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IN BRIEF

The Athens Effect: 5 Reasons Why France (and the EU) Should go Greek on Debt

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Greece - The Long Road Back

Greece has long been viewed as the weakest member of the Euro Area. Its three rescue packages, organised initially by the European Commission, European Central Bank (ECB) and the International Monetary Fund (IMF) sparked an unprecedented decade of economic and political turbulence. The austerity (and declining living standards) associated with the bailout period came to define the structural flaws of the Euro currency. For a time in the mid-2010s, Greece's survival in the Euro was irrevocably entwined with political events in both Brussels and Berlin. Yet, throughout this period Greek public support for both EU and Eurozone membership remained high.

With the onset of the Covid-19 pandemic in 2020, Greece's debt to GDP ratio was pushed to a historic high of 207%, higher even than during the bailout crises of the preceding decade.

However, the past four years have seen a remarkable transformation of Greece's long term debt sustainability. As of Quarter 3, 2023 Greece's debt stood at 165% of GDP – a decline of over 42 percentage points, or over a fifth – in just three years. Longer-term projections indicate that debt to GDP levels will continue to fall and may achieve a lower level than Italy and France by the end of the decade.

In 2023, Greece – for the first time since 2010 - reattained investment grade status from three of the four biggest ratings agencies. Latest forecasts indicate continued strong debt reduction driven by moderate growth and sustained primary budget surpluses. Debt to GDP levels are likely to fall under 150% in late 2024/early 2025. Despite continued structural challenges – low productivity, demographic profile and increasing environmental risks – Greece is still projected to outperform its Euro Area peers in the medium to long term.

France – The First Cut is the Deepest

France, on the other hand, is still unwilling to confront its economic crisis. Distracted by its relative economic stability, it is, in effect, sleepwalking into a Greek-style debt reckoning.

During the Great Financial Crisis, even sympathetic economists noted that the "*Greek government has had a habit of living beyond its means*". Similar sentiments should now be applied to France. Remarkably, France has not run a budget surplus since 1974 despite repeated policy proposals to rein in public spending from both sides of the political spectrum. French debt levels rose from 20% of GDP in 1980 to over 111% in 2023. Public spending now accounts for over 58% of the total economy in France (compared to about 50% for Greece).

This has resulted in a French budget deficit of 5.5% in 2023 and an acknowledgement that existing measures to reduce public spending are woefully inadequate. President Macron has no plan to balance France's budget. Even his modest aim of reducing borrowing to 3% of GDP by 2027 is increasingly

unlikely to be achieved given the scale of the spending cuts required.

As one French economist noted, "*France has twin problems of a negative trade balance and wide public deficits….now rising interest rates and slowing growth have shown the risks of this broken model, and everyone is panicking. But we should have panicked long ago!*"

Worryingly for France (and the EU), Paris' economic estimates are having to be revised due to its economic weakness. This is having a negative impact on its economic credibility. International investors are already doubting the French government's credibility on debt reduction and are reducing their exposure to French debt.

Sound familiar? This bears direct echoes to the onset of the Greek crisis in 2008 and 2009.

5 Reasons Why France (and the EU) should go Greek on Debt

The past decade has been filled with a plethora of studies, reports and opinions as to the lessons arising from the Greek crises. However, much of this analysis focuses on the causes of the initial crisis or on the rights and wrongs of the specific bailout programmes.

However, Greece's economic renaissance (and disappearing debt) over the past years shows that the "*Athens Effect*" can provide political pointers for future policy in both Paris and Brussels. Lessons which, if not fully understood and applied, will likely result in another Euro Area crisis in the not-too-distant future.

1. In an Unfinished Currency Union, Monetary Policy Can't be an Excuse for Political Inaction

Worryingly from both a French and Euro Area perspective is that the Euro's institutional architecture remains incomplete. Banking Union and Capital Markets Union remain stuck in the political wilderness. Worse, there remains no clear strategy for their development.

Political will to reform the Euro dramatically declined following Mario Draghi's "*whatever it takes*" mantra in 2012. Politically, the attraction of using monetary policy (i.e., cheap money) as an easy fix to avoid fiscal or structural reforms remains strong. President Macron *de facto* espoused this view in his recent Sorbonne speech calling for a revamped Euro Area (i.e., French) monetary and fiscal policy.

The reality for countries like France is that the markets' view of their debt sustainability is no longer based on economic fundamentals. Rather, it is now predicated on the explicit assumption that the ECB will intervene in the debt markets no matter what the crisis ahead.

However – politically - such an approach is just a convenient excuse for domestic inaction, particularly regarding the failure to implement difficult (but necessary) economic reforms. Similarly, it reduces the incentives to tackle ever-expanding levels of public spending.

This political approach serves no coherent economic strategy. Rather, it will just foist further borrowings upon economies barely able to generate meaningful growth. As seen in Greece, only consistent primary budget surpluses and an ongoing programme of structural reform can reduce debt levels significantly and sustainably in the long run.

2. Growth – not Inflation – Is the Key Determinant of Debt Reduction

Detailed analysis highlights that growth – not inflation – remains the key component driving the reduction in Greece's debt to GDP ratio since 2020. This is a key characteristic of the vast majority of EU member states who have seen debt levels decline since the pandemic (Cyprus, Portugal and Croatia).

Historically, some states such as the United Kingdom (UK) post-1945 used financial repression to reduce high debt levels (The UK's debt approached 270% of GDP at the end of World War 2). This strategy – involving a high level of centralised coordination between government and the financial sector – requires inflation to be kept consistently higher than interest rates, and is once again proving a popular point of discussion among economists. Such an approach has obvious attractions for politicians in the context of point 1 above.

And while there are many similarities between the policies employed by the Euro Area to deal with the Greek crises, it is also clear that these measures are having longer-term negative impacts on the functioning of the common currency area. Similarly, such policies are practically impossible to implement in a currency union of 20 members.

Financial repression is not a viable tool for high debt member states – like France – to reduce their public debts.

3. *Political Continuity (and Policy Coherence) are Essential*

Nothing signals the end of meaningful reform efforts like a recent national election, or the opposition of well entrenched interest groups like trade unions. President Macron's overdue adjustments to the French pension system resulted in mass protests and contributed directly to his declining public support. His domestic focus is also continually distracted by his wider insertion into wider global affairs.

The experience of Greece since 2019 illustrates two key elements underpinning successful debt reduction strategies. The first is political continuity – at least two parliamentary terms – are required to implement a continuous range of structural reforms. Even now in 2024 – 5 years since first entering power - the government of Greek Prime Minister Mitsotakis is engaging in an ongoing process of economic modernisation involving reducing tax evasion, speeding up the judicial system and broadening the range of university education, among a host of other initiatives. It's a constant process of unblocking structural inefficiencies.

Yet, this level of political continuity must be accompanied by a commitment to policy coherence, even in the face of considerable domestic political opposition. This, in turn, requires a high level of political focus and coherence at parliamentary level. It also necessitates an ability to pursue key reforms irrespective of the prevailing economic climate or wider geopolitical concerns. These issues are often used as a rationale for slowing or abandoning much needed modernisation efforts.

France is the obvious example of where a degree of political continuity has not been matched with policy coherence. The result is broad inaction.

4. *France (and the EU) Can't Afford to Wait for the Next Crisis*

Despite the comfort offered by access to the financial markets, Euro Area membership and its sheer size (second largest economy in the EU), France cannot ignore indefinitely its increasing national debt nor its inability to generate sufficient growth levels to change its underlying debt to GDP dynamics.

The ongoing currency crisis facing the Japanese Yen – and the constraints Japan's high public debt imposes upon its government – is a timely reminder of the wider economic vulnerabilities associated with limited fiscal space. Despite what many progressive politicians (and economists) so desperately want to believe – debt still matters, and debt still narrows political options in a crisis.

High debt, no credibility on reform, no long-term strategy on economic modernisation and political inaction are a dangerous recipe for an economy dependent on public spending for a huge amount of its economic activity.

Such a cocktail makes France uniquely vulnerable to the next Euro Area crisis. And while the implicit assumption in Paris is that France is "*too big to fail*" – the socio-economic costs associated with managing the next crisis would likely push French debt past the levels Greece witnessed during the Great Financial Crisis. This, in turn, would necessitate a level of fiscal retrenchment currently deemed unrealistic in Paris.

Yet, given France's scale, the next crisis may well have more negative outcomes for both France and the Euro Area as a whole.

5. *"Finally, it all Comes Down to Politics" (and Political Credibility)*

Ultimately, Greece's ongoing success in reducing its public debt is based on a combination of political continuity, commitment to reform, fiscal management, constant

modernisation and a laser-like focus on maintaining sufficient growth to sustain positive debt dynamics.

This *Athens Effect* should be used as a template for other members of the Euro Area.

Underpinning all these actions is a level of political credibility which derives from a commitment to achieving an easily understood economic strategy.

And that's why France, and the rest of the EU, should go Greek on debt.

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