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A Euro-Crisis View from Greece*

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RÉSUMÉ

L'un des programmes les plus sévères d'austérité jamais appliqués à l'échelle mondiale a évolué au cours des deux dernières années et demie en Grèce. Les "Mémorandums" (premier et deuxième), signés entre le gouvernement grec et les créanciers institutionnels de la Grèce, le la soi-disant «troïka» (Commission européenne, Fonds monétaire international et Banque centrale européenne) ont non seulement renforcé le clivage profond existant dans la société grecque entre pro-européens partisans de l'Europe européistes et nationalistes, mais il a également servi en tant que nouvelle ligne de démarcation de la société grecque et du corps à la politique, créant la polarisation entre les camps «pro-» et «anti-mémoire». Le gouvernement actuel pro-européen de coalition réformiste, (Nouvelle Démocratie, le PASOK et la Gauche démocratique) - qui a été rendue possible parce que dans les élections de juin 2012 la peur de la sortie de l'euro a prévalu sur l'opposition aux politiques d'austérité - réalise que la conditionnalité politique d'ajustement est en effet la dernière chance de la Grèce de réformer l'État grec et l'économie au sein de l'euro. Cependant, les seuls efforts de la Grèce, quoi que nécessaires ne sont pas suffisants pour réussir. A la fin de la journée, tout dépendra si la zone euro va démontrer convoquer la volonté de traiter la crise en zone euro comme une crise systémique de l'UEM, ce qui nécessite de profondes modifications de son architecture et de l'innovation dans les politiques appliquées. En effet, le grand défi à venir pour la zone euro est à venir avec la nouvelle opportunité affaire grandiose qui assurera l'euro pour une durée de vie de sorte que le mur de séparation qui est en cours de construction creepingly dans la zone euro, c'est à dire entre les «vertueux» du Nord et les "ratés" du Sud, soit démoli avant de détruire démolir l'Union.

ABSTRACT

One of the harshest austerity programs ever applied on a global scale has been evolving over the last two and a half years in Greece. The "Memorandum" (first and second), signed between the Greek government and Greece's institutional creditors, the so-called "troika" (European Commission, International Monetary Fund and European Central Bank) have served as the new dividing line of the Greek society and body politic, polarizing between "pro" and "anti-Memorandum" camps. The current coalition government (New Democracy, PASOK and the Democratic Left) –which was made possible because in the June 2012

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elections the fear of euro-exit prevailed over opposition to austerity policies– realizes that adjustment policy conditionality is indeed Greece's last chance to reform the Greek state and economy within the euro. Greece's efforts alone are, however, necessary but not sufficient for succeeding. At the end of the day, it will all depend on whether the eurozone will summon the determination to treat the eurozone crisis as a systemic crisis of the EMU, requiring far-reaching amendments to its architecture and innovativeness in the applied policies. Indeed, the great challenge ahead for the eurozone is to come up with the new grand bargain that will secure the euro for a lifetime so as the dividing wall that is creepingly being erected in the eurozone, i.e. between the "virtuous" North and the "failed" South, be torn down before it brings down the Union.

Crisis, adjustment, recession and despair

Greece's current debate on Europe has been subsumed by the ongoing eurozone crisis, which the country is experiencing in the most traumatic way. Greece's GDP shrank by little below 7% in 2011, and it is expected to decline by another 7% in 2012. In what is already the fifth consecutive year of recession, the country has lost cumulatively over one fifth of its 2008 GDP. 2013 is also forecast to be a year of recession. Unemployment is at 24%; 55% of young people up to 25 are unemployed and 630.000 Greeks are long-term unemployed. Social services have been affected by massive spending cuts, which have slashed the waste of the pre-crisis period, but have also led to serious shortages in the provision of vital social services, such as health care and childcare. Poverty rates, homelessness, crime, and suicide rates are galloping. Desperation is everywhere.

One of the harshest austerity programs ever applied on a global scale has been evolving over the last two and a half years. The total primary budget deficit was reduced by 8,2 percentage points of GDP over two years (2010-11); in cyclically adjusted terms the reduction was 11 percentage points. This is the fastest fiscal consolidation in any OECD country for decades, and it carried a toll in aggravating recession. At the writing of this report, new additional 14bn budget cuts were being finalized by the three-party coalition government. Successive nominal wage and pension cuts have been applied since early 2010, together with sharp tax increases. An average public sector employee has probably lost about 30% of their take home income. Similar wage cuts have been widely implemented across the private sector, where labor legislation has been liberalized, opening way to extensive flexible and part-time employment. In February 2012, a 22% minimum wage reduction (32% for new workers under 25) was instituted, in an effort to frontload the reduction of unit labor costs.

Unsurprisingly, public sentiment has been heavily affected. Public trust in government, the parties and institutions has sharply declined. The two parties (ND and PASOK) that dominated Greek political life alternating in power since 1974, fell from a total vote of 77% in 2009, to just 32% and 42% in the twin elections of 2012 (May and June). On top of being implicated in serious corruption and mismanagement scandals of the past, both parties are heavily blamed for the crisis. But the blame this time is also pointed towards Europe.

Greece traditionally posted a public opinion which, since the 1990s, was among the most pro-EU. Over the 1990s and 2000s, the Eurobarometer surveys of Greek public opinion indicated some of the highest rates of support for European integration. Europe love has turned bitter, and national confidence has been shattered under the worst economic crisis of the entire postwar period. The typical EU acceptance question on the May 2011 Eurobarometer registered 38% of respondents replying that Greece's EU membership is a "good thing", with an unprecedented 33% considering it a "bad thing". A 5% positive margin (from the highs of 60% and 70% in the 1990s and 2000s) was the lowest recorded since the 1981 launch of the Eurobarometer. And pro-EU sentiment is declining rapidly. In the spring 2012 Eurobarometer, the negative image of the EU among Greek respondents exceeds the positive by 14 percentage points. Indignation is vented against the entire status quo, domestic and European.

A bitter sentiment is spreading in Greek society, that eurozone partners have subjected Greece to excessive and unjustified austerity. Toxic assertions of a "punitive" treatment of Greece by Germany are spreading like wildfire in the public debate. Extremists and populists have rushed to exploit anti-German sentiment, stirring up wartime memories and nationalistic impulses.

Division Lines I: Europeanists vs Nationalists

The crisis is intensifying a deep-running cleavage in Greek society between, to put it simplistically, Europeanists and nationalists. There is growing nationalism and anti-globalism on the right- and left-wing extremes of the ideological spectrum. In the recent 2012 elections, the ages between 18 and the 30s overwhelmingly voted for parties either of the radical left (Syriza) or of the extreme and nationalistic right. The moderate, pro-European ideological centre, traditionally expressed by ND and PASOK, is hollowing down, limiting its electoral influence to older age cohorts.

That said, the radical left Syriza, the major opposition party, has avoided anti-European and nationalistic rhetoric. Though comprising different factions, some of which are far too extreme even to be taken seriously, Syriza officially remains a party of the European radical left. Its virulent opposition to the "Memorandum" and "Merkel's policies" rallies against austerity, advocating a maximalistic and rather inchoate anti-capitalist vision of Europe, which, despite elements of economic nationalism, shuns cultural nationalism and vociferously opposes xenophobia.

Despite societal anguish and disillusionment, Greece so far remains anchored to the EU project. Over the 1990s and 2000s, a pro-European ideology became hegemonic in Greek society, seeing the European Union and its most advanced members as the model towards which Greece should aspire. This was not an unconditional hegemony, for the Europeanist ideology always had to cohabit with (and often appease through various concessions) a traditionalist, ethnocentric, anti-Western, instinctively Euro-skeptic ideology. Western-leaning, reform-minded elites have vitally relied on the EU as the single most important strategic and ideological ally, "enlisting Europe" in the purpose of promoting the country's socio-political and institutional modernization.[1] Such elite and middle class groups have consistently operated as an influential advocacy coalition in support of EU-led reforms in Greek society. By and large, they supported the George Papandreou government's effort to prevent a chaotic default of the Greek economy in 2010, championed the November 2011 coalition government under Lucas Papademos, and are backing the effort of the present coalition government of Antonis Samaras to implement the program agreed with Greece's partners and creditors.

Moreover, despite extensive pockets of Southern or Balkan parochialism, Greece remains an overall highly educated, middle class, European society, with globally one of the largest rates of student emigration abroad. A country which has experienced its 30 years of EU participation in a beneficial manner, and which, in large numbers, cannot conceive a national trajectory outside the European Union. And about 70% of the public opinion wants Greece to remain in the euro. No major political force is against Greece's EU or EMU membership, with the isolated exceptions of the orthodox Communist Party (KKE) and the fascist Chryssi Avgi (Golden Dawn); the latter entered Parliament in 2012 with a shocking 7% of the national vote. Some voices from Syriza have also expressed a preference for return to a national currency, but the party remains officially pro-EU and pro-euro.

It is easy to understand that the closer one moves towards the "drachma camp" or the nationalist fringes, the greater the euroscepticism. In these fringes alternative geopolitical "visions" of Greece's vocation are being proposed. Under their rather amorphous line of thinking, the benefits from Greece's allegiance to EU institutions are dwindling, the eurozone is becoming the locus of unconditional German hegemony and endless austerity, and the only way for Greece to reassert its sovereignty and defend its national interests is to embark on a "realist" policy of exploiting its new geopolitical standing in the regional security and energy map or seek strategic alliances and partnerships with other geopolitical actors active in the region, such as Russia. Though marginal, such type of thinking is gaining momentum.

Division Lines II: Euro vs Drachma

Not only is there little nostalgia for the days of the drachma (times of high inflation and low growth) but the catastrophic implications of a Greek exit from the euro are broadly understood by a majority of Greeks. The Greek economy would lose decades of development, and the country would slide into socioeconomic and political chaos. The large currency devaluation (or consecutive devaluations) would result in uncontrollable inflation, which would undercut any competitive boost gained in the first place. But even that would be questionable. Greece has a tiny export sector of little above 20% GDP; Greek exports have a high import content, relying heavily on imported energy, raw materials and other components. Thus currency devaluation would not deliver the anticipated advantages. Instead, a euro-exit would involve devastating consequences. Bank deposits would be wiped out, mass private sector bankruptcies would further increase unemployment, real wages would fall, prolonged legal and financial chaos would ensue, a steep, probably double digit loss of output would follow as a direct aftermath of a euro exit. The country would still have to reduce deficits and implement reforms, but it would lose its main reform impetus for doing so. A euro exit would constitute national defeat, depriving Greece of its crowning post-1974 strategic achievement, participation in the core of EU institutions.

Division Lines III: Pro-vs anti-Memorandum

The "Memorandum" (first and second), signed between the Greek government and the so-called "troika",[2] has been the focal point of the public debate since the 2010 bailout and attached conditionality. It has served as the new dividing line of the Greek society and body politic, polarizing between "pro-" and "anti-Memorandum" forces. This branding of course is not symmetrical; the term is employed by the "anti-Memorandum" camp to define themselves and their opponents, defenders of the necessity or sheer inevitability of adjustment.

It is an only apparent paradox that the societal majority is both pro-euro and anti-Memorandum. In a January 2012 opinion poll (Public Issue), 72% of respondents declared themselves against the Memorandum, with only 16% in support. The current coalition government of ND, PASOK and the Democratic Left was made possible because in the June 2012 elections the fear of euro-exit prevailed over opposition to austerity policies, and the 50-seat bonus to the first party helped ensure a parliamentary majority. A growing part of the Greek party system and society, while pro-euro, also strongly believes that the austerity policy mix, without compensating measures, is by now too strong and "killing the patient". This section of the electorate is probably the new middle-ground in crisis-time Greek politics, providing the new pivotal median voter. The coexistence of a pro-euro and anti-Memorandum stance is also conveniently combined with a belief that the threat of a forced "Grexit" is exaggerated, given the profound destabilization it would cause for the remaining eurozone members. Syriza's 2012 dynamic appeal to a large part of erstwhile PASOK voters is explained by the systematic dissemination of the aforementioned triptych of assertions (euro is good, Memorandum is bad, Grexit is impossible), leading to an adventurist electoral pledge of unilateral abrogation of the Memorandum.

A Moment of Self-Awareness: the Reformist Narrative

To a significant extent, the Greek adjustment flies in the face of conventional economic wisdom. The right time to cut budget deficits is when the economy is growing, not shrinking. The moment to implement reforms is in good times, not bad. However, by joining the euro, Greece consciously surrendered a significant degree of autonomy for the club goods of EMU. And by ending up with a huge net foreign debt and an unserviceable public debt, Greece lost any remaining autonomy to its creditors. Greece had ample opportunity to sustain primary budget surpluses and implement reforms under a far more favorable environment until 2008, but it didn't.

Contrary to Spain or Ireland, whose crises resulted from private sector imbalances on which EMU was neglectful, the Greek debt crisis was the orthodox public sector crisis the EMU handbook kept warning about, yet

EMU proved incapable of preventing. Greece's crisis did not originate from its banks; it was a public debt crisis that subsequently spread to the banking system and the real economy. By the beginning of 2010, Greece was already the weakest link in the eurozone as a result of chronic loss of fiscal control, a bloated and corrupt public sector, a narrow tax revenue base, an unsustainable current account deficit, a huge public debt, and a large net foreign debt of 90% GDP, from single digit levels in the mid-1990s.

The Greek crisis was the meeting point of a domestic public debt crisis and a euro-systemic crisis. Two storms met over Greece, and created the perfect storm. A prolonged high growth period until 2008 had been wasted without sustaining primary budget surpluses and reducing the public debt/GDP ratio. The good times had not been employed to reform public administration and local government, the health and pension system, the labor and product markets, the education system, the professions and services sector, the justice system, fiscal governance and tax administration. These reforms are now being applied under severely adverse circumstances, some heavily contributing to the recession. Yet such reforms are necessary, and they require a greater degree of domestic ownership.

The pro-European, reformist coalition realizes that Greece is not viable within the euro unless the country confronts the structural problems that led to the crisis in the first place. They see the crisis and adjustment policy conditionality as a last chance to reform the Greek state and economy within the euro. But they also realize the tremendous risks of a prolonged shock therapy that ends up severely debilitating the patient. And they are aware that, though Greece must do whatever it takes to remain in the euro, Greece's efforts alone are necessary but not sufficient for succeeding. At the end of the day, it will all depend on whether the eurozone will summon the determination to treat the eurozone crisis for what it really is, a systemic crisis of the EMU, requiring far-reaching amendments to its architecture and innovativeness in the applied policies.

Adjustment Delivering - but the Vicious Spiral Must End

Arduously and painfully, under the tight monitoring of the troika of partners and creditors, Greece is changing. Despite serious implementation problems, an unprecedented scale of long-due reforms has already taken place, earning Greece the 1st place on responsiveness to OECD growth recommendations in the OECD *Going for Growth* report of March 2012. Three years after the gasping fiscal deficit of 15,6% GDP was revealed for 2009, Greece is a breath away from primary budget balance. The much maligned internal devaluation strategy seems to be delivering. In terms of real effective exchange rate based on unit labor costs, Greece has recovered 2/3 to 3/4 of the ground lost since euro accession, and in 2013 the recovery will probably be completed.[3] The external account is improving as the recession reduces imports. Much of the competitiveness and productivity gains result from production declining at a slower rate compared to the decline of employment. Recession is the main mechanism through which the accumulated economic imbalances of the pre-2008 period are correcting. But further recession cannot go on for long.

Greek commitment to the adjustment program is prerequisite to any solution. But simultaneous austerity programs in Europe and the decline of global and European demand are undermining the eurozone periphery's effort to exit recession through export-led recovery. Fiscal contraction, at a time of recession, is self-defeating, as it leads to deeper recession and target slippage, necessitating even heavier portions of austerity, into a vicious spiral. Structural reforms are growth-conducive only on the medium- to longer-term. Urgently needed are serious offsetting measures to provide the necessary oxygen for the economy to breathe, and these can only come from the eurozone.

For some time now, Greece's main problem is not the budget deficit (which is declining), nor even competitiveness (which is recovering); it is the lack of finance for the real economy. Credit has all but frozen even for healthy companies, foreign suppliers are demanding cash for imports, and investors are reluctant to commit capital under an endlessly poisonous speculation about a Greek euro-exit. Even efficient, export-oriented Greek companies are unable to compete if they cannot access finance or if their cost of capital is many times that of their Northern competitors. "Country risk" is leading the Greek economy to suffocation.[4] "Convertibility risk" is reproduced and sustained as long as the eurozone fails to put an end to the Grexit speculation once and for all and convincingly defend the irreversibility of the euro project. An unequivocal and determined backstop to the euro-exit speculation is the first eurozone-level prerequisite for halting the vicious downward spiral of the Greek economy.

Negative Scenarios - Mapping the Risks

Greece's strategic effort through the crisis has been to adjust and persevere, to remain around the table until a collective solution for the eurozone crisis is reached, and be part of that collective solution. One may thus conceive several negative scenarios. Their probability is low but not negligible:

1. Greece clinches on but the eurozone fails to provide a viable collective solution by moving to deeper integration. Intra-eurozone imbalances grow out of control, political divisions intensify, the eurozone eventually breaks up. Clearly, this is not just a return to the EMU status quo ante. European integration regresses, the single market *acquis* is at stake, and Greek confidence in Europe is shattered.

2. The eurozone reaches a collective solution but Greece is unable to follow. The euro moves ahead without Greece. Greece is cut off or falls behind as a result of economic collapse, party political implosion, social explosion, an anti-euro government, or a government unable to hold on, or a combination of the above. Should Greece exit, the breakup dynamic would be uncontainable for the rest of the eurozone.

3. Greece stays in the euro but is unable to bounce back to recovery. It sinks deeper into recession, depression evolving into a humanitarian crisis. Greece becomes a critical fragile state, further destabilizing an already unstable neighborhood.

Scenario 1 is negative, scenarios 2 and 3 are catastrophic. If Greece is cut-off from the euro or if austerity continues to hurt for a generation, then Greece's EU commitment could come into question. The new generation of Greeks would permanently identify the EU with joblessness, misery and impoverishment. Long-term unemployment would cut them off permanently from a proper career track, turning them into a lost generation. The influence of anti-EU and anti-systemic forces would multiply. Social tensions would spread from Greece to the rest of the Eurozone South. For several years Greece would fall under the deleterious influence of extremist politics. A country which, since 1974, was positively transformed under the benign forces of Europeanization, would now feature as a flagrant failure of Europe.

Though frequently recycled by international analysts, such scenarios remain of low probability, multiplied however by their catastrophic implications. The eurozone has recently demonstrated the determination to defend the single currency area in its integrity. Nevertheless, taking such low-probability scenarios into account helps illuminate the risks that lie ahead. Moreover, given the domestic and regional fluidity, one realizes that the geopolitical and security implications of the Greek economic crisis are potentially consequential. It is dawning upon Western and European partners that a catastrophic upshot of the Greek drama could face them not just with incalculable economic and sociopolitical costs but also, few years down the road, with the historically charged question "who lost Greece?"

A Positive -and Plausible- Way Forward

It is more interesting and challenging to sketch a plausible way out of the crisis.

Implementation of the economic program is the minimum precondition, especially with regard to the structural reforms. It could lead the Greek economy to sustainable recovery in 2014 if supported by important adjustments:

- a frontloading of program financing or extension of the fiscal adjustment by two years, to moderate its harsh recessionary impact;
- a direct growth stimulus at EU level, through a combination of: direct targeting of budget resources, structural funds and urgent unemployment relief, to offset the procyclicality of adjustment policies in the South; greater engagement of the EIB and the EIF; a demand stimulus in the core eurozone countries, to facilitate intra-euro rebalancing as the South reduces unit labor costs; a depreciation of the euro towards the same effect;[5]
- some public debt relief, as debt sustainability has been undermined not by non-compliance but by excessive recession. This could involve a realistic adjustment of the current official debt service profile through extended debt maturities, low coupons, and bank recapitalization directly through EFSF/ESM, combined perhaps with a buy-back program for the public debt that remains in the markets. In addition, a mild OSI not affecting eurozone governments could be considered, to bring down the public debt/GDP ratio to as close to 100% by 2020.

The positive scenario presupposes that the eurozone survives the crisis intact, by making brave strides to the direction of banking, fiscal, economic, and political union, as outlined by several converging reports.[6]

The great challenge ahead for the eurozone is to come up with the new grand bargain that will secure the euro for a lifetime. Through further integration, EMU continues to remain a positive sum game; it falls upon European leaders to persuasively convey this to discontented electorates. And it also falls upon them to counter the nationalistic animosity, resentment and stereotyping that prepare the ground for the mental and psychological disintegration of Europe. The new dividing wall that is creepingly being erected in the eurozone, between the "virtuous" North and the "failed" South, must be torn down before it brings down the Union.

So far, the Greeks have been clinching on to the euro, taking unprecedented pain as the inevitable price to be paid. They have endured far-reaching and necessary adjustment, buying time together with the Eurozone as the latter strives to find its own pace. But the Eurozone muddling through cannot go on indefinitely, and the pain threshold has already been exceeded.

NOTES

1. G. Pagoulatos and X. Yataganas, "Europe Othered, Europe Enlisted, Europe Possessed: Greek Public Intellectuals and the European Union", in J. Lacroix and K. Nikolaidis (eds) *European Stories: How National Intellectuals Debate Europe*, Oxford, Oxford University Press, 2010, pp.183-202.
2. Memorandum of Understanding (MOU) on Economic Policy Conditionality, Signed between Greece and the Institutional Creditors (EC, IMF, ECB).
3. Bank of Greece, Monetary Policy 2011-2012, March 2012, p.27. http://www.bankofgreece.gr/BogEkdoseis/NomPol20112012.pdf
4. G. Pagoulatos, "Greece Should not be Sacrificed for the Euro", *Financial Times*, 15.8.2012.
5. S. Darvas, "Intra-euro Rebalancing is Inevitable but Insufficient", Bruegel Policy Contribution, 2012/15, August 2012.
6. Most notably the proposals of President Van Rompuy; also the Report of the Tommaso Padoa-Schioppa Group, "Completing the Euro: A Road Map Towards Fiscal Union in Europe", Notre Europe, June 2012.