professionals is also very important, and can open the way to tax cuts, which are now infeasible. Additionally, in the present period of austerity, it is absolutely necessary for any reform package to contain funds for new investment that will promote growth. Greek banks need to expand their capital to deal with the risks of the crisis. Finally the rampant corruption has to be dealt with if Greece is to join modern European nations, attract foreign investment and avoid international economic isolation, regressing to being a poor third world country. This requires legal reforms to ensure that dishonesty is not left unpunished and particularly strict enforcement of the law.

Given the catastrophic effects of a unilateral suspension of debt payments, there is no doubt that Greece has to choose the alternative of reform no matter how difficult. In the current contingency, Greece has the good fortune that it is in the interests of its EU partners to support her because of the very adverse effects its bankruptcy would have on European banks and the threat of contagion to other weak countries, such as Ireland, Portugal and Spain and because of other political considerations. However, this is the last chance for Greece to modernize itself and this opportunity will not last long. As EU banks reduce their exposure to a future Greek bankruptcy, the EU

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incentives to keep helping Greece are reduced. This underlines the importance of implementing the reforms now.

In conclusion, Greece has to implement deep structural reforms now. Their implementation will for now at least stave off bankruptcy and its frightening economic and social consequences, and will offer a credible way out of the quagmire of a dysfunctional economy. The immediate adoption and implementation of reforms will lead Greece to a trajectory of growth and prosperity. The Greek people have suffered significantly in the last 20 months, and these reforms will justify their sacrifices.

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