Desperately hanging on:

A euro-crisis view from Greece*

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The Greek debate over Europe is directly related to its traumatic experience at the epicentre of the crisis. Since 2010 the country has had to deal with sky high interest rates, severe recession, harsh austerity, structural reform and the indignity of emergency injections of cash to keep it solvent. Many Greeks, who had seen membership of the European Union as a factor of socioeconomic progress, now blame elements of Europe for much of what they face. New political movements such as Syriza have capitalised on this discontent. However, the most negative – even catastrophic – scenarios involving Greece remain unlikely, provided conditions allow the fundamentally pro-European sentiments of the majority of Greeks to reassert themselves. If not, Greece could become the weakest point for the European project, with the potential to inflict incalculable economic and socio-political costs on the rest of the EU.

The figures show the extent of the trauma that Greece is undergoing. Its GDP shrunk by around 7% in 2011 with a similar decline expected in 2012; in this fifth year of recession it has lost cumulatively over 20% of its 2008 GDP; unemployment sits at 24% (55% for young people) with 630,000 long-term unemployed; vital social services have been caught up in the massive spending cuts; poverty, homelessness, crime, and suicide rates are galloping.[1] The harsh austerity programme is making itself felt in pensions and take home pay in both the public and private sectors.

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[1] See also Nicos Chrysoloras, "Greece's Economic Despair Gives Rise to anti-European Sentiment", http://www.eliamep.gr/wp-content/uploads/2012/07/chrys1.pdf

Unsurprisingly, public sentiment has been badly affected. Public trust in government, the parties and institutions has sharply declined. The two parties (New Democracy 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 finger of blame is also pointed towards Europe.

By spring 2012 the Eurobarometer survey suggested that 14% more Greeks consider the EU a 'bad' thing than a 'good' thing. This is a reversal of the situation over the previous two decades, when the gap between those with a positive view of the EU compared to a negative view reached highs of over 60%. Greece's Eurozone partners (especially Germany) are blamed for subjecting the country to excessive and unjustified punitive austerity, and these sentiments have been seized upon by extremists and populists.

Division lines I: Europeanists versus nationalists

The crisis is intensifying a deep-running cleavage in Greek society between, to put it simplistically, Europeanists and nationalists.

Nationalism and anti-globalisation is found on both extremes of the political spectrum, appealing in particular to the young (who tended to vote for the radical left (Syriza) or the nationalist right in the 2012 elections). Support for the traditional pro-European centre parties (ND and PASOK) is increasingly limited to older cohorts. (However, Syriza has avoided anti-European rhetoric. Its virulent opposition to the 'Memorandum' and 'Merkel's policies' may incorporate elements of economic nationalism, but it shuns cultural nationalism and vociferously opposes xenophobia.)

Despite this, Greece has remained anchored to the EU project. During the 1990s and 2000s a pro-European ideology was largely hegemonic in Greek society, seeing advanced EU members as the model towards which Greece should aspire and 'enlisting Europe' to assist in the modernisation project. [2] The elite and middle class groups who formed the core of this ideology supported the Papandreou government's efforts to prevent a chaotic default in 2010, championed Lucas Papademos' November 2011 coalition, and are backing the efforts of the current Samaras administration to implement the programme agreed with Greece's partners and creditors.

This ideology is based upon the benefits Greece has gained from the EU over 30 years of participation, including high levels of studying abroad. Most Greeks cannot conceive of the

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[2] 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.

country existing outside the EU, and membership is only opposed by the orthodox Communist Party (KKE) and the fascist Chryssi Avgi (Golden Dawn).

The alternative geopolitical visions that are proposed on the fringes are based upon the supposition that the benefits of EU membership are dwindling, with the Eurozone the locus of unconditional German hegemony and endless austerity. The argument follows that Greece must assert its sovereignty and defend its national interests by embarking on a 'realist' policy that exploits a new geopolitical standing in the regional security and energy map, or seek new strategic alliances with other actors such as Russia. Though marginal, such thinking is gaining momentum.

Division lines II: euro versus drachma

The broad pro-European anchor in Greek society is echoed in wide support for the euro – around 70% say they want to remain in the single currency. Not only is there little nostalgia for the drachma (memories of high inflation and low growth) but the catastrophic implications of an exit from the euro are broadly understood by a majority of Greeks to mean the loss of decades of development along with socioeconomic and political chaos. A devalued currency would lead to uncontrolled inflation, offsetting and undercutting any gains in competitiveness (although with a tiny export sector (just over 20% of GDP) that is itself heavily reliant upon imported energy and materials, such gains would be limited). Meanwhile bank deposits would be wiped out, mass private sector bankruptcies would increase unemployment, real wages would fall, and prolonged legal and financial chaos would ensue. 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- versus anti-Memorandum

The "Memorandum" (first and second), signed between the Greek government and the so-called "troika",[3] has been the focal point of the public debate since the 2010 bailout and the attached conditionality. Given the general pro-EU and pro-euro consensus the Memorandum has served as the new dividing line for Greek politics and society. 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 for the leading 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 now too strong and "killing the patient" (in a January 2012 opinion poll (Public Issue),

[3] Memorandum of Understanding (MOU) on economic policy conditionality, signed between Greece and the institutional creditors (EC, IMF, ECB).

72% of respondents declared themselves against the Memorandum, with only 16% in support). This pro-euro, anti-Memorandum section of the electorate is probably the new middle-ground in Greek politics, and conveniently combines with the belief that the threat of a forced "Grexit" is exaggerated, given the profound destabilisation 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 that holds that budget deficits should be cut and reforms implemented as economies grow, not shrink. Greece had a far more favourable environment to adjust before 2008, but did not. 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 proved incapable of preventing. It was a public debt crisis that subsequently spread to the banking system and the real economy. The Greek crisis was the perfect storm of a domestic public debt crisis meeting a euro-systemic crisis.

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% of GDP (from single digit levels in the mid-1990s). Reforms are seen as necessary in areas ranging from labour markets to the health system, pensions to the services sector, yet their implementation under current adverse circumstances may even be contributing to the recession. The pro-European, reformist coalition realises 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 realise the tremendous risks of a prolonged shock therapy that ends up severely debilitating the patient. And they are aware that Greece's efforts alone are necessary but not sufficient for succeeding: it will all depend on whether the Eurozone summons the determination to treat the Eurozone crisis as a systemic crisis of the EMU, requiring far-reaching amendments to its architecture.

Delivering adjustment - 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, a programme of long-awaited reforms at an unprecedented scale is already being implemented, 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 unit labour costs.[4]

Greek commitment to the adjustment program is prerequisite to any solution. But simultaneous austerity programs across Europe and the decline of global and European demand are undermining the Eurozone periphery's efforts to exit recession through export-led recovery. Fiscal contraction during 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. Offsetting measures are required to provide the oxygen the Greek economy needs to breathe, and these can only come from the Eurozone.

For some time now, Greece's main problem has not been the budget deficit (which is declining), nor even competitiveness (which is recovering); it is the lack of finance for the real economy. Credit has been all but frozen even for healthy companies, foreign suppliers are demanding cash for imports, and investors are reluctant to commit capital under 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.[5] "Convertibility risk" is reproduced and sustained so 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, including Greece.

Negative scenarios - mapping the risks

Given the importance of measures from the Eurozone, Greece's strategic effort through the crisis has been to adjust and persevere, to remain at the table until a collective solution for the crisis is reached, and be part of that collective solution. One may thus conceive of several negative scenarios with low (but not negligible) probability:

1. Greece ploughs on with austerity and reforms, 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 and the Eurozone eventually breaks up. 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. 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

[4] Bank of Greece, Monetary Policy 2011-2012, March 2012, p.27. http://www.bankofgreece.gr/BogEkdoseis/NomPol20112012.pdf

[5] G. Pagoulatos, "Greece should not be sacrificed for the euro", *Financial Times*, 15.8.2012.

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, with depression evolving into a humanitarian crisis. Greece becomes a critical fragile state, further destabilising an already unstable neighbourhood.

All three scenarios are potentially catastrophic, in different ways. If Greece is cut off from the euro or if austerity continues to hurt for a generation, Greece's European commitment could come into question. A lost generation would identify the EU with joblessness, misery and impoverishment. The influence of anti-EU and anti-systemic forces would multiply, with social tensions spreading from Greece to the rest of the Eurozone South. A country which, since 1974, was positively transformed under the benign forces of Europeanisation, would now be a flagrant failure of Europe.

Although the Eurozone has recently demonstrated its determination to defend the single currency area in its integrity, taking such low-probability scenarios into account helps illuminate the risks that lie ahead. Given the domestic and regional fluidity, the geopolitical and security implications of the Greek economic crisis are potentially consequential. It is now dawning upon its partners that a catastrophic upshot of the Greek drama could face them not just with incalculable economic and sociopolitical costs but also, a 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 programme (especially structural reforms) is the minimum precondition. The Greek economy could be led towards sustainable recovery in 2014 if supported by important adjustments:

- 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 labour costs; a depreciation of the euro towards the same effect.[6]
- Some public debt relief (as debt sustainability has been undermined not by non-compliance but by excessive recession), involving measures such as extending debt maturities and bank recapitalisation directly through the EFSF/ESM.

[6] S. Darvas, "Intra-euro rebalancing is inevitable but insufficient", Bruegel Policy Contribution, 2012/15, August 2012.

Of course this positive scenario presupposes that the Eurozone survives the crisis intact, by making brave strides to the direction of banking, fiscal, economic, and political union.[7] The Greek experience shows that sacrifices can be made as the price for a new grand bargain that will secure the euro for a lifetime, and prevent the divide that is growing between the 'virtuous' North and the 'failed' South. Just as Greece lies at the centre of the euro crisis, it is also at the centre of what happens next. If Greece fails to contain the internal forces generated by the crisis and the response to it, the impact will be felt across Europe; if Europe fails to find an effective way to deal with the euro crisis, the impact on Greece will be catastrophic. But forging a sustainable euro in the longer term will rely heavily upon Greece's continuing commitment to being a meaningful part of the project of European integration, despite its current pain.

[7] 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.