



Greece's Problems, Europe's Crisis

Carlo Bastasin calls on Greece to cut costs and regain its competitive edge—and for Europe to recognize the difficulties of market liberalization in Greece.

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Steve Weisman: Greece is facing a crisis, and that means Europe is facing a crisis as well.

This is Steve Weisman at the Peterson Institute for International Economics. My guest on Peterson Perspectives is Carlo Bastasin, visiting fellow at the Institute and editor and columnist at *Il Sole 24 Ore*, a daily newspaper based in Milan. And thank you, Carlo, for helping us understand what's going on in Europe today.

Carlo Bastasin: Thanks for having me.

Steve Weisman: Carlo, let's start with some simple questions. What is the nature of the crisis facing Greece right now?

Carlo Bastasin: There are probably two different crises at least. One is the classical crisis of a fiscal nature. We've seen the loss of credibility in the last weeks due to the mismanagement and deception by the Greek government affecting the credibility and sustainability of its fiscal debt. But there is another crisis. It has to do with competitiveness of the Greek economy and that is reflected in the current account deficit showing that the Greek economy is in some ways struggling to keep pace with its European trade partners.

Steve Weisman: Greece is in danger of sovereign default, which would be quite a blow not only to the European economy but with repercussions around the world. What is being discussed to help avert such a default? Might there be a bailout that would give Greece time to get its house in order?

Carlo Bastasin: I think that the risk of default is somewhat overstated. Probably the European partners meeting in different environments, both at the European Union level and the eurozone group level, have succeeded in lending some credibility to the short-term efforts of the Greek government to reestablish its credibility and in the future rein in the public accounts.

We should not underestimate the effectiveness of the political pressure in Europe as far as fiscal policy is regarded. Let me give two examples. Belgium in the last 10 years managed to cut its public debt by one-third and even Italy, whose public debt was ranging around 126 percent 15 years ago, was expected this year to bring it down to 98 percent. But slowly the political pressure exercised by European partners is very effective and I expect that the Greeks will follow the same path.

Steve Weisman: What's the fastest way for it to reduce its debt? If it has to rein in public expenditures and wages, there's precedent for that as well, isn't there?

Carlo Bastasin: You probably are referring to the example last month of the Irish government. The Irish had a similar problematic situation and they reacted, cutting wages and regaining competitiveness. And they cut wages by a substantial measure. In the case of the public sector wages, they were cut by 15 percent, and that set an example for the private sector.

In the short term, the Irish position was much more problematic than the Greek one. But for Ireland, sure, they can cut costs, and the shortest way to cut costs is cut wages. But that wouldn't be enough. Cutting wages has a good implication for reducing the trade deficit but it has a bad implication for the Greek fiscal deficit.

Steve Weisman: How so?

Carlo Bastasin: [Cutting wages] makes it more difficult to raise taxes, for instance. And that fact can produce doubts about the long-term sustainability of the fiscal equilibrium. So Greece has to go along two parallel tracks. One is cutting costs, cutting wages; and the other is structural reform—privatization, liberalizing the market.

Let me give you a simple figure that can give you an idea of how much the room of maneuver still remains there. During the last five years, wages increased in Greece by 4.1 percent while productivity increased 1.1 percent.

Steve Weisman: Is that annual?

Carlo Bastasin: Yearly. And this is an average over the period between 2005 and 2009. In the same period, competitive countries that are competing in the eurozone with Greece—like Germany, France, and Austria—had a relatively lower increase in wages than in productivity. That means, for Greece, losing 12 percent in productivity against its partners in only four or five years. This kind of productivity loss has to be recuperated.

Steve Weisman: If Greece had not joined the eurozone, it could have done what a lot of countries do in such instances, with the encouragement I suppose of the IMF, which would be to devalue.

Carlo Bastasin: It's not an option now, and I doubt that would have been a right way even before. The point for Greece is to have a more efficient use of its productive factors: labor and capital. Otherwise, it will be able to compete only cutting prices and costs, either by devaluing or cutting wages. But this will never be enough to have growth and keep pace with the other partners.

And this is not the story only of today. It's a story of tomorrow. The kind of signals coming from Germany in the last days or weeks show that Germany is strongly determined to follow a pattern of competition based on lowering labor costs.

Steve Weisman: Maybe the German political system is ready for that—there is a conservative government. But I think you have argued in your writings that the European Union

itself is not forthcoming on having a political discussion about these issues within the European Union.

Carlo Bastasin: The nature of policy coordination in the European Union is strongly conditioned by the problem of bringing down fiscal deficits. Fiscal convergence was the main preoccupation. And actually, the European Union managed to have a relative fiscal convergence that functioned pretty well before the crisis—the fiscal deficits were actually convergent.

But this is not enough. As problems in the current account balance in the periphery of Europe show, the divergence is not on the fiscal side but on the capacity of single countries to compete in the global market or even in the European market, with good productivity, lower cost—this kind of thing.

To coordinate policy and reduce the divergence in current accounts in the European Union, you need to be able to influence national policies on labor and capital—the two factors affecting the policies toward the trade unions or increasing competition in the service sectors. This is something that is typically the prerogative of national sovereignty. If the European Union wants to and needs to affect these profound factors in the social structure of the member countries, it needs to adopt a political personality.

Steve Weisman: Do you think Germany finally is showing any signs of being ready to enter into a discussion about its own policies on competitiveness, which may be creating potential instability in other parts of Europe?

Carlo Bastasin: Germans often need some time to appreciate the effects of their national policies. But think of the intertwined situation. If 50 percent of the European economies cannot import German goods because they need to grow more slowly, the German economy will be affected. If Greek bonds become problematic, well, most of them are in the portfolios of German banks. I mean, the structure of the European economy is so much cross-border now that this kind of awareness will [be] seen in the light of day, [whether Germans are] willing or not.

Steve Weisman: Carlo, thanks very much for explaining the opportunities but also the perils of economic integration in Europe.

Carlo Bastasin: My pleasure, thank you.

