The Greek Trajectory to the Crisis: An Orthodox Failure

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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 discources: 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

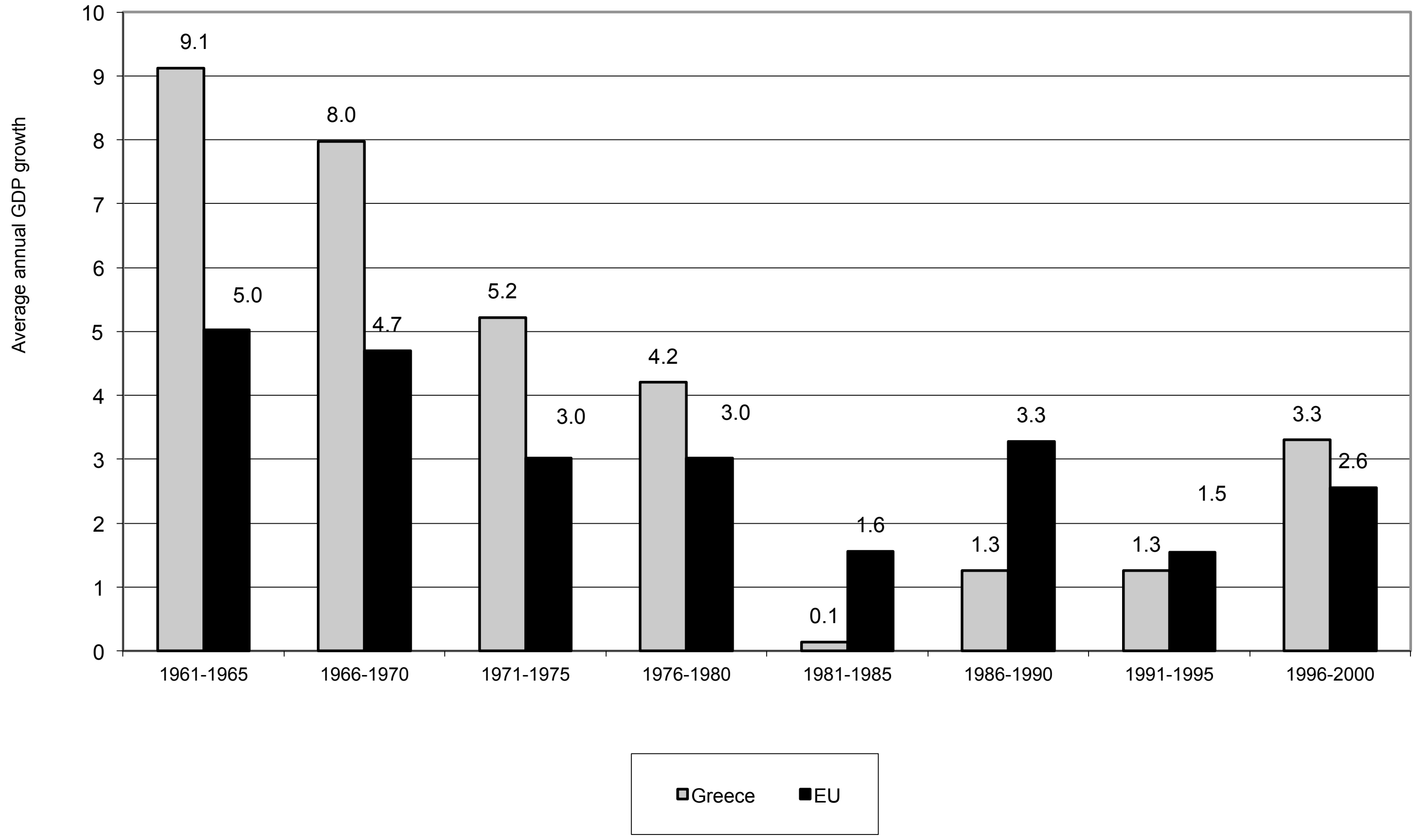
From Divergence to Convergence (1981-1999)

- **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



Source: European Commission (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

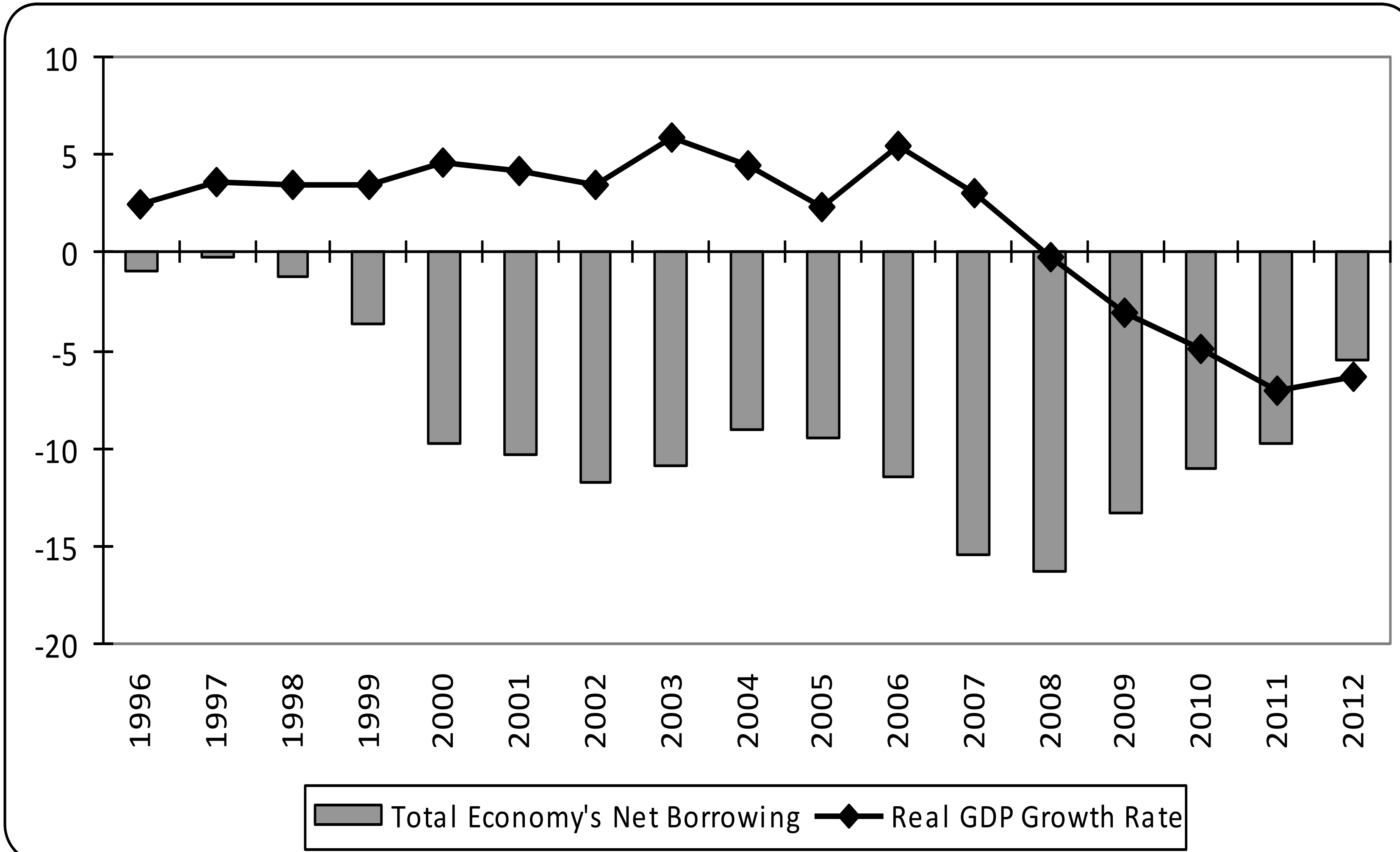
- **1990s:** The period of adjustment and convergence
  - 1991: another balance of payments support loan; Commission included more austere adjustment policies and a stricter surveillance mechanism
  - By mid-1990s: Domestic political discourse elevated EMU accession to the main national objective; scope 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)

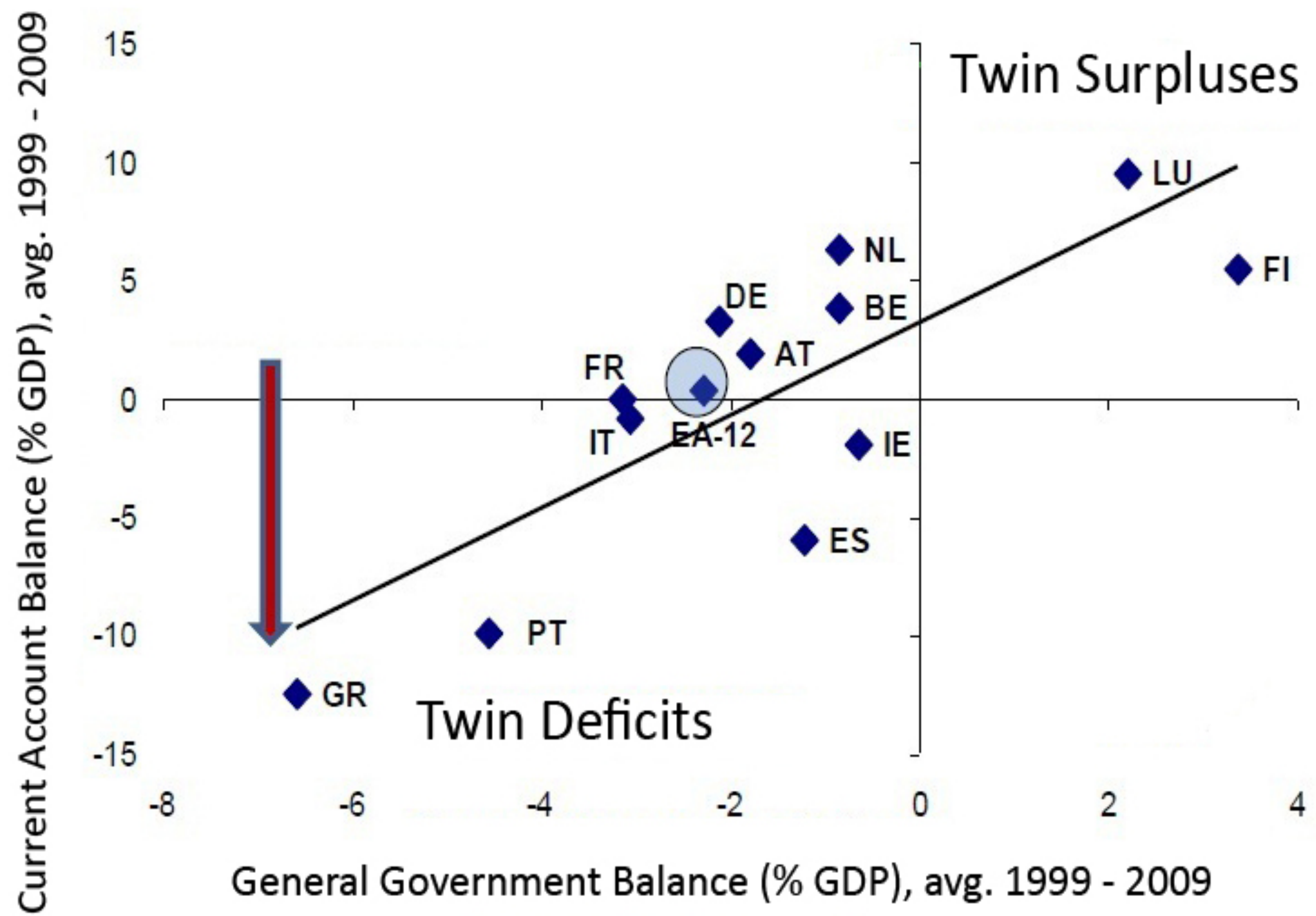
- In retrospective, accession to the Eurozone did not provide the safe macroeconomic harbour Greece was looking for,
- Why? (a) structural deficiencies of the Eurozone *per se*; (b) domestic economic mismanagement
- Greek crisis in the late 2000s as the meeting point of two crises: a Eurozone structural 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).



Twin Surpluses
Twin Deficits
Current Account Balance (% GDP), avg. 1999 - 2009
General Government Balance (% GDP), avg. 1999 - 2009
15
10
5
0
-5
-10
-15
-8
-6
-4
-2
0
2
4
LU
FI
NL
BE
DE
AT
FR
IT
EA-12
IE
ES
PT
GR

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