THE UNPRECEDENTED ASPECTS OF THE GREEK CRISIS

Despite favorable conditions for economic development for more than a decade, the Greek state was the first eurozone member to face a near collapse in May 2010 amidst global financial turmoil. The crisis started six years ago as a sovereign debt crisis and evolved into a deep political and social crisis with unique features. This article examines the unprecedented aspects of the Greek crisis, which was a historic event in terms of rescue programs, and marks a turning point in European economic governance and beyond.

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May 2010 was not the first time modern Greece experienced a severe fiscal crisis. The state had already survived four other crises. By the beginning of the 21st century, however, it seemed that Greece had modernized and converged with its European partners, having joined the core of the European Union (e.g. ECDP, Schengen, and eurozone). Benefiting from a stable political system after its successful transition from dictatorship and profiting from European structural funds assistance, the Greek economy has grown faster than any other EU member state (except Ireland) at about 4.5 percent per year since the mid-1990s. The external shock of post-communist transition experienced by all its northern neighbors was successfully managed by Greece. The country absorbed a migration inflow (approximately 10 percent of its population) and became a major investor and trade partner in southeast European economies.

Despite these favorable conditions, the Greek state was the first eurozone member to face a near collapse in May 2010 amidst global financial turmoil. Persisting structural weaknesses, feeble institutions, and political inability to address the roots of the problem postponed any resolution of the debt crisis, turning it into a protracted and multifaceted crisis of fiscal, economic, social, and political dimensions. Since 2010, we have seen in Greece "one of the most astonishing reversals of fortunes a country has ever experienced."[1] Gross domestic product (GDP) has declined by 26 percent since 2008; the unemployment rate stands at 25 percent, with youth unemployment rate twice that. Greece experienced "a historic failure of the post-democratic development model; a model based on extensive statism, weak institutions, political clientism."[2]

A number of books and academic articles have addressed different aspects of the endogenous causes and exogenous triggers in the Greek crisis. Political and institutional explanations that focus on domestic factors have been the major explanations for the particularities of this case.[3] It is argued that structural deficiencies, the malfunction of the Greek political system, and rent-seeking led to the failure of structural reforms that were attempted in previous years. Others point to the liabilities of the eurozone design and the consequences of the faulty mechanisms of the coordination process between the fiscal and monetary policy of the eurozone members.[4]

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[1] Vasilis Monastiriotis, "A Very Greek Crisis," *Intereconomics Journal* Vol. 48, No. 1 (2013), p. 4-9.

[2] Panagiotis Liargovas, ed., *Greece, Economics, Political and Social Issues* (New York: Nova, 2012), p. 1-9.

[3] Pantelis Sklias, "The Political Economy of the Greek Crisis Revisited: Economic Growth versus Political Development" in *Greece, Economics, Political and Social Issues*, Panagiotis Liargovas, ed., (New York: Nova, 2012), p. 71-87; Christos Lyrintzis, "Greek Politics in the Era of Economic Crisis: Reassessing Causes and Effects," The Hellenic Observatory - *The European Institute*, GreeSE Paper 45 (March 2011); Michael Mitsopoulos and Theodor Pelagidis, "Vikings in Greece. Kleptocratic Interest Groups in a Rent-Seeking Society," *The CATO Journal*, Vol. 29, No. 3 (2009), p. 400; Vasilis Monastiriotis, "A Very Greek Crisis," *Intereconomics Journal* Vol. 48, No. 1 (2013), p. 4-9.

[4] Joseph Stiglitz, *The Euro and its Threat to the Future of Europe* (London: Penguin, 2016).

Others use Marxist explanations to show that the Greek crisis was caused by the "'broad unequal exchange' existing between the euro-center and the euro-periphery [which] contributed to the Greek capital's falling profitability."[5] Regardless of the hermeneutics, the political elite has been at the heart of the Greek economic crisis both in leading the country into economic collapse after 30 years of rule and in managing the crisis. Therefore, the old party system and its two ruling parties were the first political victims of the Greek crisis since the New Democracy (conservative) and the PASOK (socialist) parties have suffered a loss of political power. Anti-reform dynamics notwithstanding, Greece has undergone extensive macroeconomic – especially fiscal – adjustments followed by structural reforms since 2010, even though they were forced or externally imposed. Fiscal adjustments were unprecedented for a developed country due to the high initial imbalances and the amount of assistance required. This article will examine the unprecedented aspects of the Greek crisis which mark a new page in European economic governance and beyond.

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What Was Unprecedented?

The Greek crisis has been the first one of its type. The existence of a single currency (i.e. the euro) made a significant difference between this crisis and its management and any of the previous rescue programs offered by the International Monetary Fund (IMF).[6]

Rescuing a Currency Union Member

In May 2010, Greece became the first eurozone member (Ireland and Portugal followed) to request financial assistance (bail out) from the EU and the IMF. As Greece is a member of the eurozone, policies and decisions set at the union level influenced its economic situation and Athens' (as well as the IMF's) ability to manage the crisis independently from other eurozone members. Even though the rescue policies targeted the respective country, they often required political agreement and action at a union level, which meant that consensus and policy-making required a long process of negotiations.

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[5] Stavros Mavroudeas, ed., *Greek Capitalism in Crisis: Marxist Analyses* (Abingdon and New York: Routledge, 2015).

[6] International Monetary Fund, "Crisis Programme Review," (December 2015). http://www.imf.org/external/np/pp/eng/2015/110915.pdf

From an IMF point of view, currency union membership this time meant a very limited adjustment in nominal exchange rates.[7] Thus, the adjustment strategy relied on so-called "internal devaluation" which seeks to restore external competitiveness by lowering domestic prices instead of the nominal exchange rate. For the IMF, this was a new historical event where not all of its monetary tools were available. It was the first time the IMF was called to rescue a currency union member.

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Systemic Repercussions

Global attention to the Greek crisis was primarily triggered by the fact that in May 2010 Greece was the first eurozone country to experience a sovereign or government debt crisis. In the subsequent months, Ireland, Portugal, Spain, and Italy followed. Due to the interlinkages between European economies, the absence of a crisis management framework, and the expected systemic repercussions, the Greek crisis became the epicenter of the global financial turmoil that began in 2007-8 in the US. Despite the small size of the Greek economy (Greek GDP was 307 billion dollars in 2010, or two percent of the EU's GDP), its collapse had the potential to destabilize the whole eurozone and trigger a global recession through contamination effects. Fears were that given the exposure of a number of large European banks to the Greek banking sector, a Greek default would constitute for the European financial system an event comparable to what the September 2008 bankruptcy of Lehman Brothers represented for the financial system of the industrialized world.[8] The worst systemic effects were avoided, and the euro maintained its value but at a high cost in terms of borrowed money and the institutional and regulatory revamping of European economic governance. To prevent a complete collapse of the banking system, European governments came to the rescue of their banks with urgent support on an unprecedented scale - 1.6 trillion euros committed between 2008 and 2011, which is equivalent to 13 percent of the EU's annual GDP.

The Extent of the Rescue

The amount of financial assistance offered to Greece has been the largest ever offered

[7] International Monetary Fund, "Crisis Programme Review," (December 2015), http://www.imf.org/external/np/pp/eng/2015/110915.pdf

[8] Fabio Colasanti, *Financial Assistance to Greece: Three Programmes*, Discussion Paper, (Brussels: European Policy Center, 2016).

to a national economy. It is estimated that between 2010 and 2018, the euro-area countries and the IMF will have committed almost 300 billion euros to Greece, representing more than twice the annual budget of the EU in 2015 and more than 120 percent of Greece's GDP in 2010 before it started to shrink. By comparison, the financial support extended to Ireland was equal to 41 percent of its GDP and that given to Cyprus was 55 percent of its GDP. The main reason for the large size of the intervention in Greece is the fact that previously support was usually extended in order to help a country face a balance of payments crisis, but this time it was designed to avoid the default of a country on its public debt. A balance of payment crisis typically requires financing equal to a few points of GDP (rarely more than 15/20 points); a public debt crisis involves much larger amounts (62 percent of GDP in the case of Argentina, 137 percent of GDP in the case of Greece).[9]

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There have been three programs agreed upon to support the Greek economy accompanied with an unprecedented level of lending to a developed OECD country. The programs in total have lasted much more than the typical three- to four-year IMF program. The first one in May 2010 was about 110 billion euros. The first rescue program was cut short by the need for a larger second bailout. In total, the first bailout provided Greece with 73 billion euros (52.9 billion euros from other eurozone countries and 20.1 billion euros from the IMF). In October 2011, a second economic adjustment program was agreed upon to supplement the first one with an additional 130 billion euros (extended until June 2015). During the period covered by the second economic adjustment program (which started in March 2012 and was extended until 30 June 2015), the IMF disbursed 11.8 billion euros and the European Financial Stability Facility (EFSF) 130.9 billion euros, respectively.[10] By the time Syriza came to power in January 2015, a total of 142.7 billion euros had been provided to Greece. After prolonged negotiations with its lenders and contrary to the results of a polarizing referendum (approximately 60 percent voted against a new bailout) on whether Greece was to accept the bailout conditions in the country's government-debt crisis proposed jointly by the lenders (EU, the European Central Bank [ECB], and IMF), the new government finally agreed on a third economic adjustment program. The new loan provided by the euro-area countries would total a maximum of 86 billion euros which would be

[9] Fabio Colasanti (2016) p. 13-14.
[10] Fabio Colasanti (2016).

made available through the European Stability Mechanism (ESM), the permanent mechanism inaugurated in October 2012. The ECB also purchased Greek government bonds under its Securities Markets Program. It held 33.9 billion euros in these bonds by end 2012.

"The Greek debt restructuring of 2012 stands out in the history of sovereign defaults as the largest debt restructuring for a single developed country."

Institutional Novelties

The Greek crisis triggered institutional change primarily within the EU. In parallel, a new model of a Troika rescue scheme (a tripartite committee of the IMF, the ECB, and the EC) was built based on the experience gained by managing the Greek case. The function of the "lender of last resort" was this time undertaken not only by the IMF but, mainly, by EU members and institutions. For European integration, the management of the Greek crisis has been a turning point, as Micossi points out "[f]or decades, the center of gravity of common policies was internal market opening, international trade, and agriculture but now has shifted to the coordination of EU members' national economic policies."[11] This required a number of new legal instruments such as the Two Pack, the Six Pack, the Fiscal Compact, and the Macroeconomic Imbalances Procedure. It also forced new decision-making procedures such as the European Semester. New European economic governance meant the shifting of authoritative power from the national to the supra-national level (especially the EC and the ECB), thus constraining national policy autonomy. Furthermore, the EU has been working towards a banking union to address the weaknesses revealed by the crisis. Banks in the eurozone countries will report to a common supervisor, the ECB, and decisions on how to handle a failing bank will be made centrally, according to a common set of rules that have been designed. As part of these efforts, three European supervisory bodies were created to help coordinate the work of national regulators and safeguard EU-level rules: the European Banking Authority (EBA), which deals with bank supervision, including oversight on the recapitalization of banks; the European Securities and Markets Authority (ESMA), which deals with the supervision of capital markets and carries out direct supervision with regard to credit rating agencies and trade repositories; and the European Insurance and Occupational Pensions Authority (EIOPA), which handles insurance oversight.[12]

[11] Stefano Micossi, "The Eurozone crisis and EU institutional change," *Policy Insight*, CEPR, 15 April 2013.

[12] European Commission, "A comprehensive EU response to the financial crisis: substantial progress towards a strong financial framework for Europe and a banking union for the Eurozone," *MEMO*, (Brussels: European Commission, 2014), http://europa.eu/rapid/press-release_MEMO-14-244_en.htm?locale=en) Spring 2016 Update, Adjusting"

Debt Restructuring

> *"The Greek crisis shook confidence in the European integration process, starting a discussion of democracy and sovereignty at a national and European level."*

The Greek debt restructuring of 2012 stands out in the history of sovereign defaults as the largest debt restructuring for a single developed country. Debt relief was over 50 percent of 2012 GDP with minimal financial disruption. It is historically significant for at least four reasons.[13] First, it set a new world record in terms of restructured debt volume amounting to 106 billion euros and aggregate creditor losses, surpassing previous cases such as the restructuring of Argentina in 2001-2005. Second, it was the first major debt restructuring in Europe since the defaults preceding World War Two. Third, it was a turning point in the history of the European debt crisis plausibly contributing to its expansion in the summer of 2011. Fourth, it introduced legal innovations which helped to plan an orderly debt exchange, overcoming the collective action problem facing Greek and EU policymakers as they sought to manage the crisis and restructure a large amount of debt dispersed among many private creditors.[14]

Fiscal Adjustment

The adjustment in terms of fiscal consolidation, current account balance, and structural reforms though delayed at the first stage of the crisis has been remarkable. Greece has achieved "one of the largest and fastest rates of fiscal consolidation in the developed world."[15] In 2010, Greece had a huge current account deficit near 15 percent of the GDP which made the economy unstainable. Since then, an impressive improvement has been recorded with the current account deficit declining by 13 percent of thee GDP between 2009 and 2015. According to OECD data, the general government deficit declined sharply from 15 percent of the GDP in 2009 to seven percent in 2015 (the recapitalization of the banking sector completed in late 2015 temporarily deteriorated the fiscal balance). The primary budget deficit of the general government similarly declined by 9.1 percent of the GDP in the same

[13] Jeromin Zettelmeyer, Christoph Trebesch, and Mitu Gulati, "The Greek Debt Restructuring: An Autopsy," *Working Paper Series WP13-8* (Washington D.C.: Peterson Institute for International Economics, August 2013), p. 2; Miranta Xafa, "Sovereign Debt Crisis Management: Lessons from the 2012 Greek Debt Restructuring," CIGI Paper 33 (June 2014).

[14] On the Greek crisis as collective action problem see Panagiota Manoli, "The Political Economy of the Greek Crisis: Collective Action Perspectives," in *Greece: Economics, Political and Social Issues*, Panagiotis Liargovas, ed., (New York: Nova Science Publishers, 2012), p. 177-196.

[15] George Pagoulatos, "The Greek Economy is not Adjusting" in *Greek Myths and Reality*, (Washington DC: ELIAMEP and Brookings Institute, 2013), p. 6-7.

period (2009-2012), and posted a surplus in 2015. Cyclical adjusted primary fiscal balance improved by 14 percent of the GDP between 2009 and 2014. This vast fiscal consolidation has been the outcome of heavily front-loaded austerity measures and has taken place during a severe recession. The harshness of the fiscal adjustment has impacted the real economy as Greece lost 26 percent of its 2008 GDP. Prior to the crisis and for the period 1999-2002, reforms in Greece were the lowest among the eurozone members.[16] Adjustment Progress Indicator (API), Greece continued in 2015 to lead the adjustment ranking as it did in the years 2012 to 2014.[17] The API takes into account three measures of adjustment: 1) a reduction (or increase) in the fiscal deficit, adjusted for interest payments and cyclical factors, 2) the rise (or fall) in exports relative to imports in the external accounts, and 3) changes in unit labor costs.

Concluding Remarks

This article attempted to explain the novel aspects of the Greek crisis for the European and global political economy. Not only was the Greek crisis the first crisis of its type i.e. a fiscal crisis of a common currency member, but the extent of the rescue, of debt restructuring, and of fiscal adjustment are historic events in the global economy. New institutions and models of crisis management were created (such as the Troika rescue scheme of the IMF, the EU, and the ECB) and novel economic governance rules were established, especially at the European level.

Though the economic and institutional aspects of the unprecedented nature of the Greek crisis are important, one should not overlook the wider political repercussions. The Greek crisis shook confidence in the European integration process, starting a discussion of democracy and sovereignty at both national and European levels. The inability of primarily national (i.e. Greek) authorities and their European equals to adequately and promptly address the crisis had serious political repercussions, opening new ground for euroscepticism on the one hand and the demolition of "traditional" or orthodox political powers in Greece and beyond on the other hand. Whether the "ever closer union" could actually foster prosperity and solidarity among all Europeans is now being questioned. Europeans are now confronted with a difficult task, namely reforming EU institutions and keeping the union spirit alive amidst reactionary and anti-reform political forces that envision a 20th rather than 21st century world.

[16] European Commission, "European Economy 2006," No. 6 (Brussels: European Commission, 2007), p. 194.

[17] Berenberg Bank and the Lisbon Council, *The Euro Plus Monitor*, (Spring 2016), http://www.lisboncouncil.net/news-a-events/690-the-euro-plus-monitor-spring-2016-update-.html