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The Greek economy: State of play and necessary reforms

Greece's GDP is 26% lower today than it was in 2008. Yet the Greeks are not the "worst off" in Europe: Lithuania has a GDP per capita of €11,800, compared with €16,500 in Greece. Despite that, Lithuania pays into the European Stability Mechanism, which provides financial assistance to... Greece.

The structure of the Greek economy is a problem, as it exports very little (the Germans import only 0.2% of their goods from Greece). It must increase its **productive capacity**. Its exports consist primarily of petroleum products, followed by agricultural and food products. Manufactured goods accounted for only 36% of Greek exports in 2013.

The **need for reform is incontestable**. Priorities include: "combating tax evasion and fraud by modernising the tax and customs authorities" in order to create a new culture of tax compliance; "pursuing reforms to modernise public services" (tax collection, statistics, etc.); and "controlling spending" and "modernising the pension system". Syriza has pledged not to cancel ongoing privatisations, and to maintain privatisation programmes for which a transfer process is already underway. The next few days will shed more light on the reforms planned by the new government.

C.U.

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Greek debt: from a shared responsibility to shared efforts

A four-month extension to the Greek aid programme was agreed on 24 February. **A short respite, but the hardest part is yet to come.** The Syriza government must substantiate its programme of reforms. The Greeks voted for Syriza because it promised change, but they have withdrawn around €2 billion from their bank accounts! They are deeply confused.

Could **Grexit** be the best option for them? Valery Giscard d'Estaing believes it is the only way to get the Greek economy back on its feet. However, it is not what Syriza wants right now. It wants to renegotiate the terms of the bailout agreement. There is no doubt that Grexit would be brutal. What would the consequences be? Greece would default on its debt and would no longer have access to the financial markets. It is highly dependent on imports, the cost of which would skyrocket. As a result, it would have to turn to China or Russia for assistance. As for the Eurozone, some believe the new governance structures established since 2012 would reduce the risk of contagion. Greece's exit would nonetheless strike a severe blow to monetary union! Because it would undermine the public finances of creditor nations. Because it would ramp up political tensions across the EU, between governing parties and "outsiders". Because it would weaken countries that have introduced tough reforms. But above all because it would prove that Eurozone membership is not irrevocable and would therefore considerably weaken the EMU by reducing it to a currency area with a fixed peg. The suggestion that a Euro does not have the same value everywhere would be corroborated. **It would not be in anybody's interest if that were to happen**.

So what should we do about the Greek debt? The Greek debt amounts to €321 billion, i.e. 177% of Greece's GDP. 80% of it is held by the Eurozone and the IMF. Who is responsible for it? Many economists believe responsibility is shared. Successive Greek governments have contributed to their country's financial failure. In 2007, Greece spent more than 14% of GDP above what it produced! Its total public and private debt was twice as big as Spain's. Greece's responsibility is undeniable. But **for every featherbrained borrower, there is a featherbrained lender!** The banks in northern Europe made huge profits. Only a very small proportion of the loans issued by the Eurozone and the IMF have gone to the Greek people (16% to pay off the interest on the national debt and 11% to pay for the Greek government's activities). The rest has mainly been used to repay creditors, in other words "northern" banks! Embarrassing.

The possibility of restructuring the Greek debt was envisaged as of 2010, but it was rejected because of the fear of contagion across the rest of the Eurozone. Should the Greeks be expected to pay for this delay? **Thomas Philippon**, a professor at the NY Stern School of Business, thinks not. Greece's debt amounts to 177% of GDP[1], 30% of this debt can be attributed to the collective management of the crisis and should therefore be shared. Of course, Greece has advantageous loan conditions. However, requiring Greece to meet a primary budget surplus target of 3% this year and 4.5% in 2016 is very harsh.

Everybody must be willing to make an effort and to grant concessions. "The Eurozone must continue to bend, if it is not to break"[1]. Let's listen to what Greek voters want, but not let ourselves be blackmailed. Let's encourage **a responsible debt restructuring plan** by reducing the primary surplus required, extending debt maturities and lowering interest rates to lighten the burden. But such measures must be accompanied **by in-depth reforms and extensive reorientation of the Greek economy**. Let's support the new government in its efforts to develop **Greek production capacity**: that is the best hope for the Greek people's future.

Carole Ulmer,
Director of Studies, Confrontations Europe

[1] http://www.voxeu.org/article/fair-debt-relief-greece-new-calculations

[2] Keneth Rogoff, « *Quel plan B pour la Grèce ?* » Les Echos, February 27th 2015

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A long road ahead

The Green Paper is just one of a whole host of initiatives. At a first glance, it seems that there is nothing to distinguish it from the others, since it is just a framework document[1]. But the debate is only just starting. The Commission's agenda spans several topics, including rights attached to securities, prudential rules for insurers and pension funds, corporate bankruptcy law, financial information and transparency, the infrastructure framework in the Union and taxation. All these topics are potentially relevant to the development of such an ambitious project. **The CMU is also a long-term project**, which we cannot expect to stimulate growth in the short term; it will only be able to influence potential growth.

But **one essential ingredient is missing and that is trust**. Trust is something that cannot be imposed upon individual investors against their will, especially if they lack the basic knowledge of how capital markets work. It is glaringly absent from the Green Paper. The Nordic countries have shown that developing a specific culture to support the groundwork produces convincing results, which can be measured by the success of Nordic stock exchanges in financing businesses. And technology plays an instrumental role in this.

Let's use this consultation to push this subject forward too.

M-F.B

[1] see the minutes from the meeting of the "Financing the Economy" working group, held on 24 February 2015, as it began deciphering the CMU (www.confrontations.org)

Capital Market Union: a long-term structuring project

By creating a 28-member Capital Markets Union (CMU), the Commission aims to "unlock frozen capital to revitalise the economy", according to the words of the Commissioner for Financial Services, Lord Hill. The CMU will make it easier to **channel available savings into the productive economy**, **broaden the range of funding sources for SMEs** and **remove the obstacles to cross-border investments**. Given the economic challenges that Europe is facing right now, the CMU is a major initiative that is in keeping with the Commission's priority goal of promoting growth and employment. The Green Paper opens the consultation on preparing a plan of action.

The CMU sits at the confluence of several issues: economic growth, investment financing, the allocation of savings and taxation. The underlying idea is to tackle problems relating to investment, lending and savings within the current context of risk aversion. The goal, once the financial situation is more stable, is to make it easier for growing businesses to access the capital markets. Is recourse to the capital market an inevitable structural trend? In fact, **only a small number of fast-growing companies are concerned**; the CMU targets a minority of SMEs, not all of them. The debate on capital market integration has been going on for years. Since the 90s, Europe has been striving to create a deep, liquid market through various regulations but has failed to prevent its fragmentation. Indeed, **unequal access to the capital markets** is a big problem in the Eurozone because of operational obstacles and the sovereign debt crisis, which has accentuated national cultural biases. It is still much easier in countries that are not subject to such tensions, and for large companies.

The dual economic purpose of this initiative – to promote stability and growth – ensures its legitimacy. However, it does raise a number of questions: how might the goals of promoting growth and facilitating access to capital be turned into practical measures? **The Green Paper lays the foundations for increasing the supply of credit**, through securitisation and private placement. Securitisation could generate €20 billion of funds for businesses. It would have to be underpinned by high European standards of quality, transparency and legal certainty, as it does engender mistrust. Private placement is a less controversial solution and is expanding rapidly in France and Germany. Lastly, the review of the Prospectus Directive should reduce the heavy administrative burden for businesses, particularly SMEs, and make it easier for them to raise capital while maintaining investor protection.

Giving a purpose to savings: how to attract the attention of private investors? This is addressed only very briefly in the Green Paper, even though it is vital to channel savings into the capital markets. According to ECB statistics, 42% of household savings in the Eurozone are invested in financial products or deposited in banks; this compares with 15% in the United States, where households prefer to invest in shares and mutual investment funds. This helps keep the capital market buoyant and gives it a certain depth.

It is by no means guaranteed that the new ELTIF[1] regulation, which is being hailed as a major breakthrough, will attract households and institutional investors. The EIOPA[2] is introducing an individual retirement saving account to encourage households to invest in the capital markets, with a long-term option. The idea is not to harmonise national pension schemes but to offer an additional (29th) scheme with a pan-European reach. Other points of vigilance: the CMU needs powerful investment banks and institutional investors to work. What will happens after the structural reform of the banking sector is of the utmost strategic importance. At institutional level, a consistent approach to monitoring both people and products is vital: what role could ESMA, the European Securities and Markets Authority, play?

Marie-France Baud,
Director of the Brussels office, Confrontations Europe

[1] European Long-Term Investment Fund
[2] European Insurance and Occupational Pensions Authority

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Nuclear power at the centre of a fierce battle on competitiveness and climate

The share of nuclear power in the European energy mix has dropped by 4.9% since 2002, from 32% to 26.7%. Bearing in mind that the global nuclear industry is taking off again – with the construction of 72 new reactors worldwide (vs. 25 in 2004) – a European disengagement now would be detrimental not only in terms of exports but also in terms of safety, which is a global public good.

Yet the nuclear industry needs long-term contracts that require the Commission's approval. After Mankala in Finland and Exeltium in France, the Commission has approved the British energy market reform, notably the CfD (Contract for Difference). This sends a strong message to countries like Poland, which are reflecting on the possible role of nuclear power in their energy mix alongside coal.

The Commission's decision has been challenged by Austria and Germany, which are threatening to bring the matter before the Court of Justice, thus provoking a reaction from 8 countries[1]. In an open letter to the Commission, they have demanded that nuclear power be recognised as a source of carbon-free energy.

The role of nuclear power in the European energy mix is still a controversial subject among the Member States: some want to step up cooperation in the field while others are battling to prevent it. Meanwhile, the IPCC has announced that without nuclear power global warming reduction targets will not be met.

C. F.

[1] France, the UK, Romania, Poland, Czech Republic, Lithuania, Slovenia and Slovakia

Energy Union: coordinating supply-side policy with demand-side policy

By comparing the Energy union to the ECSC, the Commission has voiced aspirations that fit with our own proposals[1]. But **the objectives of the new project need to be discussed, especially since there is no global vision** to give it coherence. The ECSC had a strategy of industrial expansion. Today, too much emphasis is placed on demand reduction policies alone, **disregarding the fact that the European Union also needs a supply-side policy** to stimulate new growth and boost its global competitiveness.

In today's context of crisis and rising tension with producing countries – especially Russia – energy security has (once again) become a vital economic pillar. To reduce imports (currently 53% of our consumption) and our annual €400 billion energy bill (before the drop in oil prices), the Commission has proposed that we further diversify energy sources and supply routes, develop electricity exchanges between the Member States and negotiate intergovernmental agreements with third countries. Rather than putting "an end to our dependence", **shouldn't we try to manage complex interdependencies** with energy producers and distributors more efficiently, bearing in mind that most of them live off the associated economic rent? How can we increase our exports and build new trade relations with these countries, which need to diversify their economies, and thereby promote our own industries?

The Commission has suggested building **an interconnected energy market** to enable each Member State to export 10% of its electricity production to its neighbours. It says that, as a result, consumers would save €12 to 40 billion annually, but meeting the 10% electricity interconnection target would require an investment of €40 billion. We cannot however ignore the fact that some Member States are far from producing enough electricity to meet their own needs and that the fragmentation of the internal market, coupled with the boosting of renewable energy, has had counter-productive effects: higher prices and grid costs and a greater dependence on coal to the detriment of gas and nuclear power, not to mention the fact that the business models of the big energy firms have been damaged and that fuel poverty is on the rise. Wouldn't it be wiser to think about the **incentives** needed to achieve a much **better price investment ratio**?

Such a strategy requires an **energy solidarity pact**, with the aim of developing an integrated market that optimises diversified, carbon-free electricity production at least cost. Although the 3x20 strategy had the effect of dividing Europeans instead of promoting solidarity, **the Commission is persisting along the same lines despite growing criticism**: it is imposing 3 restrictive new targets, which interact and oppose any desire to promote national energy diversity and do not give the Member States any real choice regarding their energy mix. Furthermore, although **energy efficiency** is a vital issue, all initiatives to promote it to date have **failed because they have not developed into a real industrial policy** that would not only reduce consumption but also improve energy performance in the residential and transport sectors.

Lastly, the **2030 greenhouse gas reduction target of 40%** (60% by 2050) **is justified** but it must be brought into line with our growth model and our global competitiveness. Any **reform of the carbon quota market** must be accompanied by the introduction of an appropriate **tax system** and (why not) the establishment of a central carbon bank. Only by clarifying the economic stakes can we bring on board countries like China and the USA, which have become the biggest polluters on the planet. They could then become our allies in promoting carbon-free energy sources.

Claude Fischer,
Director, ASCPE-Les Entretiens européen

[1] See the booklet published by Confrontations Europe "Energy: a pioneer of European construction yesterday, a driver of European reconstruction today. For a competitive and inclusive European climate strategy by 2030." May 2013. www.confrontations.org.

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Juncker Plan: social investment

Some senior EU officials are calling for part of the €315 billion under the **Juncker plan to be invested in social projects**, which do not only generate costs, but are also a factor of development[1]. But is the EU really able to implement the recommendations of the 2013 Social Investment Package? Considering the discussions at the two conferences co-hosted by Confrontations[1], **it is doubtful.**

If we limit ourselves to using existing tools, there are a number of issues that have to be addressed:

- defining social impact goals ex ante for budget and financial rationalisation reasons and then accurately measuring them ex post is difficult when the goals in question concern human capital, innovation and very long-term investment, as there will always be an element of unmeasurability;
- monetising impact assessments to incorporate them into cost/benefit analyses can therefore lead us to invest only in what we already know and to steer the future with our eyes constantly on the rear-view mirror, while granting increasing authority to experts;
- Lastly, investment in social organisations that are an integral part of long-standing systems of protection cannot be governed by straightforward venture capital rules. Therefore, to maintain the necessary diversity of methods, an essential programme of theoretical and practical research is being implemented.

Nicole Alix,
Confrontations Europe

[1]« Unequal Europe, Recommendations for a more Caring EU », High level groupe report on « Social Union », Les Amis de l'Europe, spring 2015.

[2].http://www.confrontations.org/fr/conferences/2015

Social impact investment: testing, evaluating, debating

In June 2013, B. Hamon asked me to represent France in a **G8 task force** on **social impact investment**. I accepted for three reasons. Because it was the Minister for the Social and Solidarity Economy who was asking, which was a reflection of the French government's position on the matter. Because France must take part in international discussions on the subject, and not just drop it simply because the British and Americans have taken the leading role. And because we are going through a period of social and economic change and new social approaches are needed. I am interested in finding out how we can "**go from social spending to social investment**" while continuing to adhere to objectives of general interest. Social impact bonds are not, in my opinion, deemed to replace subventions, but they should complete them, by financing innovation.

I set up a committee of 29 qualified individuals with backgrounds in solidarity finance, social entrepreneurship, public and private banking, academia, government, international organisations and so on. I have just one regret, which is that traditional associations working in the health and welfare sectors for example are under-represented. For a year I took part in meetings of the international task force, and I have a few remarks I would like to make. First, the diversity of the French committee was an advantage in itself. Second, these people are not used to talking to each other and do not know each other very well. We decided to continue these valuable discussions into 2015. Talking to other countries helps us progress and move forward. Seven countries shared their experiences in social and financial innovation with the task force, which was chaired by Ronald Cohen. It acted as a "knowledge centre" on this new and exciting subject. However, I quickly realised that **there is not enough past experience of social impact investment to develop sure and universal methods**. **Everyone is searching,** in particular for **greater efficiency, in terms of social public spending/measurable results for the beneficiaries.** France can be proud of its efforts in this respect. We presented the French solidarity finance system to the task force, putting the spotlight on solidarity-based employee savings and 90/10 funding.

The French report contained **21 proposals**. Unfortunately, the debate focused rather too quickly on "social impact bonds". Social impact investment is a much broader concept. It involves using public money as leverage. It obliges stakeholders to sit down around a table and define common objectives, identify the resources needed and develop assessment indicators. This requires further reflection and public debate.

Therefore, the initiatives taken by Confrontations Europe in Paris and Brussels are very important: they allowed an **open debate** between numerous stakeholders and they offered an **opportunity for academics to study the subject in depth.** Eve Chiappelo's work is, in this respect, promising. Another key point is that they **stepped up the debate with the Germans.** Their social model is significantly different to the Anglo-Saxon model. We need to listen to what they have to say about social impact investment. Last but not least, they **aimed to develop a pan-European approach.**

President Juncker needs to tell us what role he foresees for social impact investment in his plan to stimulate the economy through investment (€300 billion). He also needs to pick up Commissioner Barnier's work on social entrepreneurship and the measurement of social impact as a matter of urgency.

As for me, I have set my sights on two goals: **protecting the interests of beneficiaries and promoting co-production.**

Hugues Sibille,
President of the French Committee for Social Impact Investment.

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