The Greek Crisis and the Search for Political Leadership

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Despite two bailout agreements of unprecedented size and the implementation of a harsh austerity programme, no solution to the Greek crisis is in sight. As a result, Greece continues to be a hotspot, sending sporadic tremors to a fragile eurozone. The outcome so far leaves no doubts about the grave mishandling of the crisis. The most important cause of this failure is the lack of political leadership at both the national and European levels. Accordingly, a solution to the Greek crisis will remain elusive unless Greek and Europeans politicians overcome the constraints of national political calculations and exercise leadership commensurate to the challenge of rescuing Greece and indeed the eurozone itself.

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The bailout of Greece has failed. This failure can be clearly seen in the increasingly deteriorating Greek economy, which is heading for its sixth consecutive year in recession, the widespread social destitution, bound to increase further after unemployment increased to an unprecedented 24 percent in the first half of 2012, and the intensifying political upheaval that threatens the country's political stability and social cohesion. A series of faults in both the design and implementation of the bailout programmes are responsible for this development. However, these failures in policy design and implementation are not simply instances of technocratic oversight or political misjudgement, but manifestations of a deeper problem, which is the lack of political leadership. The mishandling of the crisis in Greece has largely been the result of lack of political leadership at both the domestic and European levels.

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A brief overview of the crisis

The beginnings of the Greek crisis can be traced back to 2009[1] when, following the change of government in October, it emerged that the country's projected fiscal deficit was going to be more than double the figure estimated by the outgoing centre-right New Democracy government. As it turned out, the deficit would reach a staggering 15.8 percent of GDP. This revelation shook the country's credibility and focused the attention of financial markets on the desperate state of the Greek economy. Public debt at the end of 2009 stood at approximately €300 billion or 129 percent of GDP and, given the high fiscal deficit, was bound to increase further in the following years. At the same time, despite the recession, the country's current account deficit remained very high at 11 percent of GDP, revealing a serious competitiveness problem. As the crisis unfolded, Greece's credit rating gradually deteriorated to the point that, by the end of April 2010, Greek bonds had been relegated to 'junk' status and their spread exceeded 1,000 basis points. Unable to access funding from the financial markets, the Greek government made an official request for aid. On 2 May 2010, Greece signed a bailout agreement for a three year, €110 billion loan, provided by the European states and the International Monetary Fund (IMF). The agreement came with strict conditionality in the form of a comprehensive policy programme (memorandum) that would be supervised by the so-called Troika (the IMF, the European Commission and the European Central Bank–ECB).

Initially, the focus of the programme was on tax increases and horizontal cuts in government expenses (e.g. through reductions in salaries and pensions). These policies had an immediate effect and the government was able to boast a spectacular reduction of the fiscal deficit by more than 5 percentage points by the end of 2010. However, further progress in reducing the fiscal deficit, but also in the crucial task of restoring the country's competitiveness, required complex, difficult and time-consuming structural reforms in both the state apparatus and the private economy. In addition to their complexity, these reforms elicited strong and well organised opposition from interest groups that stood to lose from their implementation. As a result, the structural reforms' programme soon came to a standstill.

Meanwhile, austerity was starting to take its toll on the economy, deepening the recession, thereby driving the government's fiscal targets off track. Progressively, increasing social opposition to austerity policies, gradual derailment of the fiscal programme and stagnation in the area of structural reforms undermined the government's standing, both domestically and in Europe. In the first months of 2011, it was already becoming clear that Greece would not be able to meet the

[1] This refers to the manifestation of the current crisis and not its true origins which, as will be shown later, are deep-rooted and go back many years.

programme's targets. The Troika gradually and reluctantly accepted the need to negotiate a second bailout agreement with additional funds, while reducing Greek debt to sustainable levels. The result was a second, €130 billion, bailout agreement in February 2012 including a debt restructuring deal (so-called Private Sector Involvement or PSI), which reduced the privately held Greek debt by €106 billion, while extending the remainder for up to 30 years.

Despite these benefits, the second bailout agreement did nothing to change the mood in a country that found itself in a desperate social, economic and political situation. In 2012, Greece entered its fifth consecutive year in recession, having already lost cumulatively approximately 14 percent of its GDP. Austerity policies deepened the recession with hundreds of thousands of businesses going bankrupt, while unemployment reached 22 percent in the first quarter of 2012. Frustration and anger simmered among the population. These feelings were openly vented at the elections of 6 May. These elections changed fundamentally (and perhaps irrevocably) the political map of Greece. The once mighty, socialist PASOK, which had come to power in the October 2009 elections, was relegated to third place, losing more than 30 percentage points in the polls. New Democracy did not fare much better, despite having been on the opposition most of this time; while taking first place, it recorded its worst electoral result ever. The winners of the election were the extreme parties on the left and the right, united by their opposition to the bailout agreement and the memorandum. Particularly impressive was the performance of Syriza, a radical left-wing party, which took second place, recording an extraordinary improvement in its share of the vote.

Following an impasse in the negotiations to form a coalition government, new elections were called for 17 June. The new elections confirmed the transformation of the Greek political landscape; this time however, the results offered a way out, as New Democracy, PASOK and the moderate Democratic Left, pressed by the certainty of bankruptcy should the country go to a third round of elections, were able to form a coalition government with a mandate to renegotiate the Greek bailout agreement. However, neither the political upheaval caused by the elections nor the rejection of austerity policies by the Greek electorate, were enough to alter the Troika's insistence that Greece implement the memorandum's policies before any discussion on renegotiation is initiated. As a result, throughout the summer and until late October, the Greek government was engaged in a tough negotiation with the Troika over a new €11.5 billion package of austerity measures, intended to cover a projected deviation from fiscal adjustment targets in the years 2013 and 2014. The completion of these negotiations offers Greece an opportunity to renegotiate issues such as the duration of the fiscal adjustment programme, which would for the first time during the crisis relax the emphasis on austerity, thereby improving the chances of a return to economic growth.

Accounting for a failed rescue

As is evident from the above, the 'rescue' attempt in its current form has failed. Faults in both the design and implementation of the bailout programmes are responsible for this failure. The most significant design fault was the programme's ambition. The first memorandum required the reduction of fiscal deficit by 11 percent of GDP by 2013, an annual reduction of approximately 3 percent of GDP. At the same time, it required an extraordinary number of major structural reforms, ranging from the reassessment and redesign of the public sector's overall operational structure and remuneration system, to the overhaul of the national pension and health systems, to major interventions in the private economy, such as the comprehensive reform of closed professions and the labour market. In effect, the memorandum called for a complete overhaul of the Greek state and economy in the span of only a few years, so that Greece would stop being dependent on official aid and could return to the markets as soon as 2013.

The scope and speed of the structural reforms has stretched the resources of an already poorly qualified and equipped state apparatus. Its inability to design and implement the required reforms has been further constrained by aggressive fiscal adjustment policies, which have reduced the budgets for state services and pushed many civil servants into early retirement, leaving these services seriously understaffed. At the same time, the aggressiveness of fiscal adjustment has led the Greek economy into deep recession which, in turn, has undermined the government's fiscal consolidation effort since tax revenues have plummeted, while social welfare expenses, particularly those associated with unemployment benefits, have increased substantially. To make up for the deviations from the fiscal targets, the government has been forced to introduce new austerity measures which however only deepen the recession, thus further undermining the effort to reduce the deficit. This vicious cycle has plunged the country into a downward economic spiral, which discourages both investment and consumption and therefore limits the prospects of recovery. In addition, this policy has been implemented at a time when credit has disappeared from the Greek economy. The Greek banking system, cut off from the international interbank market and having lost approximately €70 billion worth of deposits since 2010, has been unable to provide liquidity to the Greek economy. This has put even more strain on cash-strapped businesses, furthering the deterioration of the domestic economy.

The situation has left Greece suspended in a state of uncertainty about its economic prospects and its position in the eurozone, which has further aggravated the country's economic troubles by discouraging foreign investment. As a result, forecasts are being continuously revised downwards, with recession now projected between 6–7 percent in 2012, compared to the original projection for mediocre growth of 0.8 percent. With current projections, a return to growth is not expected before 2014.

The notion that the Troika did not foresee these developments is hard to accept. The problem is not ignorance, but a deficit in political leadership at both the national and European levels. At the European level, there has been an obvious lack of political vision as both European leaders and European Union (EU) officials failed to evaluate properly the situation in Greece, as well as the potential risk that an unstable member state could pose for the entire Economic and Monetary Union (EMU), no matter how small its economic weight. As a result, they underestimated the scale of the Greek crisis and adopted a hard stance *vis-à-vis* the country, rejecting early calls for assistance and demanding that the government sort out the situation with a tough policy programme.

The reaction of Greece's European partners hastened its recourse to official aid by compounding the pressure of the financial markets, which until then operated under the assumption of an implicit bailout guarantee in case of crisis in the eurozone. In some countries, like Germany, this stance seems to have been part of a deliberate political strategy on the part of the government. In view of a political calendar packed with upcoming elections in many German *Länder*, the government sought to capitalise on a tough stance towards Greece, while tolerating populist rhetoric – which often bordered on racism – from large parts of the media and the political system.

When assistance to Greece could no longer be postponed, this attitude led to a narrow-sighted and politically motivated handling of the crisis by the Troika, which has often adopted a punitive approach towards the ill-disciplined Greek politicians and officials, rather than focusing on helping the country exit the crisis. The memorandum has given priority to achieving fiscal adjustment in as few years as possible, in order to limit the length and volume of funding to Greece, an approach directly responsible for its detrimental ambition described above. It has lacked vision and a political and symbolic narrative that would explain Greece's predicament in simple terms and offer a viable way out. While this is a failure shared with the Greek political establishment, the responsibility of the IMF in particular is significant, given its extensive experience with such programmes.

On the domestic front, the failure of the Greek bailout programme has to do with the poor implementation record of the Greek government, particularly in the area of structural reforms. The most important cause for this lack of progress has been the lack of political will. The Greek political system has traditionally been characterized by patronage and clientilism. State power has been used by political parties as a means to extend benefits and privileges in exchange for electoral support. As a result, the structure and operation of the state apparatus has been completely distorted, and its haphazard expansion into all areas of public life has been dictated by party politics and electoral calculations.

Moreover, these practices have also distorted the operation of the private economy, a large part of which has become entirely dependent on state contracts and commissions, while another part has been operating within a state-imposed framework that limits competition and accords privileges to specific professions and interest groups. In this context, the Greek political parties were unwilling to implement structural reforms aimed at eliminating distortions in the operation of the public sector and the private economy because, by doing so, they would hurt their own political clients.

This was particularly true for PASOK, which had very close ties with trade unions in both the public and the private sector. In order to overcome its predicament, the PASOK government adopted a series of horizontal fiscal measures in the form of increases in taxation and reductions in pensions and salaries, while dragging its feet when it came to structural reforms. In this way, it hoped it could meet the fiscal adjustment targets while avoiding substantial political costs, as the discontent caused by the measures would be spread 'thin' across the entire population, without hurting well organised interest constituencies close to the party. To some degree, this reluctance to implement the programme's structural reforms was also due to PASOK's ideological reservations about implementing a fundamentally liberal economic programme, which stood in sharp contrast to its election platform. However, such ideological conflicts took second place to electoral calculations, as clearly demonstrated by the fact that for most of this period, New Democracy, a liberal centre-right party, opposed the liberally oriented memorandum as well.

Moreover, the Greek political elite has failed to articulate a national vision and long-term plan for the future direction of Greece, which would justify and legitimise the sacrifices demanded by the memorandum. This has been a crucial factor for the lack of ownership of the programme, and has nurtured the impression among large parts of the population that the memorandum has been imposed on the country by its international creditors and is designed to serve their interests. This impression has also been kindled by the political establishment's failure to promote a political discourse based on a sober, detailed and evidence-based argumentation of alternative policy paths. During the crisis, public debate has been conducted in general, populist terms, which polarised the political climate at a time when consensus-building should have been a political priority. What is worse, during the crisis, the political parties have spent a lot of their energy threatening to or actually initiating parliamentary investigations against each other, either for past scandals or indeed for the handling of the crisis, a practice bound to increase polarisation further.

In search of political leadership

Greek politicians have been finding it difficult to acknowledge the need for fundamental change because that would require undoing their own system of clientele politics. In this sense, before reforming the Greek state and economy, the Greek political establishment needs to re-invent itself. In this challenge, it has utterly failed until now. However, this is exactly what is needed and nothing less will suffice.

The decline of the two major parties in the recent elections proved a catalyst for the creation of a tripartite coalition government covering most of the mainstream political spectrum. This, in itself, is a significant step forward for Greece, where there is virtually no tradition of coalition politics. Whether the coalition will hold through the rough waters the government will have to navigate is still uncertain; the first round of negotiations with the Troika over the €11.5 billion package of new austerity measures, proved a significant test for the cohesion of the governing coalition. The apparent intransigence of the Troika representatives, who seem to insist on extreme austerity measures and radical reforms, is certain to test the fragile coalition again in the future. In this sense, the sustainability of change in the Greek political establishment largely depends on the change in European political leadership. European leaders need to clarify once and for all whether they back the European integration project at all costs. If this is the case, they need to stop using the eurozone crisis for domestic political games. What is required is a strong, unambiguous vision of European integration, whose benefits and costs will be communicated in detailed but simple terms to the peoples of Europe.

Such a vision cannot be limited only to proclamations of much needed reforms in the European economy, but should be complemented by a political agenda founded on the principle of solidarity. In the case of Greece, this means that the programme needs to be redesigned with a view to reforming fundamentally the Greek economy and state, in order to secure viable long-term economic growth, without however devastating Greek society in the process. This could be done, for example, by extending the fiscal adjustment programme for two more years, as the government has been proposing. The additional funding that would be required for such an extension could be secured through intelligent solutions such as the roll-over of Greek debt by the ECB, or agreement by the latter to waive the profits made on its Greek bond purchasing programme.[2] At the same time, a shift of focus towards reforms which could deliver short-term benefits in the fiscal adjustment effort, such as the redesign of the taxation framework, the reform of the tax collection mechanism or the upgrading of information technology systems in health and insurance, in order to reduce cases of oversubscription and false pension claims, could go a long way towards filling the country's funding gap. Finally, any new programme should be accompanied by a set of pro-growth policy initiatives at both the national and European levels. Such measures should include a more flexible and efficient use of EU structural funds, as well as increased funding

[2] Such proposals were made by Greek Prime Minster Samaras to ECB President Mario Draghi in their meeting in September 2012.

by the European Investment Bank, whose mandate and function need to be seriously reconsidered.

Continuing on the same path, as if nothing has changed with the recent elections, is not an option. It risks social eruption and political fallout, derailing the programme for good. The consequences of such a development will be catastrophic for Greece not only economically but also politically, as the appeal of extreme parties on both the left and the right is bound to increase further. The descent of Greece into social disorder and political instability – with unforeseen consequences – would be a defeat for the European integration project, far worse than the destabilisation and potential breakup of the EMU.