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Greece after the Bailouts: Assessment of a Qualified Failure

George Pagoulatos

THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

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George Pagoulatos*

ABSTRACT

Lax fiscal oversight, loose credit following euro-accession, and credibility conferred by Eurozone membership led Greece to a debt-driven growth funded by external capital inflows. These private flows came to a "sudden stop" in 2010, forcing a bailout. The first adjustment program viewed the problem as one of liquidity rather than solvency, imposing heavily front-loaded austerity, that accentuated recession and led to complete target slippage. The second program included debt restructuring, exhibited greater flexibility, and focused on decreasing labour costs to improve competitiveness. The third program, whose size increased by the 2015 deterioration of the economy, contained much of what had been left undone, and was the only one completed. Despite deleveraging, both public and private debt as share of GDP continued to grow because of the steep recession, procyclical policy mix, and bank-sovereign doom loop. Eventually, hard external conditionality overcame much of the resistance of status quo coalitions to reforms. Despite the successive reform programmes, the Greek economy continues to suffer a weak public administration, slow functioning justice system, low savings, high consumption, small average business size, and a still weak export sector. Prolonged austerity has left a heavy legacy in terms of poverty, social vulnerability, and weakened productive capacity, as steep disinvestment and the decline of employment are dragging down the economy's growth potential. On the other hand, the twin deficits (fiscal and current account) have been eradicated, a wide array of significant structural reforms have been implemented, exports have increased, and the administrative capacity of the state has relatively improved. Greece represented a Mediterranean market economy, driven by domestic demand and deficit-financing; the crisis has brought about an evolving rebalancing of the economy towards a fiscally disciplined, reform-driven, and more export-oriented growth model.

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1. Introduction

In the comparative analysis of the Eurozone bailout programs, Greece stands out as an uncontroverted failure of historic proportions. The first country to resort to a financial assistance program in May 2010, Greece was the only country to require three consecutive programs, and the last to graduate, in August 2018, having spent over eight years subject to heavy monitoring and conditionality. An endless succession of policy reforms and heavy austerity measures were applied, contributing to a steep recession.

Since its first year of recession in 2008, Greece registered an eight-year long equivalent of a Great Depression, as steep as that of the US in the 1930s, but double as long. By the time it completed its third program, Greece had lost a quarter of its 2008 GDP, unemployment was at 20% (having reached 27.5% at its peak), one out of three Greeks were below the poverty line, youth unemployment affected four out of ten young Greeks. Over 400.000 people (some 9% of the country's labor force) were estimated to have emigrated during the crisis. By the end of the third program, even the lender institutions agreed that the handling and outcomes of the Greek crisis suggested a case of grave failure, though the exact allocation of responsibility varied.

What were the reasons why Greece ended up in this sadly exceptional state? Why did it fail to graduate following its second bailout? What were the policy errors and failures, and what is the legacy of Greece's bailout programs? We explore these questions looking at (a) the content of the conditionality programs and what was left behind, (b) the surrounding macroeconomic conditions; (c) the sociopolitics of Greece's "forced adjustment"; (d) the implications for Greece's variety of capitalism.

2. The tyranny of antecedent circumstances: from boom to crash

Greece's main incentive for pursuing euro-accession in the 1990s was two-fold. First, all governments, across party lines, had pursued to be at the inner core of European integration, the EU viewed at the time as the main provider of political security, institutional stability, and driver of domestic economic modernisation. Second, for an economy with a legacy of high fiscal deficits, public debt, inflation, and a weak currency, the EU provided the vital external constraint (the *vincolo esterno* -Dyson and Featherstone, 1996) that would catalyze macroeconomic adjustment to overcome the lack of domestic fiscal discipline and the low reform capacity (Featherstone and Papadimitriou, 2008).

Indeed, Greece entered the 1990s with high fiscal deficits, public debt and inflation, bequeathed by a period of expansionary economic policies that followed the country's transition to democracy (1974) and the first socialist government of PASOK under A. Papandreou (1981-85). Macroeconomic adjustment was pursued throughout the 1990s, initially under the centre-right ND government (1990-93), and subsequently (and more successfully) under PASOK led by A. Papandreou (1993-96) and Kostas Simitis (1996-2004). Stabilisation was initiated in 1985-87, interrupted in 1988-89, relaunched after 1990, but began to deliver after 1994.

Macroeconomic stabilisation was tightly interwoven with the EU single market program. The objectives of coping with the single market (culminating with the liberalisation of short-term capital movements in 1994) and fulfilling the EMU nominal convergence targets, implied a rigorous framework within which Greece should achieve macroeconomic stabilisation, market liberalisation, and institutional modernisation. In the constraining Maastricht framework, inflation de-escalated, fiscal discipline was restored, and from the mid-1990s the government began to post primary budget surpluses.

As part of the single market process, the financial system was gradually liberalised over the second half of the 1980s and into the 1990s, in view of the liberalisation of the capital account scheduled for 1994. Under financial "repression", the public sector had enjoyed below-market borrowing costs, which rose sharply in the early 1990s, as interest rates adjusted to market levels, pushing the public debt/ GDP ratio upwards. Over the 1990s, financial liberalisation allowed monetary policy to become assertive as interest rates increased, aligned behind the Bundesbank after 1994. But financial liberalisation also brought about an important reallocation of resources from sectors traditionally favoured for developmental or redistributive purposes (manufacturing, small- and medium-sized enterprises, agriculture, public investment), to increasingly modernizing non-tradable sectors (banking, real estate, constructions, media, retail trade) that corresponded to the strong demand for consumption created by trade and capital liberalisation (Pagoulatos, 2003). Following financial liberalisation, private sector creditors and financial institutions expanded, fueling consumption-driven growth.

High real interest rates in the mid-1990s, and the Maastricht-induced fiscal discipline, reduced inflation and suppressed budget deficits, allowing Greece to narrowly satisfy the EMU accession criteria and join the single currency with the second wave on 1/1/2001. In 1998 Greece implemented a final devaluation of the drachma before "irrevocably" joining the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS), the official antechamber of the single currency. After that, real interest rates began to decline, which, combined with the prospect of euro accession, led to a financial market boom, typical of an 'emerging' and euro-denominated market. Government access to globalised financial markets allowed cheap government borrowing and expansion. Boosted by the cost of the 2004 Olympic Games, primary budget deficits (i.e. net of interest payments on the public debt) re-emerged from 2003 and would last for a decade. The government (whose public debt was increasingly held by foreign investors) became subject to the power of global financial markets, susceptible to a self-fulfilling debt crisis at the first serious sign of financial vulnerability.

At first sight, EMU offered a much-anticipated framework of imported stability and growth. Low financing costs and ample supply of investment capital provided the Greek economy the opportunity to build productive capacity, develop comparative advantages, address structural deficiencies, and expand in a rule-based macroeconomic environment. However, these advantages were overridden by the irresponsible economic governance exercised by the Greek authorities up to the end of 2009. The social-democratic PASOK was succeeded in power by the conservative ND, which governed between March 2004 and October 2009. Greece posted a primary budget deficit every single year from 2003 until 2013, despite the economy growing at one of

the fastest rates in the Eurozone until 2007 (annual GDP growth averaged 4.1% in 2000-07). The governments failed to use the opportunity of rapid growth and low interest rates to generate primary surpluses and reduce the stock of debt. While public spending grew (financing pension and wage increases, investment, and personnel expansion), tax revenues remained stagnant. The externally imposed fiscal discipline lost its teeth, as the 'hard' Maastricht constraint (where fiscal divergence carried the maximum cost of EMU exclusion) was succeeded by a Stability and Growth Pact which became 'softer', flexible and politicized after its deficit limits were defied by France and Germany in 2003 (Blavoukos and Pagoulatos, 2008). The Commission was incapable or reluctant to impose fiscal discipline, and the Eurostat lacked the power to independently audit the numbers presented by a Greek Statistical Authority which (until its 2010 reform) remained subservient to the government (see Savage and Verdun, 2016).

Up to 2008, annual credit expansion grew at average double-digit rates, pulling GDP growth. Below the surface of a prosperous-looking economy lay deep rooted structural deficiencies: an unsustainable pension system, a wasteful and corrupt health sector, an excessively rigid labor market, closed products and services markets, an antiquated, inefficient and corrupt tax administration, a slow and overburdened justice system, a public sector overwhelmed by patronage appointments and red tape. Instead of using the high growth period to implement such long-needed reforms, the governments by and large refrained from any significant reform in the above sectors from 2001 to 2009. The rapid economic growth inside the euro, fueled by low-interest debt financing, generated complacency and an illusion of perpetual prosperity. Cheap finance and exuberant credit growth sustained an inordinate expansion of consumer demand. Fiscal deficit creation was again a major driver, to which growing private sector liabilities were added, both mainly funded by copious capital inflows. The twin deficit, which peaked when the 2007/2008 financial crisis shook the global economy, summarised the profound macroeconomic destabilisation (TABLE 1).

The stealthy destabilizing factor at work were the growing external imbalances. Cheap capital inflows ended up a factor of macroeconomic divergence rather than convergence, funding a steadily expanding current account deficit. The economy grew through foreign debt-fueled financial and credit expansion, visible in the rapid growth of real estate, consumption (government and private), and other non-tradeable sectors of the economy. Between 1998 and 2008, private sector debt (which had been low, with consumer and mortgage debt at dormant levels) almost tripled as GDP share, funded by annual credit expansion rates higher than the European average, though the stock of private debt always remained lower than the EU average. Contrary to the debt creation of the 1980s (funded mainly by domestic banks and general government entities), debt-driven growth after the late 1990s was financed predominantly by external capital inflows, via capital, debt or interbank channels. Inside the euro, reflecting the deficient EMU structure, external deficits reached levels hitherto unseen, as they would have otherwise necessitated an adjustment via exchange rate depreciation or devaluation. Indicating the economy's overall net exposure to foreign creditors, the net foreign debt grew as GDP ratio from single digit in the mid-1990s to well over 90% on the eve of the debt crisis (Meghir et al, 2017: 17).

As an economy in the Eurozone periphery, Greece experienced a far-reaching distortion (though less extreme for Greece compared to Spain or Ireland): an inflation of the non-traded sectors (banks, public enterprises, imports, constructions, telecoms, services, retail trade, media, etc) at the expense of exports and tradables. Higher returns on capital and labor (given the ample possibilities for private sector deficit financing) directed resources to these sectors, away from manufacturing, where global competition compressed profits. Traditional local industrialists turned into financiers or investors in real estate, where prices and returns rallied every year (Pagoulatos, 2014). The significant increase of wages in the sheltered, non-tradable sectors (led by public sector, utilities and banks, all heavily unionised and over-represented in the national confederation of labor unions) passed on their higher prices to the rest of the economy, undercutting competitiveness. Since euro-accession, the Greek economy had suffered a serious erosion of competitiveness, the result of lax fiscal and incomes policies, large capital inflows, rapid credit expansion, and higher inflation compared to its Eurozone partners. Between 2000 and 2010, the unit-labor cost-based real effective exchange rate rose by 26%, while the nominal unit labor cost increased by 47%, among the highest increases in the Eurozone. The Greek and Southern European erosion of competitiveness and divergence up to the crisis was magnified by the opposite policy of aggressive wage deflation pursued by the German economy through most of the 2000s.

The state-driven expansion and debt-driven growth up to the debt crisis not only contravened EMU fiscal rules but could not be justified on economic grounds either. The fiscal expansion was highly procyclical, at a time when the ECB monetary policy was too loose for the peripheral economies that were growing rapidly and with consistently positive inflation differentials from the Eurozone average. In that, the growth of private debt in Greece up to 2008 was not a substitute or compensation for fiscal consolidation, but grew in parallel with the persistently high levels of public sector indebtedness. The Eurozone was too discreet or politically cautious to intervene in the fiscal transgressions, and (perhaps even worse) was agnostic regarding the accumulation of large external imbalances in the Eurozone periphery, which under a single currency were perceived as almost immaterial. As was squandered the opportunity to exploit the unique conjuncture of high GDP growth and low-cost government borrowing to reduce the debt stock, and huge net foreign liabilities were accumulating, the economy was becoming increasingly susceptible to an external shock. The Greek state ended up crashing under its extreme vulnerability, as illustrated in a gaping current account deficit of 15% in 2008, 15% fiscal deficit and 127% public debt to GDP in 2009. The structure of capital inflows pre-crisis (debt rather than equity –FDI inflows being low) amplified crisis vulnerability. The shock, the debt crisis, came as a “sudden stop” of private sector capital inflows, in 2010 (Baldwin and Giavazzi, 2015), which had to be compensated for by Eurosystem or official bailout lending.

Table 1. Macroeconomic Destabilisation

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
GDP, constant prices (bn)	249.878	239.132	226.031	205.389	190.395	184.223	185.586	185.047	184.595	187.089	190.877*
Real GDP growth rate	-0.3	-4.3	-5.5	-9.1p	-7.3p	-3.2p	0.7p	-0.3p	-0.2p	1.4p	1.9(f)
Output gap (% potential GDP)	11.2	8	4.3	-2.8	-7.6	-8.5	-6.1	-5.2	-4.8	-3.9*	-2.6*
Gross fixed capital formation (% GDP)	24.5	18.3	17	15.1	12.8	11.6	11.9	9.8	10.6	11.7	12.8 (f)
Inflation, consumer price index	4.2	1.2	4.7	3.3	1.5	-0.9	-1.3	-1.7	-0.8	1.1	0.5 (f)
Unemployment rate	7.8	9.6	12.7	17.9	24.5	27.5	26.5	24.9	23.6	21.5	20.1 (f)
General government fiscal balance (% GDP)	-10.2	-15.1	-11.2	-10.3	-8.9	-13.2	-3.6	-5.7	0.6	0.8	0.4 (f)
General government primary balance (% GDP)	-5.4	-10.1	-5.3	-3	-3.8	-9.1	0.4	-2.1	3.9	4	3.7 (f)
General government gross public debt (% GDP)	109.4	126.7	146.2	172.1	159.6	177.4	178.9	176.8	180.8	178.6	177.8 (f)
Balance on current transactions with the rest of the world (% GDP)	-15.8	-12.5	-11.3	-10.3	-4.2	-2.2	-2.1	0	-0.7	-0.9	-0.4 (f)

P = provisional * = IMF staff estimates

Sources: International Monetary Fund, *World Economic Outlook Database*; Eurostat, September 2018; AMECO.

3. From crash to bailout: the 1st and 2nd financial assistance programs

The 2010 debt crisis terminated the illusive pursuit of debt-financed growth. When the global financial crisis erupted in 2008, the ND government rushed to shore up the banks, making available a total of €28bn by way of government bonds, preferred shares and state guarantees (Pagoulatos and Triantopoulos, 2009). However, very little was done to restore fiscal discipline, especially as elections were approaching and the economy was halting. In February 2009, for the second time since 2004, Greece came under the Excessive Deficit Procedure. In 2008-09 tax revenues declined and the economy was heading unhinged to the October 2009 elections. The socialist PASOK under George Papandreou won the elections on an expansionary platform, but directly sought to acquire an accurate picture of the fiscal situation. What was officially projected to be a fiscal deficit of 6% for 2009, was gradually revealed to be double-digit, eventually settling at 15% GDP.

By the end of 2008 the 10-year government bond spread over the German bund was over 200 bps; by the end of 2009 it had stabilised just below 300 bps. During the first months of 2010, as the fiscal outlook was revealed far worse than expected, markets were panicking, every fiscal package announced was deemed insufficient, and the Eurozone was wavering on how to deal with an imminent sovereign default, which only made things worse. Lehman provided a cautionary tale on what can happen if a systemically important debtor is left to collapse. Eurozone banks (predominantly French and German) were heavily exposed to Greek debt,[2] and Greece's bailout emerged as the only way to avoid catastrophic financial contagion in a Eurozone that lacked substantial crisis reaction instruments. By April 2010, days before the bailout package would be decided, the 10-year government bond spread over the German bund had exceeded 700 bps, rendering it clear that the government was unable to access the market.

The predominant emphasis of the 1st financial assistance program, signed in May 2010, was on rapidly reducing the budget deficit. It contained a wide array of fiscal austerity measures split between the revenue and the spending side, ranging from public sector wage and pension cuts to the increase in VAT and other tax rates and the abolition of tax credits (See TABLE 2). Many of the policies implemented under the 1st program represented critical structural reforms, that would enhance fiscal discipline and the overall efficiency of the economy. Among them: the full institutional independence to the Greek Statistical Office; a new organic budget law requiring multi-year top-down budgeting with expenditure ceilings for the state budget and deficit targets for the general government; a Parliamentary Budget Office; strengthening of the General Accounting Office (GAO) in budget planning and control, publication by GAO of timely monthly statistics on revenue, expenditure and financing, including arrears; establishment of a single authority for the payment of public sector wages until then scattered between different public sector entities; comprehensive pension reform consolidating the highly fragmented pension system (many more rounds of pension reform would follow); establishment of a central directorate general for debt collection, and a large-scale tax payers unit; comprehensive reform to rationalise public health spending (until then among the most inefficient and corrupt sectors of government) including strengthening

[2] According to the Bank for International Settlements (BIS), in 2010 total exposure of French and German banks to the Greek sovereign and banks amounted to $120bn, which by mid-2011 had been reduced by $35bn.

central procurement, e-health capacity and pharmaceuticals savings by expanding generics; merging the largest four health insurance schemes into one national organisation for the provision of health services; merging municipalities, prefectures and regions to reduce operating costs.

TABLE 2: Greece Bailout Programmes

1st Economic Adjustment Programme
Agreed: 2 May 2010 **PM**: George Papandreou, PASOK **Tenure**: May 2010 – June 2013 **Size**: *110 bn **Contributors**: GLF (Bilateral Loans pooled from the EA) (€80bn), IMF (€30bn) **Objectives:** • Implementation of sustainability-enhancing fiscal consolidation; • implementation of financial sector policies to stabilize the system; • Reforms in the economy's structure towards a more investment -and export-led growth model; • Restore Greece's credibility for private investors. Status: *€72.8bn were disbursed by March 2012, when the programme was superseded by the 2nd Economic Adjustment Programme.* **This amount was eventually reduced by €2.7 billion, as Slovakia decided not to participate in the GLF while Ireland and Portugal stepped down from the facility as they requested financial assistance themselves.*
2nd Economic Adjustment Programme
Agreed: 1 March 2012 (PM: Lucas Papademos, ND, PASOK) **Tenure**: March 2012-end 2014 **Size**: €130bn + €34.5bn (undisbursed amounts of the GLF) **Contributors**: EFSF (€144.7bn), IMF (€19.8bn until 2016) **Objectives:** • Restructuring debt held by private creditors to bring the total debt level back to a sustainable path; • Underpin fiscal consolidation efforts with structural reforms, to boost growth, and improve competitiveness. Status: *The Programme was extended to 30 June 2015 and expired. The Greek government failed to repay about €1.5bn to the IMF. A three-week bank holiday took place.* Total amount disbursed: €153.7bn *(On 27 February 2015, the €10.9bn that were earmarked but not needed for bank recapitalisation were returned by the Hellenic Financial Stability Fund (HFSF) to the EFSF)*
3rd Economic Adjustment Programme
Agreed: 19 August 2015 (PM: Alexis Tsipras, SYRIZA/ANEL) **Tenure**: August 2015- August 2018 **Amount**: up to €86bn * **Contributors**: ESM Objectives: • Restoring fiscal sustainability; • Safeguarding financial stability; boosting growth, competitiveness and investment, and; • Reforming the public administration. Status: *Greece successfully concluded the Programme* **€ 61.9 bn were disbursed*

Thus, the Greek economy was subjected to far-reaching externally forced adjustment (Pagoulatos, 2012). The program(s) represented the hardest conditionality, each review attached to a tranche disbursement merely sufficient to prevent a sovereign default. Greece's eventually three consecutive bailout programs imposed fiscal consolidation, internal devaluation and market-liberal structural reforms. Welfare state retrenchment became a priority, focusing on pension system and health sector structural spending cuts, primary sources of government deficits. Failure to adjust in good times necessitated harsh, painful and heavily frontloaded fiscal and external adjustment. The harshness was amplified by a punitive approach of the Eurozone lenders, who preferred to view the Greek crash as an exclusive result of Greek fiscal recklessness, overlooking lenders' responsibilities, and Eurozone level systemic flaws and policy omissions.

From the crisis onset, the Greek sovereign debt problem was officially branded one of illiquidity rather than insolvency. The creditors were unwilling to even discuss a mild reprofiling, let alone restructuring the debt. An admission of state insolvency would have required debt restructuring, which German and French banks (heavily exposed to the Greek debt) and an ECB concerned about Eurozone systemic stability, vehemently opposed. Moral hazard and financial contagion considerations (firewalls not yet there) prevented treating the Greek state as insolvent, which raised the overall adjustment cost.[3] Driven by moral hazard concerns, Eurozone governments set the official lending rates at over 6% (subsequently reduced). A heavily front-loaded schedule of fiscal adjustment was imposed, targeting a primary budget surplus for 2013, thus foreseeing an end of the program in 3 years, instead of the 5-6 proposed by the IMF. The 1st bailout program being funded by guarantees provided by the Eurozone member states, made it difficult for the governments to obtain agreement by their Parliaments to bailout a country still running a primary budget deficit. Thus, the EU chose to buy time, both for itself and for Greece, until the Eurozone had erected the firewalls, and Greece had adopted front-loaded painful austerity to both address moral hazard and eradicate the primary deficit. Frontloading adjustment went together with backloading the issue of debt sustainability, in a strategy of "extend and pretend".

In summer 2010, the European Commission (2010: 22) acknowledged half of the fiscal adjustment envisaged up to 2014 was implemented within the first semester 2010. Many rounds of additional fiscal measures would be demanded from the Greek governments. The 1st program proved excessively optimistic on the deficit and debt reduction targets, GDP growth assumptions, and anticipated speed of recovery. The overambitious fiscal targets were a function of the unwillingness of the Eurozone to consider additional concessional financing or to frontload debt relief, as was also observed by the IMF's ex post independent evaluation (IMF IEO, 2016: viii). The European Commission's October 2011 (5th) Review of the program began acknowledging a contraction in economic activity "substantially deeper than previously projected". The main driver of recession was the magnitude of austerity measures, implemented in a sociopolitical environment that soon became extremely confrontational, and would remain so throughout most of the crisis. Grexit speculation, the Eurozone

[3] Between May 2010 (when the 1st bailout program was launched) and February 2012 (when the 2nd was adopted), an approximate €58bn of Greek public debt matured and was repaid at face value. If debt restructuring had taken place at the 53.5% haircut rate, this would have reduced the public debt by €31bn, equivalent to 16% of the 2012 GDP (to which lower interest payments should be added). A non-negligible difference, which would have allowed milder austerity.

reluctance to provide a definitive backstop to the Greek crisis, and the slowdown of the European economy only made things worse. So did the subsequent upward revisions of the 2009 budget deficit by Eurostat in 2010, necessitating additional fiscal measures, that worsened recession and target slippage, in a vicious cycle, while destroying the political capital of the Papandreou government.

Given the steep fall of nominal GDP, public debt soon became glaringly unsustainable. Even following the adoption of the 1st program, government bond and CDS markets continued to price in a very high probability of sovereign default, as the Commission recognised from summer 2010 (European Commission, 2010: 16). Though the markets had briefly stabilised during the first good months of program implementation, peripheral spreads shot up after October 2010, when, in Deauville, Merkel and Sarkozy agreed that private sector debt-holders would take a hit next time a Eurozone government were to be bailed out. The massive sellout of Greek bonds by international investors (including French and German banks) had dire consequences for Greek banks, major investors and holders of their sovereign's paper.

The 2nd bailout was thus necessitated by the looming funding gap of the 1st program and Greece's indubitable inability to access the markets upon its conclusion. Thus, the 2nd program *ipso facto* represented an admission of failure of the 1st program, with two new elements:

First, the 2nd program, which contained what had been left incomplete from the first, was now much more focused and detailed not only on fiscal reforms but on a range of competitiveness-enhancing reforms, featuring among others an expansion of labor market liberalisation initiated by the 1st program, including a sharp reduction of the minimum wage by 22% (32% for the subminimum wage of young employees) that affected labor costs in the private sector. The reforms of the 1st program (tax governance, pension system and health system reform, labor market flexibility, liberalisation of market entry, etc) were strengthened and expanded to include reforms in public administration and the justice system, regulatory reform, and extensive market liberalisation. Importantly, the 2nd program contained a controversial obligation to sharply reduce public employment, including the transfer of 25 000 employees to the mandatory mobility ("availability") scheme, an antechamber for layoffs. During the program, further reforms improving the business environment were added, such as establishing a "one stop shop", reducing administrative burdens for business, setting up a general commercial registry, reducing the minimum required capital for establishing a limited liability company, and introducing a new legal type of low-capital and flexible private company. In 2013-14, the government adopted much of the so-called OECD toolkit, containing several hundreds of specific measures aimed to reduce restrictions to competition in retail, tourism, construction materials and food processing.

Second, the 2nd program introduced public debt restructuring. A mild 20% reprofiling agreed in July 2011 was revised upward to 50% in October 2011, while it was also agreed that Greece would need a new 2nd bailout possibly exceeding the 1st. Finally, private sector holders of Greek public debt were forced to "voluntarily" accept a haircut of 53.5% on the nominal value of their Greek government bonds. This unprecedented and highly complex exercise

(euphemistically named "private sector involvement" -PSI) wiped out €106bn (54% GDP)[4] from the total €198bn of privately held GGBs. Some €50bn from the 2nd financial assistance program was earmarked for the recapitalisation and resolution of Greek banks, whose initial losses were multiplied by the effects of PSI on their portfolios. In November and December 2012, additional reprofiling interventions were implemented (this time affecting the debt held by the official creditors -official sector involvement, OSI) including the repatriation of profits made on GGBs by Eurosystem central banks, and a bond buy-back scheme amounting to a net debt reduction of €21bn (10.8% GDP). From 2011 to 2015, the creditor institutions defined debt sustainability in (stock) terms of debt/GDP, setting an arbitrary target of medium-term reduction of the ratio at 120% GDP or below. Only in 2015, the official stance shifted into realizing that debt sustainability was a matter of ability to service the debt, thereby shifting to the (flows) concept of gross financing needs (GFN), not to exceed 15% GDP annually. By that time, and following the 2012 PSI, several additional reprofiling interventions had taken place, significantly reducing the net present value of the debt.

The first and second program were pursued under conditions of grave political instability, fierce political opposition, social tensions, but considerable policy and government continuity instilled by the tight conditionality of the program(s). Program implementation and the economy were seriously derailed on the way to national elections (in May and June 2012, and in January 2015) or by domestic political crises. Such was the announced and subsequently revoked referendum under George Papandreou, which led to his resignation from prime minister and succession, in November 2011, by a grand coalition government under former ECB vice president Lucas Papademos, backed by a 3-party majority (PASOK, ND and the ultraright-wing LAOS). Typically, different governments and ministers displayed a diverse record on program implementation, either moving fast and efficiently in completing milestones and reviews (as in the first months of the 1st program in 2010, or in 2013) or more frequently dragging their feet. Overall, program "ownership" by the governments remained low, if compared to Ireland, Portugal, Spain, later Cyprus. Both ND under Antonis Samaras and SYRIZA under Alexis Tsipras when in opposition vigorously campaigned against the program, promising to "renegotiate" it (Samaras) or to entirely repeal it (Tsipras), only to change tack after coming to government. In the case of Samaras this happened within days after his election as prime minister in June 2012. In the case of Tsipras in 2015, it would take six months culminating in the July 2015 referendum and capital controls, which brought Greece to the verge of Eurozone exit, before implementing a momentous U-turn and signing a 3rd financial assistance program.

The 2nd program was negotiated and voted by the coalition government of L. Papademos, but mostly implemented (after being updated) by the Samaras coalition government. Samaras came to power in June 2012, initially as a three-party coalition between ND, PASOK, and the Democratic Left. The insistence of the IMF on redundancies of public sector employees contributed to the Democratic Left eventually leaving the coalition. Nonetheless, the government registered considerable progress in implementing a large number of reforms, and in achieving the fiscal targets, after the fiscal adjustment path was extended by two years in November 2012, to make up for the steep deterioration of the economy under two

[4] The net reduction of public debt actually amounted to €68bn (34% GDP), as the PSI had a cost of €38bn (20% GDP) for the Greek banks whose GGB portfolio was written down, and which were subsequently recapitalised with public funds from the 2nd bailout program earmarked for bank recapitalisation (Bank of Greece, 2012).

consecutive elections in May and June 2012. The more realistic fiscal path now involved a reduction of the primary surplus target for 2014 from an extreme 4.5% to 1.5% GDP, and an even annual adjustment of 1.5% GDP targeting a primary surplus of 4.5% GDP for 2016.

Four reviews of the 2nd program were successfully completed by April 2014, which lasted much longer than intended, a demonstration of implementation delays. Through the summer 2014, the economy was recovering on all counts: investment, consumption, exports, consumer confidence, employment, all were showing signs of improvement. The forth review registered that the 2013 fiscal target had been exceeded with a 0.8% GDP primary surplus. In spring 2014 the government tapped the bond market successfully for the first time since 2009, and two of the four systemic banks raised more than the capital required fully from private investors. By 2014 the banks had substantially reduced reliance on Eurosystem funding.

Following the May 2014 European elections, and alarmed by the rise of SYRIZA, the Samaras government implemented a cabinet reshuffle that signaled a populist shift. From summer 2014 progress stalled under the spectrum of an early election in early 2015, if the government failed to gather the necessary Parliament supermajority to elect President. The risk became imminent in autumn 2014, and the government geared towards an election which SYRIZA was projected to win. The fifth review, which was to complete the 2nd program and open way to a softer conditionality under an ESM precautionary credit line, was never completed.

4. The 3rd financial assistance program and the political economy of bailouts

The norm of overall policy continuity between 2010 and end 2014 was interrupted in January 2015, when the coalition of SYRIZA and Independent Greeks (ANEL) rose to power, representing the most populist government coalition in Europe at that time. A radical left-wing party and an ultraright-wing nationalist party, united by their virulent opposition and demonisation of the adjustment programs (the “Memoranda”) applied since 2010, elected with the extravagant promise to unilaterally terminate the programs, end austerity, restructure the public debt, and remain in the euro.

Alexis Tsipras came to power with his own “impossible trinity”: he could not implement his program of repealing the Memoranda, keep Greece inside the Eurozone, and remain in government all at the same time. One of the three would have to give. In order not to be accused of betraying the anti-austerity cause and committing the “summersault” pundits expected, the Tsipras government, with Varoufakis as finance minister, applied extreme brinkmanship. The newly elected government announced the termination of the 2nd MOU program and the troika. Then an erratic back and forth with the creditors took the negotiation to the wire for five months, in what many viewed as a chicken game, finally calling a referendum advocating the rejection of the troika proposals. This prompted a run on the

banks (whose deposits were flowing out from the end of 2014 and through the first half of 2015) which could only be halted through the imposition of capital controls.[5]

On the aftermath of a resounding "No" in the July 2015 referendum, the Tsipras government, under the imminent threat of disorderly default and Grexit, was forced to capitulate into accepting a new €86bn ESM program. Its large size corresponded to the funding gap which had grown rapidly, and the higher recapitalisation needs of the banks whose capital had severely deteriorated. The conditionality program featured bold reforms and a gradual path to a primary surplus of 3.5% in 2018. Notably, by extending ESM loans at very low interest rates and long maturities (amortisation not before 2034, some maturities extending over 40 years) the 3rd bailout brought about a significant reduction in the refinancing needs and net present value of the (officially held) sovereign debt.

The 3rd program was a continuity of the 2nd, containing what had been left incomplete. However, by that time the anti-austerity arguments had been gaining momentum in Europe, the Eurozone economy was more confident under the ECB's PSPP and finally growing, and the European Commission had become more politically thoughtful in its approach. The 3rd program allowed a smoother fiscal adjustment path than any previous program, taking account the severe economic derailment. Indeed, the economy had returned to recession (after 0.8% GDP growth in 2014) and the public debt (which in 2014 was viewed by the IMF as "sustainable but highly vulnerable" (IMF, 2015a)) by July 2015 had become "highly unsustainable" (IMF, 2015b). The primary surplus targets agreed (-0.25% for 2015, 0.50% for 2016, 1.75% for 2017, and 3.5% GDP for 2018) ensured continuation of austerity, but less aggressively this time.

The reforms were bold and more focused than before. Some of the most controversial items such as public sector layoffs not only were absent, but the Tsipras government had been allowed to rehire those laid off directly upon coming to power. Apart from fiscal austerity, reforms prioritised financial stability, pensions, and the business environment, including among others: the introduction of a framework to enable the reduction of non-performing exposures (NPEs) of banks; adoption of out-of-court workout mechanism and the relevant electronic platform for debt restructurings and NPL resolution; reform of household and corporate insolvency legislation; full autonomy to the Independent Authority for Public Revenue; further pension reform and consolidation; completion of the merge of all insured persons and related data into the single pension fund (EFKA); centralised collection of the social security contributions and debt into EFKA; completion of public procurement and health system expenditure reform; corporate governance reform in the four systemic banks and the HFSF; further liberalisation of regulated professions and product markets; the establishment of a new independent privatisation and investment fund to manage and maximise the value of important Greek assets; more privatisations; liberalisation of gas and

[5] The Bank of Greece has estimated the overall cost of the 2015 brinkmanship and capital controls at over €86bn, equal to the size of the 3rd bailout program; Klaus Regling of the ESM put the number at over €100bn. This included among others profits of Eurosystem central banks that were lost to the Greek budget, an approximate €25bn of market value of the country's systemic banks that evaporated when the stock market crashed following capital controls, at a loss for the banks' principal public shareholder, the Hellenic Financial Stability Fund (HFSF). One could also add the opportunity cost resulting from two additional years of recession or zero growth (2015 and 2016) instead of the strong growth that was widely forecast by institutions and market analysts.

electricity markets; public administration reforms including the annual performance assessments for all public officials; acceleration of the judicial process.

The three consecutive economic adjustment programs represented an integral policy framework, despite differences. Each program was more realistic in its assumptions and forecasts compared to its predecessor. The 2nd program incorporated more flexibility than the 1st (in 2012 the 4.5% primary budget surplus target was deferred from 2014 to 2016) and the 3rd program the mildest fiscal adjustment path compared to both previous ones. The 2nd and the 3rd program were combined with debt relief. The 2nd program was able to incorporate better terms on the back of the sizeable adjustment implemented until then, but also the serious macroeconomic deterioration that resulted from two consecutive national elections (in May and June 2012) that led the program implementation off-track. The 3rd program drew on the magnitude of adjustment implemented between 2010 and 2014, combined with the severe destabilisation by the plebiscite of July 2015 and capital controls. Each program drew its existence from the failure of the previous.

The 2nd program was more successful than the 1st in achieving its revised fiscal targets, even though the economy deteriorated worse than projected, and the 3rd was the most successful. In all three programs, structural reforms were harder to implement compared to legislated austerity measures. In a social economy of traditionally weak supply and even weaker demand for productivity-enhancing reforms, only hard externally imposed conditionality could bring about any substantive progress. Many politically costly reforms (opening up professions or liberalizing product markets) were legislated but not fully implemented, as some link in the policy chain was typically missing. Vocal interest groups such as lawyers, doctors, engineers, pharmacists, mobilised to obstruct implementation of reforms affecting their status quo, with eventually limited success. The implementation deficit, exacerbated by the weak administrative capacity, systematically undermined the credibility of the Greek governments. It was repeatedly castigated by the troika, leading them to introduce a steadily growing number of reforms as specific prior actions, ministerial decisions or cabinet acts which had to be completed before any program money was disbursed. During the various program reviews, a number of additional "structural benchmarks" were transformed into "prior actions" to ensure completion of implementation. Under the 1st program, 32 of the prescribed reforms were implemented (80% success rate), while in the 2nd program 58 reforms were implemented (66% success rate given the much larger number of reforms contained in the 2nd program) (Katsikas et al, 2018: 34). Similar was the case with the 3rd program. Reforms requiring simple legislation or government act were easier to implement compared to reforms requiring multiple actions by various branches of the executive. Obstacles were also posed by the courts: austerity measures such public sector wage cuts, were repeatedly challenged in the Council of the State, the country's supreme administrative court, whose rulings created financial liabilities such as wage refunds, financed by further cuts, usually on the public investment program.

The 3rd program enjoyed unprecedentedly favorable circumstances. First, EU leaders were relieved to see a left-wing firebrand Tsipras sign into Eurozone orthodoxy, thus also reducing the threat represented by Podemos in Spain. Second, the Eurozone was finally growing, including all bailout countries, the shrinking Greek economy of 2015 and 2016 being the only exception. Third, Greece enjoyed sociopolitical stability, as none of the main opposition parties (ND, PASOK and some smaller centrist parties) was willing to wage the kind of extreme

opposition they themselves had faced by SYRIZA-ANEL during 2010-14. The 3rd program was voted in Parliament by an unprecedented majority of 5 parties and 222 out of 300 MPs, which following the September 2015 elections (also won by Syriza) represented over 250 out of 300 parliament seats. The second Tsipras government of September 2015 was practically the first crisis government elected with the commitment to implement an adjustment program it had negotiated and signed. Such political consensus was unprecedented, and so was the social peace following the tumultuous summer of 2015. While massive and often violent demonstrations and strikes had escalated between 2010 and 2014, reaching record numbers, mass protests and industrial action declined rapidly after the July 2015 referendum, and remained subdued throughout the second Tsipras government.

Program compliance by the Tsipras government led to a significant reduction of political risk, especially since the major opposition party of ND carried a moderate market-liberal agenda representing policy continuity to a large extent. From the beginning of Greece's debt crisis, the Grexit speculation had severely undermined the economy's effort to adjust. The "currency redenomination" threat was accentuated by the intense sociopolitical instability and uncertainty about the future continuation of economic adjustment. Extravagant major opposition parties until 2015 promising to abolish the Memorandum policies if elected to power raised political risk as Grexit risk, driving away deposits, investment, raising the country's risk premium and financing costs, deterring business commitments. The Grexit speculation hovered between 2010 and end 2012, subsided in 2013-14, reemerged and peaked in 2015, and left the picture from 2016.

The second Tsipras government oversaw the return to positive growth from 2017 (albeit the weakest in the Eurozone), tapped the market for a small bond issue in 2017, and completed the program in August 2018. It graduated the program with the Eurogroup agreeing to extend the grace period on the EFSF loans from 2022 to 2032 (theoretically –but overoptimistically— ensuring debt sustainability until 2032), but subject to a post-program framework of "enhanced surveillance" tighter than the other post-bailout countries, given the size of the public debt held by the EU official sector. A primary budget surplus of 4.2% was registered in 2017, way above the program target of 1.75%. Program fiscal targets were overachieved in 2015 and 2016 as well. Fiscal overperformance (drawn from over-taxation) became a political strategy of overcompensating for the accumulated credibility deficits of the past.

Under the inexorable pressure of the official creditors, since 2010, inconceivably unpopular measures were taken, reducing the life span of any government and severely weakening the two main pillars of the post-1974 two-party system, ND and, especially, PASOK. The socialist PASOK was reduced from 44% of the national vote in the 2009 national election to 12% in June 2012 to a humiliating 5% in January 2015. Following the reverse course, the radical left SYRIZA went from 5% in 2009 to become the major opposition party in 2012 to winning the January 2015 elections with 36% and September 2015 with 35.5%. Tsipras turned out to be the most resilient prime minister of the bailout era, and his coalition the only one to have both voted and completed a bailout program.

The crisis had a far-reaching impact on Greek society. The main victims left behind were the long-term unemployed, low-wage earners, and the new poor, suffering from the massive job losses, wage cuts, and the rise of indirect taxes. Income and wealth losses went across the board, affecting former protected groups (such as civil servants, higher income pensioners,

employees of public enterprises) who were specifically targeted by the wage and pension cuts. At the same time, other formerly privileged groups (liberal professions, lawyers, notaries public, engineers, pharmacists, etc) lost much of their protected status and favorable social security benefits, and from 2016 saw their contributions increase. Even the long-cherished institution of private property was not spared, as owners were forced to pay unprecedentedly high and quite progressive property taxes. So the burden of austerity was spread relatively proportionately in the population, but the weakest suffered the most. Tax evaders (or large tax avoiders) continued to evade but doing so became relatively harder.

The radical left SYRIZA graduated from the extreme populism of its opposition years to a more pragmatic discourse of necessity. Public opinion has acquired a new "folk memory" against (private or public) over-indebtedness, a new consensus for fundamental fiscal discipline. However, though a solid public opinion majority continues to support euro membership, trust in the EU institutions, as shown in Eurobarometer surveys, reached historic all-time lows.

5. A forced adjustment under the bailouts: the vicious cycle of contraction

Greece implemented one of the toughest fiscal consolidation programs ever pursued in the OECD, heavily frontloaded and recessionary. A primary fiscal deficit of 10.1% in 2009 was turned into a 0.4% surplus in 2013, and a 2009 fiscal deficit of 15.1% became a surplus of 0.8% in 2017. In addition to fiscal consolidation, income policies became very restrictive, culminating in a 22% reduction of the statutory minimum wage in 2012 (pushing downwards private sector wages across the board), aiming to sharply reverse the unit labor cost increases of the previous period and restore cost competitiveness.

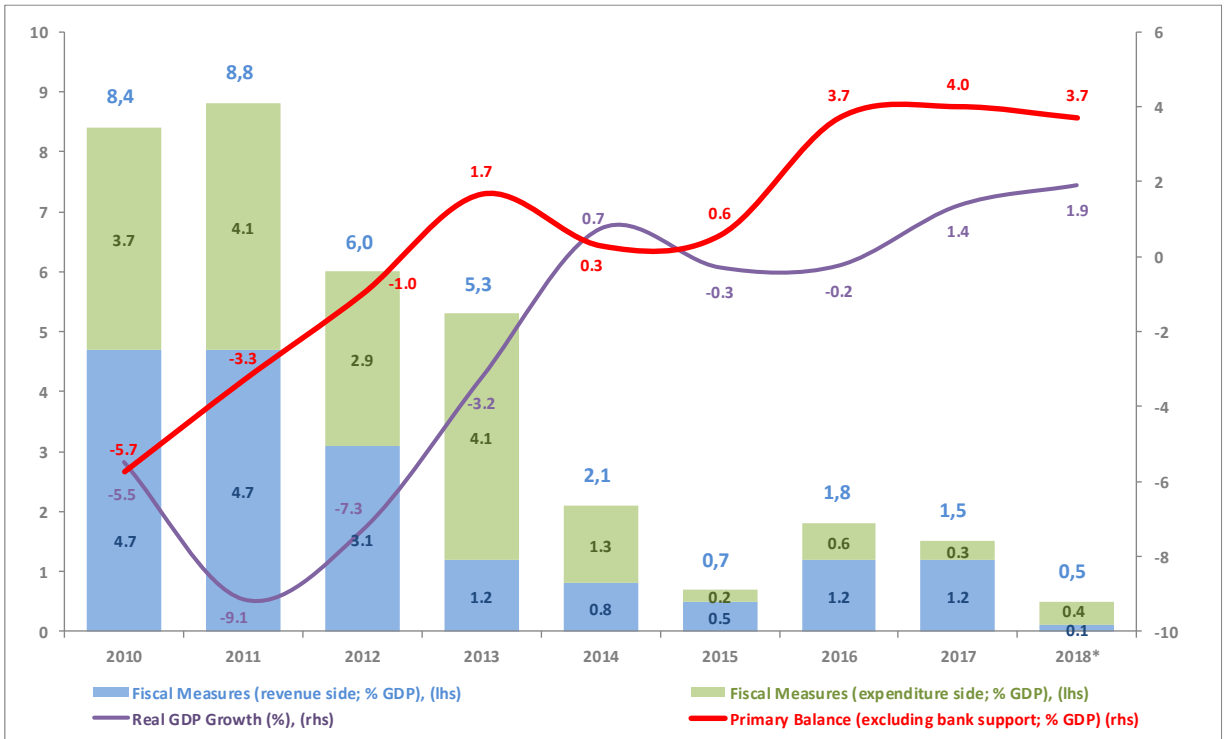
The magnitude of procyclical fiscal adjustment was directly correlated with the loss of output, as can be seen in the FIGURE 1. In the year of the deepest recession (2011), when the economy shrank by 9.1% GDP, the Greek government took the largest amount of fiscal measures, equal to 8.8% GDP. The total scale of fiscal retrenchment was huge and explains the magnitude of GDP loss from 2010 on.

The doctrine of expansionary fiscal contraction (Giavazzi and Pagano, 1990), also known as expansionary austerity, was invoked in the Eurogroup to justify the severe public expenditure cuts. Under certain conditions, reducing public spending would make room for private sector to expand. Such conditions (the economy near full employment, declining interest rates, lack of credit constraint, rapid international economic growth) were observed by Giavazzi and Pagano in Ireland and Denmark in the 1980s, but none of them held for Greece. In an institutional *mea culpa* for the IMF, Blanchard and Leigh (2013) concluded that the fiscal multiplier for government spending was not 0.5 (as the IMF initially assumed) but substantially above 1.[6] In addition, the impact of fiscal austerity on the Greek economy was accentuated by the relatively closed economy (depending excessively on domestic demand), the lowest savings rate in the EU during the crisis, the combination with steep income decline,

[6] A fiscal multiplier of 1 implies that 1% GDP expenditure-based discal consolidation reduces the GDP by an equal amount.

the credit crunch, and the severe confidence effect, associated with the threat of Grexit. Gros and Alcidi (2010) had an estimated 2.5 multiplier, predicting 15% GDP loss.

Figure 1. **Fiscal Measures and Outcomes**



Sources: ESM (2017), European Commission (2018), ELSTAT (2018) and Hellenic Ministry of Finance (2018)
Note: *European Commission estimation

The simultaneous application of contractionary policies was left without significant offsetting instruments: the accommodative monetary policy applied by the ECB failed to pass on to the periphery. Financial fragmentation and the infamous bank-sovereign doom loop had broken the monetary transmission mechanism. The crisis broke up as a sovereign debt crisis in the case of Greece, then via channels of portfolio exposure to sovereign debt and the real economy spread to the banking sector. "Double drowning" took over, when banks had to be recapitalised with public money, raising the bailout bill, adding to the debt burden, and so on. Credit contraction made it hard even for the most efficient Greek firms to access credit at reasonable rates, while the looming Grexit risk drove away prospective investors, froze economic activity, and pushed the economy deeper into the vortex of recession.

By 2018 real gross disposable incomes had lost over one third of their pre-crisis levels. The unit labor cost-based real effective exchange rate was down to the levels of 1999, meaning that the economy had more than offset the real exchange rate appreciation under the euro. These significant improvements in cost competitiveness were translated into a limited improvement in the export of goods, as discussed below. The current account deficit was eradicated mostly as a result of the sharp contraction of imports due to the recession, and to a secondary extent an increase in exports. During 2013-2015, the economy recorded negative

inflation. This improved cost-competitiveness, but also demonstrated the pain of adjustment achieved through internal devaluation, especially with an average Eurozone inflation below 1%, suggesting that adjustment in the Euro-periphery could only be achieved through suppression of prices and wages. Price inflation should have been much more negative than wage inflation to preserve purchasing power, and thus product market reforms deeper than what we have seen.

Negative inflation and the steep reduction of nominal GDP during the crisis years led to debt deflation, both sovereign and private sector debt burden growing in real terms as a result. As private debt turned into public debt (non-performing bank loans necessitating bank recapitalisations that raised public debt) the reverse process also took place. Excessive public debt necessitated such a steep fiscal consolidation that the tax burden for a wide array of taxpayers became impossible to meet. Thus, public debt was converted into private debt, owed by failing enterprises and distressed households. In 2018, a total of €102bn of tax arrears (to which another €6bn of customs debt are added) and €35bn of unpaid social security obligations were estimated, alongside the €92bn NPLs (some 45% of total loans). Altogether, these added up to a staggering private sector debt of €235bn, far exceeding the country's GDP. An estimated 4 million tax citizens (almost one out of two) owed some debt to the state.

6. The mostly negative legacies of massive austerity and positive reforms

The magnitude and scope of adjustment and reforms were unprecedented for any advanced democracy, especially undergoing a modern-era Great Depression. Even excluding reforms not fully completed, the scope of the overall adjustment remained exceptional by standards of advanced democracies. In terms of cyclically adjusted fiscal balance improvement, Greece posted the largest and fastest fiscal consolidation among OECD countries. For consecutive years after 2012, Greece was listed 1st in reform responsiveness on the OECD *Going for Growth* reports. Significantly, the programs forced the Greek government to operate upon measurable targets and milestones, bringing about an improved executive capacity.

The legacies of heavy and prolonged austerity weighed heavily on the Greek economy, not only regarding high unemployment and poverty levels, but also in terms of the economy's productive capacity. Unemployment in 2018 was down to 20%, a marked improvement from the 27% peak but in stark contrast to a Eurozone average of 8.6%. In GDP per hour worked, Greece was the only OECD economy with a negative performance during the period 2010-2016.[7] During the crisis years, the rate of GDP decline exceeded that of unemployment growth, which accounts for the negative growth of labor productivity. Total factor productivity growth was weak as well, and historically among the lowest before the crisis, due to the relatively low openness of the economy and a high share of labor in non-tradeable sectors (IMF, 2018: 56). Restoring productivity growth will be among the country's greatest challenges in the years to come, so that incomes can grow and the economy can expand

[7] https://read.oecd-ilibrary.org/economics/oecd-compendium-of-productivity-indicators-2018_pdtvy-2018-en#page1

healthily. Productivity growth has been the target of many implemented structural reforms, and those that remain on the agenda.

As a result of the crisis, national savings declined to a mere 9% GDP in 2017, the lowest in the EU (against a Eurozone average 23.9%; Spain 22.5%; Portugal 16%). Household savings collapsed from 9% pre-crisis to a negative balance of -9.7% in 2017. Consumption this time exceeded earnings because Greeks, suffering income and wage reductions, were using their savings to cover daily expenses and meet growing tax obligations.

Fixed capital formation at the end of the bailouts was 13% GDP (from 24% pre-crisis), and the employment rate (defined as aged 15-64, as percentage of total population) at 53.5% in 2017, against a Eurozone average of 66.5% (European Commission, 2018). Both the large investment gap and the low employment rate undermine the growth potential of the economy. Demonstrating the combined recessionary impact of these factors, potential GDP (the output the economy could be producing if all its resources –workforce, capital equipment, technology, natural resources—were fully utilised) was negative through most of the crisis. Indicative of the austerity path ahead, the European Commission estimated a negative output gap of -7.7% of potential GDP for 2017, and -5.2% for 2018, output gap projected negative for every year until 2022.

Austerity left a lasting legacy in the form of low employment rates, brain drain, capital destruction, which combined with worse than EU average ageing of the population are affecting negatively the country's growth potential. The IMF has invoked these exact factors (combined with the political system's reform fatigue) to estimate Greece's long-term real GDP growth rate at a paltry 1% (instead of over 1.3% supported by the EU institutions). Moreover, affecting its future path, Greece graduated the programs subject to a fiscal framework of prolonged austerity, foreseeing primary surpluses of 3.5% until 2022, and an average 2.2% GDP for 2023-2060. The IMF (among many others) has forcefully challenged the assumption that any economy (let along one exiting a prolonged and deep recession) can realistically sustain these fiscal targets for such an extended period (IMF, 2018: 60), suggesting that to pursue them on the longer run would suffocate growth of the Greek economy.

On the positive side, Greece graduated its three adjustment programs with a legacy of productivity- and growth-enhancing structural reforms, whose favorable impact will unfold with a time lag after the economy has entered recovery. Significant improvements in overall competitiveness, as a result of structural reforms undertaken by the three adjustment programs, can be substantiated if one looks at relevant indicators pre- and post-crisis. In the World Bank *Doing Business Report 2009* (World Bank, 2008) Greece was ranked 96th in 181 countries on the ease of doing business, had one of the worse scores in regulating business startups and property registration, 133 in starting a business, 109 in getting credit, 133 in employing workers, 150 in protecting investors, 62 in paying taxes, 85 in enforcing contracts. In the World Bank *Doing Business Report 2015* (World Bank, 2014) in a total of 189 countries, Greece had climbed to 61 in ease of doing business, was listed as having made the largest improvement in the area of registering property in 2013/14; it also made transferring property easier, and enforcing contracts easier by introducing an electronic filing system for court users (World Bank, 2014: 42). Greece was now ranked 52 in starting a business, 88 in dealing with construction permits, 116 in registering property, 71 in getting credit, 59 in paying taxes, 62 in protecting minority investors, 48 in trading across borders, 52 in resolving

insolvency, though retained a low score in enforcing contracts (155). Other reports by the OECD noted the progress made in reducing rigidities in the labor, product and service markets. OECD indicators show the sharpest reduction in the rigidity of product market regulation among OECD countries in 2008-2014, but Greece remained one of the highest regulated in the OECD. In 2015, an ambitious agenda of streamlining and simplifying investment licensing was launched, with the technical assistance of the World Bank, resulting in the simplification of 328 sectors between 2016 and 2018 (European Commission, 2018: 23).

In terms of political economy, the burden of price adjustment fell heavily on labor and wages (starting from the general government and extending to the private sector), and less so on the product and service markets, where powerful interest coalitions (including sector oligopolies) resisted liberalisation. The labor market was profoundly transformed, acquiring features of a liberalised market economy. Among others, reforms introduced especially by the two first programs contained the liberalisation of wage bargaining, transition from sector-level to firm-level collective agreements; easing dismissals, aligning labor conditions in former state-owned enterprises with those in the rest of the private sector, extending the use of fixed-term contracts, reducing overtime premia, extending part-time shift work (or partial lay-off) (European Commission, 2014).

Though the official objective (and proclaimed European strategy) was that of flexicurity, the reforms brought about flexibility without the security element. Given the fiscal constraint on welfare spending, and the sheer magnitude of unemployment, only a tiny percentage of long-term unemployed were receiving any state income support. During much of the crisis, after unemployment had peaked and had begun to de-escalate, long-term unemployed represented about 70% of all unemployed, and less than 20% of all unemployed were receiving an unemployment allowance, the system excluding long-term unemployed, self-employed and the young.

Active labor market policies and the expansion of vocational education and training, funded copiously by the EU budget, were relied upon as a strategy for tackling the high levels of unemployment and youth unemployment. Takeover rates and effectiveness have been questionable, but the systematic activation of such policies represents the strengthening of a structural shift from passive to active labor market policies more fit for the era of capital and labor mobility and rapid changes in the business environment.

Labor market flexibility facilitated the reduction of unemployment by 6 pps between 2013 and 2017, even though GDP growth remained nearly stagnant. It also accounted for the large majority of new jobs created during the last years of the crisis being flexible, low-paying, part-time jobs. Greece pre-crisis had one of the most rigid labor markets in the OECD, which justified much of the labor market liberalisation agenda, promising to allow easier hiring of employees when the economy recovered. However, the situation of an economy in recession, with investment rapidly declining, meant that during the first years of recession labor market flexibility facilitated the cyclical rise of unemployment.

Internal devaluation (the downward adjustment of nominal prices and wages) became a key external adjustment strategy, substituting for the lack of currency redenomination. Internal or fiscal devaluation aims to mimic the effects of a currency devaluation through fiscal measures. An example of proper fiscal devaluation would be a revenue-neutral increase in

the value-added tax (VAT) and social security contributions paid by employees combined with a reduction in the payroll taxes paid by employers. There was an obvious sociopolitical limitation to how far regressive tax measures could advance, at a time when VAT rates had already been increased, and private sector nominal wages (especially after 2012) were falling. Even employer associations were not receptive. Moreover, the already high VAT rates, combined with depressed demand, would only exacerbate tax evasion. Thus, fiscal devaluation measures were applied inconsistently, as the need to reduce short-term fiscal deficits overruled the longer-term reorientation of the Greek economy.

Overall, despite lip service to strengthening tradable sectors and improving export performance, the adjustment policy mix was only partly and belatedly successful on these objectives. The performance of manufacturing was undermined by the increasing tax burden, the delayed product market reforms, and the high cost of capital. While the reduction of social security contributions (the tax wedge) was emphasised in the 2nd program, targeting a 5pp reduction, the fiscal constraint led to more modest adjustment. The employer social contribution marginal rate went from 28.6% in 2011 gradually to 27.5% in 2013, 26% in 2014, 24.6% in 2015, to rise again to 25.1% in 2017 (OECD data).

The huge improvement in price competitiveness and unit labor costs achieved during the crisis was not mirrored in a proportionate improvement of Greek exports, which was delayed, and did not reach the annual growth rates achieved by Ireland, Spain and even Portugal. Greek exports significantly recovered only after 2017. Percentage-wise, total exports of goods and services went from 19% GDP in 2009 to 33% in 2017, an improvement reflecting the recovery of goods exports as well as the fall of GDP.

Explanations for the delayed recovery of Greek exports include: the currency redenomination risk and paralysing economic and political uncertainty during much of the crisis; the prohibitive cost of capital, including trade credit, affecting Greek exporters importing raw materials and intermediate goods for their exports; low institutional quality (lack of regulatory predictability, red tape, regulatory barriers); small size of Greek companies prohibiting them from better accessing export markets (Böwer et al., 2014).

A crippling legacy involved the banks, heavily affected by a crisis which (contrary to Spain or Ireland) originated from the sovereign sector. Non-performing loans, from 7% in 2009 had reached 14.4% of total gross loans in 2011, 23.3% in 2012, 31.9% in 2013, 33.8% in 2014, and 37% in 2016, and continued to rise to the 45% area in 2018, against a Eurozone average 6.2% for 2009-16. Three waves of bank recapitalisation unfolded between 2010 and 2018. The first, in 2011-13 was financed with €41.2bn from the bailout; the second in 2014 was entirely privately funded, raising €8.3bn mainly from foreign investors optimistic in the recovery prospects of the banking system. The third recapitalisation became inevitable after the collapse of share prices following the July 2015 capital controls. Between November 2014 and June 2015, the banks lost €40bn worth of deposits (26% of the total) and were subsisting on Emergency Liquidity Assistance. The state injected another €5.4bn in the December 2015 recapitalisation, while a total of €9bn was raised from existing private sector investors.

The authorities were late in devising and implementing a strategy to deal with NPLs, which became a priority only under the 3rd program. Until then, all borrowers were legally protected from auctions of primary residence regardless of income, wealth or size of mortgage loan,

which created a category of strategic defaulters. Banks, borrowers and politicians for different reasons converged in delaying dealing with NPLs until the creditors' pressure became inescapable. From 2016 began a process of selling NPLs in the secondary market, establishing an out-of-court workout scheme, reforming the household insolvency law and setting up an e-auction framework, all of which were producing results by the time the program was completed (European Commission, 2018). However, the banks were left in a fragile position, incapable of providing credit to the economy, facing very ambitious NPL reduction targets for the following years and the menacing specter of a new recapitalisation.

Given the dearth of national savings, the weakness of banks, the framework of fiscal austerity affecting public investment, the Greek economy is and will be forced to rely extensively on foreign investment. Far-reaching privatisations were implemented towards the end of the programs, for debt reduction and attracting foreign investment, including plots of land, airports, ports, and utility companies. Foreign direct investment (FDI), however, remained low during the crisis as much as pre-crisis, despite depreciated asset prices, mainly because of poor institutional quality, legal and administrative impediments discouraging foreign firms from investing and producing in Greece (Meghir et al., 2017: 12).

The socioeconomic effects of the crisis weighed as the programs failed to effectively target protection to the weakest groups, especially the long-term unemployed. In 2013, Greece posted the highest percentage in the EU (60%) of individuals aged 18-59 living in jobless households at-risk-of-poverty, whose total benefits received were less than 10% of total net disposable household income (EU average 25%) (Maquet et al., 2016: 43). Poverty rates severely deteriorated: the percentage of people at risk of poverty or social exclusion climbed from 28% in 2009 to 36% in 2016 (against a Eurozone average 23%). The World Bank estimated an annualised income decline of 8.4% among the bottom 40% in 2010-15, the worse performance among 91 economies (World Bank, 2018: 51). The OECD found that Greece recorded the largest drop in equivalised disposable income for children in low-income two-parent families between 2007 and 2014, 50% for the poorest 25% and over 60% for the poorest 10% (OECD, 2018: 4). The inequality impact was relatively tempered by the fact that wage and pension cuts were mainly focused on higher incomes, and progressive tax policies (income and real estate tax) spread the burden of adjustment (leaving however intact tax evading groups –mainly self-employed). The elderly improved their relative position in the income distribution while there was substantial deterioration in the relative position of the enlarged group of the unemployed (Andriopoulou et al. 2018).

Social spending cuts aside, the programs rationalised social expenditure and welfare state organisation in several respects. Consecutive pension reforms improved the sustainability of a system that was heading to bankruptcy before the crisis hit. According to the IMF, pension expenditure increased from 14.8% GDP in 2010 to 17.7% in 2015, as pensions lagged behind the fall in GDP. After a 2016 reform, pension expenditure remained above 16% of GDP, the highest in the Eurozone. Unemployment, early retirement, and steep recession severely affected pension sustainability. Health and pharmaceuticals spending, an area of extreme corruption and waste of public resources, was overhauled and rationalised. These savings allowed for a more efficient establishment of safety nets targeting vulnerable social groups towards the end of the programs. A minimum guaranteed income scheme was adopted during the 2nd program, beginning on a pilot basis and subsequently generalised. The troika supported the introduction of a Social Solidarity Income in 2017, providing income support to

the poorest households, covering some 600,000 individuals, as well as means-tested housing benefits from 2019 (European Commission, 2018: 13-14). The other safety net was the extension of universal health care coverage to uninsured Greeks and other vulnerable categories such as immigrants, entitled to receive public health care and medicines under the same conditions as insured citizens.

7. Towards a Growth Model?

The crisis terminated or certainly disrupted the unsustainable growth "model" of a demand-driven, Mediterranean economy, which can no longer rely on deficits, fiscal or external. Post-crisis, deficit-financed growth is not an option for a peripheral economy that will need to maintain a balanced current account and to generate large and sustained primary budget surpluses.

The less efficient mixed version of a capitalist economy identified as a mixed market economy or (more descriptively) as a Mediterranean market economy (Hall, 2018) has included liberal features following the adoption of market-oriented reforms, cohabiting with patterns of coordination secured by the actions and policies of the interventionist state. There arises the need to shift to a greater reliance on exports, higher value-added tradable activities, and private investment, including FDI, areas in which Mediterranean economies are less well equipped compared to export-led CMEs (Hall, 2014; Regan, 2016).

The pursuit of external competitiveness drives the post-crisis growth model, emphasising the supply side and export-orientation, seeking to strictly align wage increases to productivity gains (or otherwise rely on wage deflation), and pursuing the latter through extensive structural reforms of the general government sector and the markets. A fiscally sustainable, liberal-type welfare state, focusing on active labor market policies and the provision of an adequate minimum safety net, complements the post-crisis growth model, which also transforms a statist economy into one containing stronger liberalised features.

The direct legacies of depression however (extensive disinvestment, erosion of capital, employment decline) and the resulting decrease of potential growth cast doubt on the prospects of the said growth strategy. It indeed points to a direction of parallel reform, at national and Eurozone level, the Eurozone supporting (or necessitating) national reforms, establishing a capacity for short-term countercyclical stabilisation, and institutionalising greater risk-sharing for risk reduction.

Various growth studies have outlined comparative advantages of the Greek economy, apart from tourism and shipping, in sectors such as agro-industry, logistics, renewable energy and energy transport, pharmaceuticals, and others, while some dynamic clusters are developing in high technology and software. Some of these sectors (tourism, logistics, agro-industry, energy, renewables, software and technology startups) have seen significant growth around the end of the crisis, while manufacturing companies have increased their export orientation to compensate for the loss of domestic consumer demand. So the rebalancing of the economy is happening, albeit at slower than desirable speed.

The Greek case points to a broader research question: what becomes of a Mediterranean state and the surrounding political economy inside an imperfect single currency regime, with a strict institutionally prescribed and market-imposed fiscal framework, an only limited ability to rely on foreign borrowing, and the need to maintain competitiveness by means other than resorting to the exchange rate fix? This is an open question for future research.

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