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Greece as a cautionary tale, not a morality play

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Abstract: Hiding behind the simplistic narratives that evolved during the Greek economic crisis has masked the collective failure that triggered an economic collapse in Greece and the timid way the Eurozone reacted. The last decade has revealed weaknesses and imbalances across the Eurozone, the effects of which have mostly been felt by countries in the South, not just in Greece. The attempts to address some of these shortcomings have hit a wall. Failing to overcome this obstacle will leave the Mediterranean member states exposed and unity within the EU at risk when the next crisis hits.

Keywords: Economic crisis, Greece, Eurozone.

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Greece was the pupil that did not do their homework, the black sheep of the European flock, a southern grasshopper rather than a northern ant. During much of the Greek crisis, the country's travails were interpreted elsewhere in Europe as a morality play in which time caught up with the chancers who ruled and inhabited Greece.

Hiding behind the simplistic narratives that evolved during the crisis has masked the collective failure that triggered an economic collapse in Greece and the timid way the Eurozone reacted. The last decade has revealed weaknesses and imbalances across the Eurozone, the effects of which have mostly been felt by countries in the South, not just in Greece. The attempts to address some of these shortcomings have hit a wall. Failing to overcome this obstacle will leave the Mediterranean member states exposed and unity within the EU at risk when the next crisis hits.

A GREEK ILLNESS

Undoubtedly, the Greek crisis which began in 2009 and is barely resolved today, was about domestic corruption, waste and irresponsibility. Decades of fiscal mismanagement by Greek governments culminated in the centre-right administration led by Kostas Karamanlis losing control of primary expenditure and revenues, while also trying to hide the truth from the rest of Europe. Following a change of government in October 2009 and an overhaul of Greece's statistics agency, ELSTAT, the 2009 deficit was recognised at an eye-watering 15.4 per cent of GDP (rather than the 5.9 per cent indicated by the previous administration).[1]

Greece was not adequately prepared to join the Euro in 2001 and failed to recognise the rigours of sharing a currency with economies that were on a much stronger footing. Only a high level of fiscal discipline would have prevented Greece's shortcomings from being exposed, but the absence of self-control from local politicians meant that a solvency crisis was just a matter of time. However, countries with less pronounced problems also required bailouts from the Eurozone and the International Monetary Fund (IMF): Ireland, Portugal, Spain and Cyprus. Although they had not reached Greek levels of fiscal laxity and economic frivolity, variations of the stereotypical explanations offered for Greece's demise were also adopted for the countries from the South, keeping a more complex story hidden from Northern Europeans.

[1] Papaconstantinou (2016: 24–32).

THE ERRANT SOUTH

The suggestion that the crisis in Southern Europe was due to irresponsible spending and that the sensible North had to come to the rescue is a misrepresentation of how the Eurozone worked in the build-up to the crisis. It is true that some EU member states strayed towards economic unsustainability after joining the single currency. Greece, Spain, Portugal and Italy were among those running large current account deficits. But while the periphery was struggling, the core—including Germany and the Netherlands—recorded a surplus of around 6 per cent of their GDP. A deficit in one country requires a surplus in another to finance it.[2] What the Eurozone witnessed in the build-up to the crisis was a 'downhill' capital flow from the core,[3] which was capital-rich thanks to excessive savings, to the periphery which was in a hurry to catch up with its partners in the newly created Euro. The crisis brought these flows to a sudden stop.

Did the periphery invest its borrowed wealth wisely? In many cases, it did not. Spain produced a property bubble, Greece inflated its public spending, Portugal increased consumption and Cyprus lost control of its banks. However, where there is bad borrowing, there is also bad lending. The latter part, though, has largely been airbrushed out of the Euro crisis story. The moral hazard argument cannot apply to those who borrowed unwisely but ignore the lenders, who benefited from the financial integration that the Euro provided but avoided responsibility when their practices failed.

This aspect of the story highlights the fragility of the Euro, which lacks the shock absorbers, fiscal capacity and risk-sharing that would make it an optimal currency area. It also reminds us how easy it was for Eurozone member states to slip into deep trouble and how difficult it was for them to generate any sympathy. It is a lesson that resonated with Maltese Finance Minister Edward Scicluna in March 2013 after he saw the Cypriot government agree, following much pressure at another tortuous Eurogroup meeting, to a 10 billion euro bailout and a bail-in of depositors, leaving the country's banking system in tatters: 'Cyprus, more than all the others, holds a special place … as a case study of how an EU micro-Mediterranean island member state is expected to be treated if ever its unfortunate turn would come to seek aid from its fellow member states', Scicluna wrote in the aftermath.[4] 'The feeling one got on exiting the meeting in the early hours of the day was that never in one's life would one like to dream the experience, let alone live it.'

[2] Hobza & Zeugner (2014).
[3] Hobza & Zeugner (2013).
[4] Scicluna (2013).

ECONOMIC DICTATOR

The dread expressed by Scicluna is testament to the way in which the crisis, and the austerity-driven adjustment programmes that were chosen as an antidote, poisoned the relationship between the bailed-out states and the EU. Where the union had once been the underwriter of prosperity, it became a rather terrifying patron, holding the fate of countries in its hands. There was an attempt to disguise the crisis-induced change in the relationship between the EU and its members. Bailouts were dressed up as acts of altruism designed to rescue the weakest. Solidarity became a buzzword for European policymakers, stifling any questions about the 'cash for control' approach chosen.

This is a very limited interpretation of what happened. Members of a single currency that lacked fiscal unity and the tools to deal with an unprecedented set of challenges were bailed out with loans carrying strict conditionality.[5] And, when it was argued that demanding sharp fiscal adjustment amid sparse liquidity was not conducive to healing economies, the response from some politicians in the core was to point to the exit door.

As this adjustment took place, some of the Eurozone member states providing the loans were able to shore up their defences, via what the International Monetary Fund termed a 'holding operation',[6] to break the 'noxious link'[7] to their own banks. For example, German and French banks alone had an exposure of around 120 billion dollars to Greece in 2010.[8] This exposure meant that the option of restructuring Greece's debt as part of the first bailout was excluded by EU policymakers, who were driven by the need to prevent contagion. While the rest of the Eurozone put up the firewall, Spain, Cyprus, Portugal and Greece felt the heat of shuttered businesses, job losses and rising emigration.

Although this staved off disorderly defaults and the associated pain, meeting the bailout conditions put a severe strain on the economies of the countries concerned. In Greece's case, domestic demand and investment collapsed, wage cuts brought a 35 per cent drop in disposable income, and in a country with a labour force of around four million people, more than one million jobs were lost. We can call this process an unavoidable quid pro quo or an arrangement born of economic necessity, but for the sake of the European Union and its future, let's not pretend it was a selfless act of solidarity. The bailouts were, as Martin Sandbhu put it, 'solidarity infused with both self-interest and conceit'.[9]

[5] Sandbu (2015: 59).
[6] International Monetary Fund (2013).
[7] Wyplosz & Sgherri (2016).
[8] Minenna (2018).
[9] Sandbu (2015: 56).

NO CHOICE FOR THE OUTCAST

In Greece, the austerity policies implemented over the eight years it spent under the bailout programmes severely affected people's perception of the EU and led them in January 2015 to vote for the radical left party SYRIZA and nationalist right Independent Greeks (ANEL), on the promise of tearing up the hated Memorandum of Understanding with the creditors, even if this put membership of the single currency on the line.

The unpopularity of the measures demanded as part of the bailouts and the manner of implementation via the Eurogroup and 'troika' of lenders caused a shift in the way Greeks viewed the EU. According to the Eurobarometer survey published in June 2018, just two months before Greece exited its final bailout, Greeks were the only respondents in the EU to have a predominantly negative image of the union (37 per cent). Just 27 per cent had a positive view of the bloc, compared to a 40 per cent EU-wide average.

Yet, despite their feelings about the creditors' actions, the option of leaving the Euro, or even the EU, was too terrifying an option for many Greeks. Coming close to Grexit in 2015 made this clear.[10] Seeing banks shut for weeks and people queuing for hours at cash machines does wonders for concentrating the mind. During those fraught days, the limits on Greece's options became evident. Many people realised how precarious its existence would be if it chose to trade the, albeit deficient, support that euro and EU membership offers in return for a severely compromised form of national sovereignty.

FROM FEAR TO UNITY

Nevertheless, the future of the relationship between Greece and the EU cannot be based on fear. The division sown by the crisis can only be addressed if the euro area achieves a higher level of integration, a more level playing field and gives itself the necessary tools to prevent the next economic shock rather than ones that will help deal with the fallout.

'The status quo is synonymous, in 10 years' time, with the dismantling of the euro', said Emmanuel Macron in a speech in Berlin a few months before being elected as

[10] A survey conducted by Greek polling firm Public Issue in October 2015, just three months after the overwhelming '*Ohi*' (no) in the referendum on the third bailout, indicated that 66 per cent of Greeks had a positive view of the euro and 70 per cent thought things would be worse if Greece went back to the drachma (Public Issue 2016).

France's president in 2017. Upon assuming office, he made Eurozone reform one of his priorities. He set out a menu of proposals, including a Eurozone budget, giving the European Stability Mechanism (ESM) greater stabilisation powers and creating a backstop for Eurozone banks. Emmanuel Macron, however, has hit the same wall that hampered policymaking during the crisis, which is the unwillingness of politicians in some Nnorthern states to countenance any move that could be considered 'too romantic, pro-European, too integrative', as former German Finance Minister Wolfgang Schäuble put it.[11] Citing concerns about the possible intervention of the German constitutional court or lack of public support, Chancellor Angela Merkel and Wolfgang Schäuble consistently shut down the possibility of greater risk-sharing in the euro area.

Emmanuel Macron's calls for a Eurozone budget that would be able to fund investment or help countries suffering downturns, through tools such as a common unemployment insurance scheme, have so far been rebuffed. Even when it comes to macroeconomic stabilisation, the question being asked by several key players in the euro area is who will foot the bill, rather than if they can afford not to pay for it. 'European centralism, European statism, the communitarisation of debts, the Europeanisation of social systems, and the minimum wage would be the wrong approach', Angela Merkel's would-be successor as leader of Germany's Christian Democrats (CDU), Annegret Kramp-Karrenbauer, wrote in an op-ed for *Welt am Sonntag* published in March 2019,[12] indicating that she had no intention of straying from the line carved out by the chancellor. Germany has benefited from the low exchange and interest rates the euro has provided, especially during the crisis. The single currency and the policies within the euro area have also helped increase its exports and current account surplus. Yet, when the European Commission flags up via its macroeconomic imbalances procedure that this surplus is too high, the issue is skirted round. Instead, the focus falls on the member states that have a current account deficit or high public debt, or those that are having difficulties keeping public finances under control.

There is a similar muddying of waters when it comes to the creation of a genuine banking union. The last steps needed to complete the union, including the deposit guarantee scheme, have consistently met resistance. Core Eurozone countries insist that those who have experienced problems affecting their banking sectors over recent years must first clear up these legacy issues before the safeguards are put in place. The impression is created that, if Greek banks have a large amount of non-performing loans or Italian lenders hold nearly 400 billion euros of battered sovereign bonds, these can be dealt with internally without further impact. But if these banking systems

[11] Schäuble (2017).
[12] Kramp-Karrenbauer (2019).

run into fresh problems, who will provide the necessary assistance? If the state has to step in, it will have to be backed up by the Eurozone, especially when there is a doom-loop between banks and the sovereign bonds. The alternative is a crash that would again threaten the existence of the Euro.

SOLIDARITY IN PRACTICE

This takes us back to the start. If the EU is going to have its own, single and sustainable currency, there can be no room for scapegoats or black sheep. The idea that we are all in it together until something goes wrong is no way to run a currency union. The powerful and prosperous must be willing to use their political and economic capital for the greater good, overcoming the domestic reservations fuelled by divisive narratives. The countries that were bailed out must feel confident that they will not be cut adrift in the future. The stronger economies in the euro area cannot avoid making this commitment over the long term.

In Greece's case, the discussion about further debt relief has been put off until 2032. Its European partners have no appetite to provide any further funding in the meantime, leaving the country to tentatively feel its way back to recovery. But the Eurozone has lent around 270 billion euros to Greece since 2010 and this money will be at risk if the reluctance to complete the banking union, create a robust common fiscal capacity and deliver meaningful debt relief stifle Greece's chances of growing.

During the crisis, some in the Eurozone found it easy to hide behind morality-driven narratives rather than address what Mark Blyth calls the 'epistemic hubris' underpinning the monetary project.[13] But now the dust has settled, it should be clear that the single currency will only survive as a collective exercise. Without genuine solidarity, division will grow and when the next crisis hits, the weakest link will break. What happened to all the countries that were bailed out over the last decade, not just Greece, should serve as a cautionary tale of how brittle the single currency is and how, under pressure, it could shatter and leave our political union in pieces.

It is surprising, therefore, that the Eurozone's Mediterranean member states, which suffered so much over the last decade and are the most ill-equipped to face future crises, do not unite behind a common effort to reform the single currency. Whereas the core euro countries have joined forces in the Hanseatic League to protect their interests, blocking some of the proposals made by Macron, the South seems unwilling to fight its corner. Scrambling to disassociate themselves from what has been perceived as a 'failing' member state (how often did we hear other Southern European leaders

[13] Blyth (2013: 91).

say that their country was ‘not Greece’?) may have created too much distance between Mediterranean capitals. Perhaps speaking honestly about the single currency’s glaring errors would be the best starting point for bringing the South closer together to shape the future of the Eurozone and, as a consequence, the way Southern Europeans feel about the EU.

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