OPINION:

# Act your size

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## *A small country perspective on the ongoing Greek crisis*

The Greek crisis rolls on even after last weekend's agreement. There are sharp tensions within Europe as well as growing doubts about the political and financial sustainability of the deal.

At the core of the ongoing Greek crisis is a failure to properly understand the importance of national scale. Small countries are not scaled-down versions of large countries. Small countries face more policy constraints, are more exposed to shocks, and have much more limited margin for error. It matters that Greece is a small country, with a population of 11 million people.

This small country perspective helps to explain the origins of the crisis, why it has been mismanaged and misinterpreted, and provides some guidance on what might be done. Three groups have missed the importance of national scale: the Greek government; the creditor institutions; and large country pundits.

*Greek government*

If you are a small country, certain things follow in terms of the policy approach. But for many years Greece has not acted as a small country, has not taken seriously the experiences of other small countries, and is now suffering the consequences. Greece has made several strategic policy errors.

First, Greece has not focused on building a productive economy with firms that can compete in global markets. Greece is markedly different from other small advanced economies on multiple key measures such as: a low export share (30% of GDP compared to shares of 50-90% common among nearby small European countries); a low knowledge intensity of exports; and low public and private investment in innovation (about 0.6% of GDP compared to a small country average of about 2.5% of GDP). Greece's historical strong growth was reliant on the domestic sector, supported by loose fiscal policy.

Greece has neither a lean, productive domestic sector nor an innovative, competitive external sector. Indeed, even with a massive internal devaluation in Greece over the past few years, and now a much lower euro (because of quantitative easing by the European Central Bank), Greek exports have reduced. This is in stark contrast with other southern Europeans, such as Spain and Portugal, whose exports grew after similar events.

Second, Greece has run large, sustained fiscal deficits, reaching 14% of GDP in 2008, leading to a very high public debt stock (at about 130% of GDP before the Eurozone crisis). The lack of fiscal sustainability became obvious when growth rates slowed during the global financial crisis. This record contrasts sharply with small advanced economies, which act as fiscal conservatives – fiscal balance, low public debt – because they know that fiscal space can erode quickly in small countries and that they are subject to high levels of capital market discipline. This is why many small advanced economies made strong efforts to restore fiscal balance after the crisis.

Greece's final strategic policy error was to leave itself exposed to large countries, ignoring (perhaps ironically) the well-known lessons of Thucydides from the Peloponnesian Wars: "the strong do what they can, the weak suffer what they must". These uncomfortable political realities explain why small countries try to minimise their external financial and geopolitical exposures. Small countries should not over-estimate their importance; requiring large countries to expend financial and political capital on your behalf is a high-risk strategy (exacerbated in this case by the political grandstanding of the Syriza Government). Other small European countries, such as Ireland, positioned themselves more realistically through the crisis.

*Europe and the creditors*

Successive Greek governments are the primary authors of Greece's misfortune. But the creditor institutions also share some of the blame. This is not so much because they imposed excessive austerity, worsening the Greek recession, but that not enough focus was placed on developing a growth strategy.

Substantial debt relief is clearly required – the IMF estimates that Greek government debt will peak at about 200% of GDP in the next couple of years, even on optimistic assumptions – and this needs some agreement on stabilising the structural fiscal outlook. But the negotiations were dominated by detailed arguments on fiscal balance targets, pension cuts, increasing VAT, and the like. These matters are important, but by no means sufficient: without stronger growth, there can be little hope for achieving the fiscal targets.

And the negotiations were much less creative on the growth side. The usual laundry list of orthodox measures were on the table: labour market flexibility, privatisation, institutional capability-building – right down to greater competition among bakeries. Most of these actions are necessary for Greece, but they are unlikely to place the Greek economy on a sharply different economic trajectory. Many specific demands were made of Greece, but these measures do not amount to a small country economic strategy with a sharp focus on where and how the economy is going to compete in global markets.

The problem is that large country experts are not well-placed to advise a small country on how to grow. Greece was seen as a regular country in crisis, not as a small country in crisis. The absence of a clear understanding of the elements of a small country economic strategy has limited the outcomes achieved because the formal process has not been focused tightly on what really matters.

*Large country pundits*

Lastly, there has been a prominent stream of large country economic commentary that has treated the Greek crisis as primarily due to imposing austerity on a weak Greek economy. In this reading, the main element of a solution to the Greek crisis is substantial debt relief.

Greece's debt load is (now) clearly unsustainable. But the large country framing of the crisis as a consequence of a German-led austerity agenda mischaracterises the fundamental issues. Several high-profile US economists (such as Paul Krugman, Joseph Stiglitz, and Jeffrey Sachs) are playing out a US policy debate in a much different small country context. Many of these commentators also criticised small European countries for pursuing tight fiscal policy after the crisis, an approach that worked relatively well.

More prominent small country voices may have led to a more balanced framing, with a focus on Greek growth and competitiveness. It is instructive that the small country approach to Greece has been consistently different from many larger countries. Small country governments have been the toughest in the negotiations, perhaps because the small Europeans deeply understand what being a successful small country requires.

*Implications*

The negotiations, tension and uncertainty will likely continue for some time. But irrespective of the outcome of this process, the immediate implication is that Greece needs a small country economic growth strategy. To this end, Greece should engage seriously with small countries. Successful small countries like Singapore and New Zealand, as well as small European countries like Ireland and Denmark, could help Greece identify areas of strength, attract investment, build strong public sector institutions, and so on.

There are also direct implications for Singapore and other small advanced economies. First, the Greek experience vindicates the policy approaches that many small countries have in place: conservatism on fiscal balance, a focus on competitive strength, strong public sector institutions, and maintaining important external relationships. Small countries should continue in this direction. And it is a reminder of the acute risk exposures that small countries face, and the limited margin for error.

Second, this experience emphasises that small countries need to have a louder voice on global policy debates. More small country voices may have led to a reframing of the Greek debate, and a more constructive process. These issues are too important to be left to large country voices and institutions. Small countries, including Singapore, need to find creative ways of contributing small country perspectives more forcefully to the global policy debate.

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## About the author

Dr David Skilling is the founding Director of Landfall Strategy Group, which was established in 2011. David advises governments, companies, and financial institutions in several small countries, and writes regularly on global macro, globalisation and geopolitics from a small country perspective. David has recently served as Senior Advisor to the Secretary of Foreign Affairs & Trade in New Zealand, and as a Fellow at Singapore's Civil Service College. Previously, David was an Associate Principal with McKinsey & Company in Singapore, as well as being a Senior Fellow with the McKinsey Global Institute. Before joining McKinsey, David was the founding Chief Executive of the New Zealand Institute, a privately-funded, non-partisan think-tank. Until 2003, David was a Principal Advisor at the New Zealand Treasury. David has a Ph.D. in Public Policy, and a Master in Public Policy degree, from Harvard University, as well as a Master of Commerce degree in Economics from the University of Auckland. David was named as a Young Global Leader by the World Economic Forum in 2008.

## About Landfall Strategy Group

Landfall Strategy Group is a Singapore-based research and advisory firm that provides advice on strategic issues to governments, firms, and financial institutions, particularly in small advanced economies. We provide distinctive perspectives on emerging global trends, working with decision-makers to understand key global changes and how governments, firms, and institutions should respond and position themselves in the emerging global economic and political environment.

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