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The Catastrophic Greek Crisis

MANOS MATSAGANIS

Greece holds the rotating presidency of the European Union for the first half of 2014. As some commentators in Germany and elsewhere have been quick to note, there is surely something incongruous, if not outright absurd, in the spectacle of the most wayward member of Europe's family of nations setting the agenda (or pretending to), even for such a short time. For Greece is still in the throes of a terrible crisis. The experience of economic failure, near-bankruptcy, deep and protracted recession, a sudden fall in living standards, and bitter political conflict has dangerously raised the temperature of public debate.

As if to prove the critics right, the Greek presidency got off to an inauspicious start, marked by a series of events ranging from the grotesque to the tragic. Former Transport Minister Michalis Liapis was caught driving without a licence and with counterfeit registration plates by traffic police too young to recognize him. It then transpired that his family home had been refurbished courtesy of Europe's taxpayers: EU "structural funds" earmarked for upgrading tourism infrastructure were diverted for his private use. Since the faction Liapis belonged to in the ruling conservative party was no longer influential, the prime minister's office declined to lift a finger to stop the wheels of justice, opting instead for a show of respect for judicial independence and the rule of law. Liapis received a suspended sentence of four years.

With a weakened political elite making a virtue out of its inability to close ranks as it did in the past, the prosecution of well-known (albeit usually have-been) politicians and businessmen has become more common. Vasilis Papageorgopoulos, the conservative former mayor of Thessaloniki (Greece's second largest city), in February 2013 was given a life sentence for embezzlement—he is expected to serve at least 15 years in prison.

Akis Tsochatzopoulos, the once-powerful minister of defense and the second-ranking figure in the Panhellenic Socialist Movement (PASOK) during the long reign of its founder Andreas Papandreou, in October 2013 was sentenced to 20 years for money laundering. Lesser figures close to either the conservatives or the socialists (or sometimes both) are also facing trial or have already been convicted.

CLEAN HANDS?

Superficially, this may look like a rerun of Italy's Operation Clean Hands in the early 1990s, when judges exploited the weakness of the political elites who had been running the country since the end of World War II. Italian judges mercilessly prosecuted businessmen who paid bribes for public contracts and politicians who took them. In the process, Clean Hands caused the ignominious end of the Italian First Republic and the dissolution of its political parties.

What came next—the twenty long years of Silvio Berlusconi helping Italian politics reach new depths—should temper Greeks' enthusiasm for a judicial exit from their country's woes. After all, notwithstanding the integrity and professionalism of many members of the judiciary (who tend to be younger and often female), there is something not quite convincing about Greek judges posing as the nation's saviors. The judges are not always immune to corruption and subservience to their political masters, and their current crusade

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against politicians is suspected of being at least partly motivated by pique.

In a recent ruling, the Judicial Pay Court (yes: Greek judges practically set pay for themselves) decided that recent salary cuts (modest, and from a high level), imposed in the context of the government's austerity policies, were "anti-constitutional." The Supreme Court also annulled pay cuts for army officers on the grounds that they belonged to the "core" public sector—unlike university professors, whose savage salary cuts can now be safely regarded as consistent with the letter and the spirit of the constitution.

Other recent cases illustrate all that is wrong with the Greek justice system. In a rather idiosyncratic interpretation of freedom of speech, a court in Athens delivered a guilty verdict (with a 10-month suspended sentence) for Philippos Loizos, a 27-year blogger. His crime? A blog that parodied Elder Paisios of Mount Athos, an obscure Greek Orthodox monk who, since his death in the mid-1990s, has become something of a cult figure, his incoherent prophecies taken to be proof of sainthood by some members of the Church's flock (but not, so far, by the Church itself). The disapproval of an ultra-conservative chorus sealed the fate of the young blogger. After an indignant speech in Parliament by a member of the far-right Golden Dawn party, the public prosecutor finally authorized the Electronic Crime Squad to divert scarce resources from the pursuit of pedophilia websites to the identification of the impertinent parodist, who wrote under the pseudonym "Elder Pastitsios." Civil rights organizations protested, but were ignored.

The sustained effort necessary to modernize the Greek state is still nowhere to be seen.

This show of exemplary harshness in dealing with innocent fun contrasts unfavorably with the relatively lenient treatment of Christodoulos Xiros, who was serving a life sentence (he was actually given six life sentences plus 25 years in jail) for his part in 33 terrorist attacks by the left-wing group November 17—including 6 murders. In spite of all this, Xiros had been allowed out on short leave by two judges on *seven* occasions. On January 6, 2014, he broke parole and went missing. A few days later he posted a homemade film in which he rambled about the armed struggle and threatened spectacular actions. Since then, security around EU officials and member state ministers visiting Athens for meetings has been tightened even further.

One of the ministerial meetings concerned immigration. Greece is calling for a revision of the Dublin II Treaty provisions under which third-country nationals entering the EU illegally must apply for asylum in the country of entry—to which they will be returned if arrested elsewhere in the EU. Such provisions are seen as unfair to those member states (particularly Greece and Italy) with extended coastlines, through which the vast majority of undocumented immigrants are smuggled into Europe.

In an unintended manifestation of the incapacity or unwillingness of the Greek Coast Guard to patrol borders effectively and humanely, 12 people (including women and children) lost their lives on January 22, 2014, when they fell overboard from a boat they had shared with another 16 refugees fleeing Syria and Afghanistan. Survivors accused the Coast Guard of having done nothing to avert the loss of life; the United Nations refugee agency suggested that aid was deliberately withheld as part of a "pushback" policy to prevent asylum seekers from reaching Greek territory. Yet the Coast Guard received the immediate backing of Merchant Marine Minister Miltiadis Varvitsiotis, who failed to call for an inquiry until urged to do so by European Home Affairs Commissioner Cecilia Malmström.

Extreme Violence

Further excitement may be in store before Greece's term is over. The May 2014 European Parliament elections and the local and regional elections with which they are scheduled to coincide could turn into a rout for the government, which is backed by both the conservative New Democracy and PASOK. These two political parties have ruled the country since the restoration of democracy in 1974—sometimes (as now) in coalition, though more often in competition. The major beneficiaries of their decline, aided by a widely predicted low turnout (itself a sure sign of pervasive disenchantment), are expected to be the radical left SYRIZA and the neo-Nazi Golden Dawn.

Far-right militants have been known to assault foreign immigrants—or worse, as in the case of Shehzad Luqman, a 27-year-old Pakistani stabbed to death by two Golden Dawn supporters in January 2013. What tipped the balance and finally spurred public authorities into action was the murder of a Greek: hip-hop musician Pavlos Fyssas, who was killed at the hands of a Golden Dawn gang in September 2013. Prime Minister Antonis Samaras let it be known that he personally "asked" the public prosecutor to arrest almost the entire party leadership on charges of organizing a criminal group. (A few months earlier, the prime minister had unsuccessfully tried to reassure his European counterparts with the unfortunate remark that "racism is incompatible with the Greek DNA.") The leader of Golden Dawn, Nikos Michaloliakos, has remained in custody since October 2013, along with his deputy Christos Pappas, 4 other MPs, and 14 party supporters.

As *The Economist* rightly remarked, "The arrest of both leaders of an elected party is unprecedented for a member of the European Union." Many Greek liberals are also uncomfortable. Meanwhile, prosecutors have produced evidence of the party's *Führerprinzip* structure, linking military-type operations carried out by local members to the leadership. Remarkably, all this does not seem to have made a dent in Golden Dawn's performance in opinion polls, and may have even reinforced its credentials as an "anti-systemic" force, unfairly persecuted by the establishment.

The loss of national sovereignty has fed a nationalist-populist backlash.

In a grim development, on November 1, 2013, a hitherto unknown "urban guerrilla" group calling itself the Militant Popular Revolutionary Forces carried out the "political execution" of two Golden Dawn members (22-year-old Manolis Kapelonis and 26-year-old Giorgos Fountoulis) in cold blood, in revenge for the murder of Pavlos Fyssas. Is this a return to the street fighting of the Weimar Republic and 1930s Spain? Not as bad as that, hopefully—but clearly too close for comfort.

DRAMATIC FALL

Greece's troubles can be explained in large part by the fallout from the recession and austerity. The size of the economy in 2013 had contracted by over 23 percent in real terms relative to 2007. The loss in output—amounting to a dramatic fall in living standards—was far greater than in other southern European countries hit by the crisis (Italy, nearly -9 percent; Spain, almost -6 percent; Portugal, -7 percent) or in Ireland (-7 percent) over the same period. So deep and drawn-out a recession has few precedents in economic history, aside from the Great Depression in the United States, where GDP fell by almost 30 percent between 1929 and 1933.

The standard account of the Greek debt crisis begins at the end of 2009, when the incoming PASOK government announced that earlier fiscal data had been misreported. Revised estimates for 2009 raised the budget deficit from 3.7 percent to 15.6 percent of GDP, and the public debt from 99.6 percent to 129.4 percent of GDP. Coming as the European economy smarted from the impact of the world financial crisis, and coinciding with sluggish growth everywhere, the news revived speculation about the future of the euro zone and shattered Greece's credibility. Soon the cost of borrowing began to climb to prohibitive levels. It was about then that the Greek crisis started to assume unanticipated dimensions.

In response to market pressure, the government announced a first round of austerity in March 2010. This cost the government a great deal in terms of popularity, but failed to placate the markets. In April 2010, the rating agency Standard & Poor's downgraded Greece's credit to below investment grade, or junk status. Spreads on 10-year government bonds (the interest rate differential from German government bonds) began to rise sharply, reaching 1,000 basis points (10 percentage points), compared with 200 basis points three months before. At that point, Greece effectively lost access to the international financial markets, and a sovereign debt crisis threatened to turn into a solvency crisis.

BAILOUT AND BACKLASH

After a considerable amount of vacillation, the "no-bailout" clause of the Maastricht Treaty was unceremoniously set aside, clearing the way for a massive €110 billion loan in May 2010 from the European Commission (EC), the European Central Bank (ECB), and the International Monetary Fund (IMF)—known collectively as the "Troika." The loan was designed to cover Greece's borrowing requirements for three years; it was assumed that the country would return to the markets after that period. In return, the government was forced to sign a "Memorandum of Economic and Financial

Policies." This agreement committed the government to sweeping spending cuts and steep tax increases, aimed at reducing the public deficit to below 3 percent of GDP by 2014.

The provisions of the loan and the austerity program have been revised several times since. The latest revision (the Midterm Fiscal Strategy Framework of 2013–16) specified structural fiscal savings to the tune of €13.5 billion (7.15 percent of GDP) in 2013–14. The government hopes to return to a primary budget surplus (i.e., before interest payments) in 2014, with the economy registering zero growth—which, although unimpressive, would be a relief after six long years in recession.

The "Greek Program" eventually calmed international markets, but the price was a strong domestic reaction. Civil unrest reached a paroxysm on May 5, 2010: During a huge and largely peaceful demonstration in Athens, three workers lost their lives when extremists set fire to a bank. The tragedy cast further doubt on the country's future and lengthened the odds that the bailout package might prove effective. It also prompted Paul Krugman to comment in a *New York Times* blog post (ominously titled "Greek End Game"): "If Greece were a highly cohesive society with collective wage-setting, a sort of Aegean Austria, it might be possible to [confront the crisis] via a collectively agreed reduction in wages across the board—an 'internal devaluation.' But as today's grim events show, it isn't."

And as subsequent developments illustrated, that was indeed the shape of things to come. The bailout package had thrown a lifeline to a practically bankrupt economy, but effectively removed power over economic policy from democratically elected domestic officials, handing it over to external ones widely seen as distant, inscrutable, and largely unaccountable. This provoked a nationalist backlash across the political spectrum and transformed Greek politics almost overnight. Political rhetoric became virulent and often inflammatory. A new political cleavage emerged (pro-bailout vs. anti-bailout), recasting with a vengeance the older divisions (pro-Europe vs. anti-Western) and partly eclipsing more traditional demarcations (left vs. right). Populist formations on the radical left and the far right—including the criminal, avowedly neo-Nazi Golden Dawn—flourished.

Austerity took effect when the Greek economy was in recession and made it deeper still. As the demand for goods and services fell, many businesses went bankrupt or relocated, while most of those staying afloat resorted to cutting or not paying salaries as well as layoffs. Joblessness rose steeply: In October 2008 the seasonally adjusted unemployment rate stood at 7.5 percent of the labor force; five years later it was 27.8 percent.

Internal devaluation

In February 2012, the Troika persuaded a reluctant coalition government to try "internal devaluation." The strategy's main feature was a drastic cut in the minimum wage—22 percent in nominal terms (32 percent for workers below the age of 25)—meant to boost competitiveness, revive the economy, and reverse unemployment trends. Two years later, it seems doubtful that internal devaluation worked as intended. While the trade deficit did improve, closer inspection shows this was brought about by declining demand rather than via a "supply-side" effect. Imports fell sharply, while exports actually grew less than before. Unemployment continued to rise, though arguably at a slower rate.

Crucially, the minimum wage cut had repercussions across the earnings distribution. On the whole, average real wages lost more ground since 2009 than they had gained in the decade before that, and were 9 percent lower in 2013 than they had been in 2000. Earnings declined further in the informal sector (construction, agriculture, tourism, personal services), where employers are subject to few legal or other constraints except those implicit in the free play of unregulated market forces. Rising taxes meant losses were even more pronounced in net terms.

Whether austerity policies actually aggravated the current recession is a matter of heated debate among economists. Clearly, international agencies had seriously underestimated the size of the fiscal multiplier—the depth of recession associated with austerity. As a recent study by leading IMF economists Olivier Blanchard and Daniel Leigh conceded, early forecasts assumed a fiscal multiplier of about 0.5 (meaning that reducing the budget deficit by $10 would lead to a drop in GDP of $5), whereas the actual effect turned out to have been around 1.5 (i.e., deficit reduction of $10 led to a drop in output of $15) or more.

Larger fiscal multipliers seem to be present in the early phases of a recession, and in countries where the size of fiscal consolidation is large. This is a fair description of Greece in 2010, when the government's fiscal consolidation effort was most successful, amounting to about 5 percent of GDP.

As the Organization for Economic Cooperation and Development put it, "no other OECD country has achieved such a fiscal improvement in a single year over the past three decades."

There can be little doubt that austerity policies and the wider recession are closely connected. On the one hand, austerity causes aggregate demand to fall and therefore leads firms catering to the domestic market to reduce output, cut salaries, and lay off personnel. On the other hand, the recession weakens the capacity of austerity policies to reduce the deficit (because of lower tax receipts and higher spending on social benefits), and feeds pressure for harsher measures.

Clearly, however, domestic factors were crucial to the Greek crisis. It is worth remembering that for several years before its outbreak Greece had enjoyed a boom: Real growth rates averaged 4.1 percent in 2000–2007, compared with 2.5 percent in the EU as a whole. Nevertheless, behind the façade of prosperity based on strong consumer demand and boosted by cheap credit lay a largely uncompetitive economy.

The steady deterioration of the current account (mostly exports minus imports of goods and services), with a chronic deficit reaching 14.9 percent of GDP in 2008, was the clearest sign of an economy in bad shape. The poor performance of Greek firms in export markets preceded the crisis and made the recession inevitable, at least to some extent. Furthermore, the size of the Greek budget deficit was revealed to be 15.6 percent of GDP in 2009—compared with the 3 percent target stipulated in the euro zone's Stability and Growth Pact (and the earlier assurance by the conservative government that it would not exceed 3.7 percent of GDP). This made fiscal consolidation and hence austerity all but inescapable.

Social impact

Given the poor state of the national economy and public finances, it is difficult today to see how austerity could have been avoided in May 2010. Yet the policy content of the Greek program remained open for negotiation, both externally (with the Troika of donors) and internally (with political and social actors at home). Just how open is debatable. The standard account of detailed public policy measures being dictated to elected governments by unelected officials representing international organizations often contains more than an element of truth. But some leeway—more successfully exploited in Ireland and Portugal—was, and to some extent still is, available.

International financial assistance (including debt relief) for Greece, as with other bailed-out countries, was made conditional on satisfactory progress on a detailed set of fiscal cuts and policy reforms, formalized in successive memoranda of understanding signed by the national government and the Troika. Ireland, Latvia, and Hungary have exited similar programs and are now subject to "post-program surveillance." The pressure of external constraints is also unmistakable in Spain and Italy, even though a softer form of conditionality prevails there.

Reducing the Greek deficit, while at the same time protecting the most vulnerable and sharing equitably the burden of fiscal consolidation, was never going to be easy. But a responsible government, working together with a constructive opposition, should have been able to manage it. This has not happened so far. The responsibility largely lies with domestic actors. From the start, the Troika urged two key ingredients of a successful strategy for dealing equitably with the crisis: fighting tax evasion and strengthening the social safety net. Four years later little progress had been made on either front.

The social impact of the Greek crisis has been considerable. The real income of 45 percent of the population in 2013 fell below the 2009 poverty line. For some, poverty was extreme: 14 percent of the population was unable to pur-

From the archives of *Current History*…

"For the last ten years German unification has been the most solid and unpliable plank in the American foreign policy platform. Unpopular as it may seem this question must be faced. Is German unification in the national interest of the United States and would it serve to help preserve world peace? To claim as a self-evident truth that what is bad for the Soviets must be good for the United States is not enough."

Karl Loewenstein
"Unity for Germany?"
January 1960

chase a basic basket of goods in 2013, up from 2 percent in 2009. Some 1,200 malnourished children (2 percent of the school population in central Athens) had meals delivered to them daily by municipal agencies. Because of gaps in the social safety net, only one jobless worker in ten had access to unemployment benefits. With long-term unemployment set to remain high in the foreseeable future, the plight of children in jobless households, unsupported by social benefits and ineligible for medical insurance (except for emergency care), has become Greece's new social question.

In general, policy responses to the social effects of the crisis were misguided, inadequate, or both. Tax evasion remained pervasive. Welfare reform did produce some improvements, but most cuts were indiscriminate, causing hardship and disrupting health and social services. Labor market reform was guided by the belief that lowering workers' compensation and weakening institutions including unions, collective bargaining, and employment protections was the key to restoring competitiveness. Badly needed reform of public administration was conflated with a simple reduction in numbers of public employees. The sustained effort that is necessary to modernize the Greek state is still nowhere to be seen.

Behind the façade of prosperity lay a largely uncompetitive economy.

Current forecasts, even the most optimistic, predict a late, slow recovery with anemic growth and persistently high unemployment. The policy challenges ahead seem more intractable than ever: setting the economy on the path to sustainable growth, attracting foreign investment, creating high-skilled and high-wage jobs, tempting back the thousands of talented Greeks who have left the country to pursue more satisfactory careers abroad, taxing income and wealth fairly and efficiently, and reforming welfare in order to promote employment and provide effective social protection.

POISONED POLITICS

In the meantime, economic misery and a social emergency, coupled with a pervasive sense of impotence and loss of control, make for an explosive cocktail. In particular, the loss of national sovereignty implicit in the terms of the bailout package is widely experienced as humiliating, and has fed a nationalist-populist backlash. The failure of public institutions to rise to the occasion by preventing the economic crisis from mutating into social disaster has bred disillusionment with parliamentary democracy and brought the far right and extreme left into the political mainstream. The combination has poisoned domestic politics.

Indeed, the upheavals of recent years have changed Greece's political landscape beyond recognition. Established parties have lost authority and votes, while new ones have risen from the political margins to prominence. The rise of populist forces on the left and right, and the emergence of violent extremism in the shape of Golden Dawn, undermine democratic institutions and raise troubling questions about the future of Greece as an open society and a stable democracy.

The polarization of domestic politics between those who tacitly accept the need for a bailout package and those who vociferously reject it has diverted attention from fundamental questions, such as the actual content of the reforms needed for Greece to exit the current crisis. While populists in the opposition explicitly shun reforms in favor of radical change or a return to the previous situation (sometimes both), the moderates in government often retreat to a default stance of older traditions of patronage, clientelism, and corruption, albeit in the drastically altered context of harsh fiscal constraints. The constituency for reform has turned out to be weak: as a result, reforms have stalled.

Resistance to externally imposed modernization and attachment to old patterns of thought and action (as well as the material interests associated with them)—even when these are proving to be counterproductive—is hardly new, nor confined to Greece. These traits are also present in other "program countries," albeit to a lesser extent; they were seen, too, in earlier attempts to rescue and reform Latin America via conditionality.

The same tendencies were identified as key obstacles to change by the former New Dealers involved in the Economic Cooperation Administration Mission to Greece under the Marshall Plan in the aftermath of World War II. The rapid change in mood among American administrators in Greece, from enthusiasm and boundless self-confidence to gloom and resigned cynicism, has been well documented by the economic historian Michalis Psalidopoulos.

A WAY OUT?

For some, the way out for Greece is a government headed by the radical-left SYRIZA, which vows to finally put an end to austerity by immediately rescinding the bailout agreement and renegotiating Greece's debt with EU partners. The party seems to believe that Europe is poised for a left turn, paving the way for a Keynesian pump priming. Leaving aside the question of how realistic such an assessment may be, the recipe provides no solution to the economy's underlying weaknesses—which led to the crisis in the first place. Still, the notion that it is possible to combine a North American–type pattern of consumption with a (nearly) Middle Eastern model of production has proved persuasive so far, and is doing wonders for the party's popularity.

The trouble with demagogic populism is that it is prone to disappointing its own supporters, leaving them ready to turn for comfort to the next bunch of populist demagogues, even more extreme than the first one. In this case, Golden Dawn is waiting in the wings. Even if the threat of a resurgent far right were to be somehow dealt with effectively, Greek politics would still face polarization between the anti-Western radicalism of SYRIZA and the conservative nationalism of Prime Minister Samaras. The social liberals and center-left progressives who wish their country to be more "European"—in the sense of striving for the unique combination of (in the German sociologist Ralf Dahrendorf's words) economic prosperity, political liberty, and social cohesion—have reason to feel marginalized.

To some extent, the decline and fragmentation of the middle ground into a number of ineffectual, mutually hostile small parties (now including the once mighty PASOK) is the cost of their failure to articulate a coherent strategy for renewal and reform. Such a strategy would require them to steer Greece away from the corruption and clientelism of the last four decades, while reaffirming their commitment to the robust democratic values and steady European orientation that marked the post-1974 republic.

Not all is lost, however. As the 2010 local elections demonstrated, civil society candidates seen as progressive, competent, and honest are capable of winning even when the political parties that back them are unpopular. Giorgos Kaminis (formerly the national ombudsman) and Yiannis Boutaris (a successful winemaker) are running for reelection in May 2014 as mayors of Athens and Thessaloniki, respectively. If they win, it will be a triumph of hope over adversity—and a sure sign that the liberal center and moderate left can be more resilient than they appear, when united under a suitable candidate.

Can such a coalition be created at national level? The answer is still unclear. But a recent manifesto signed by 58 intellectuals calling for the scattered and demoralized center left to renew and unite has changed the terms of the political debate. Time will tell whether it can also change the course of events. ■