The Greek Trajectory to the Crisis: An Orthodox Failure

Spyros Blavoukos and George Pagoulatos
Greece: A Record of EU Villainy

- Greece: isolated and marginalised in the past
  - Early 1980s: 1981 change of government (socialist PASOK altered fundamentally the domestic political underpinnings of the Greece-EC/EU relationship);
  - Early 1990s: foreign policy and security issues – ‘Macedonia’ issue

- Is this time different? Why?

- Two pertinent issues rise:
  - domestic political contours and how it has internalized the external constraints associated with the European integration process over time;
  - adjustment pressures emanating from and the structural deficiencies of EU policies that have unintended or perverse effects.
The Road to Accession (1960s-1970s)

- Two distinctive discourses: economic development and sociopolitical democratization

- 1950s-1960s:
  - import substitution industrialization (ISI) and financial interventionism
  - a state-driven policy pattern corresponding to a protected market and a deeply under-developed civil society
  - Association Agreement with the European Economic Community (EEC): propped up the export orientation of the Greek economy
    - Not only a commercial Treaty; for Greece, a step towards integration in the EEC
BUT, necessary domestic institutional adjustments did not occur [lack of pressure for such changes following the interruption of the relations, 1967-74]

Greece’s postwar model of economic growth: synthesis between a steadfast commitment to monetary stability and developmental interventionism in finance

- 1960-73, real wage increases lagged substantially behind GDP growth rates
- the reallocation of workforce from farming to manufacturing (1960s) resulted in rapid increases in aggregate productivity per worker which offset wage rises [given the low marginal productivity of agricultural labour]
1970s: end of Bretton Woods; monetary policy autonomy generated an inflationary politicization of monetary policy
- over the 1970s the Greek economy was inflating at a substantially higher rate compared to its main trading partners

Democratic transition substantially expanded the limits of protectionism at the expense of macroeconomic discipline ['economic democratization']
- Socioeconomic groups, especially labour, pursued their interests more effectively
- Real unit labour costs rose (at the expense of profits) by about one third between 1975 and 1985

Primacy of politics over policy
Accession Negotiations:

- the application overlooked fundamental economic and social realities; political rather than economic rationale
- attempt to consolidate the newly restored democratic regime and advance the international position of the country after the 1974 Cyprus imbroglio
- negative Opinion of Commission
- hasty negotiations to avoid entanglement with the Iberian enlargement
- economic competition led to the gradual unveiling of the economic structural weaknesses
From Divergence to Convergence (1981-1999)

- **1980s**: Greece faced immense difficulties to adjust to the requirements of integration
  - PASOK in office (1981): first years, continuous highlighting of the ‘Greek distinctiveness’
    - Memorandum (1982) to renegotiate terms of accession (exemptions from common market *acquis* and financial assistance)
    - 1983 Drachma devaluation: total surprise to the nine European partners
    - first Greek presidency (1983) exacerbated existing frustrations
  - Economic policy:
    - very slow liberalization (only the hard core of Greece’s obligations to the EC)
    - tariffs and quotas were replaced by selective protectionist policies (quantitative restrictions, a regulatory tax on imports, and export subsidies);
    - Protectionism began to decline significantly only after 1990
macroeconomic picture: more depressing

- fiscal expansion led to inflation and deterioration of the trade balance (especially given the removal of trade barriers following EC accession)
- Throughout the 1980s, annual average growth less than 1%, well below the EU, OECD, or Southern European average
- labour productivity 0.5% ↑, compared to an annual 3% ↑ of Greece’s trading partners.
- per capita income and relative wage levels in Greece 4% ↓ vis-à-vis the EU average
FIGURE 6
Economic Growth: Greece and EU, 1961-2000

1985: second electoral victory of PASOK;

Stabilization Program (1985-7):
- first systematic move towards the orthodox economic adjustment orientation
- backed by an EC balance-of-payments support loan
  - Conditionality at work: gradual abolition of credit subsidies; EC-imposed credit liberalization the only structural reform of the program

At the same time, Integrated Mediterranean Programmes (IMPs); complemented later by the Community Support Frameworks (CSFs)
CSFs: three-fold impact on Greece:

- Constant source of fund flows in the Greek economy, (averaging 4.47% in the first and 7.20% in the second CSF); contribution to achieved growth rates: ranging from 1.9 to 2.3%; economic impact depended heavily on absorption rates.

- Important managerial challenges: a new administrative ethos and practices in the form of rational planning and decentralized management and implementation.

- Community funds have ‘purchased loyalty’ in the Greek society.
1990s: The period of adjustment and convergence
- 1991: another balance of payments support loan; Commission included more austere adjustment policies and a stricter surveillance mechanism
- By mid-1990s: Domestic political discourse elevated EMU accession to the main national objective; scope and pace of necessary reforms to achieve this objective
- Macroeconomic stabilization, reduction of public deficits and inflation, took precedence over microeconomic reforms
- Significance of EU factor: a clear, tangible and positive set of policy directions in the form of the Maastricht eligibility criteria for EMU membership.

But also unintended consequences: EC/EU-induced financial liberalization led to disinflation but also raised the cost of public debt financing.
Greek fiscal consolidation:
- relied extensively on the revenue side of the budget with timid structural reforms especially in the labour market and pension system
- privatization was more successful, driven primarily by a fiscal revenue-raising incentive but also by EU pressures for deregulation and liberalization; BUT high proceeds partly used to finance current government expenditure
- socio-political consensus was assisted by the significant policy convergence between conservative and socialdemocratic governments
Ithaca Not Found: The Unintended Effects of Eurozone Membership (2000s)

- In retrospective, accession to the Eurozone did not provide the safe macroeconomic harbour Greece was looking for,

- Why? (a) structural deficiencies of the Eurozone per se; (b) domestic economic mismanagement

- Greek crisis in the late 2000s as the meeting point of two crises: a Eurozone structural crisis and a twin domestic crisis emanating from unsustainable public borrowing levels and a whopping current account deficit that could no more be financed through cross-border capital inflows.
Between the mid-1990s and 2007, Greece registered one of the highest average annual rates of GDP growth in the Eurozone and the EU (over 3.5 percent)

BUT debt-driven growth (average level of total economy’s net borrowing exceeded 7% GDP -mainly after accession to the euro)

the Greek economy became overindebted to the rest of the world in order to finance a growth model which (being based on a bloating of imports, consumption and the non-tradeable sector of the economy) was not sustainable.
Source: Eurostat (2013) and AMECO (2013)
EMU environment: cheap credit that generated a moral hazard-type situation; soft budget constraint for the public sector, and uninhibited capital inflows (which funded the growing current account deficit)

As a cumulative result, over the 2000s, Greece suffered an estimated real exchange rate appreciation of 25-30%, leading to declining competitiveness and the gaping 15% current account deficit of 2008

the gradual build-up of the economic crisis passed almost unnoticed by the alleged Eurozone watchdog – or what remained of it -, namely the Stability and Growth Pact (SGP).
Conclusions

- Greek case illustrates two sets of limits:
  - the limits of domestic adjustment capacity
    - adjustment bounces against structural, sociopolitical and economic features of the Greek polity
  - the limits of Europeanization
    - *modus operandi* of EU policy programs and initiatives and their impact are debatable; intended and unintended (mostly negative) effects
    - Accession process/SM and capital liberalization/regional policy (structural funds)/accession to EMU/SGP functioning