Transcript

Anti-Austerity Greece: On a Collision Course with Europe?

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18 February 2015

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Kevin Featherstone

We have two very good speakers alongside me. We have Vicky Pryce, who is the chief economic adviser at the consulting firm the Centre for Economics and Business Research, and also chief executive of CEBR Energy. Vicky has had a stellar career as an economist, with different academic affiliations, and is well known to media audiences wanting to hear about the Greek crisis. Dr Holger Schmieding is the chief economist at Berenberg in London. Before joining Germany's oldest private bank in October 2010, he worked as chief economist, Europe, at Merrill Lynch, Bank of America, and at the Bank of America/Merrill Lynch in London. Again, a frequent expert on questions of the eurozone and on Greece.

Who am I? I am Kevin Featherstone and I'm a professor at the London School of Economics, in the European Institute. I hold the chair in contemporary Greek studies and I direct a research unit at the LSE specifically on Greece called the Hellenic Observatory.

We have a sequence of speakers. I was deputed to speak first and then I'm going to invite Vicky and then Holger. We're going to limit ourselves to about eight minutes each and then, in the usual format, open it up for contributions and questions from you.

By way of introduction, let me talk about the politics and then my colleagues will expertly talk about the economics.

How have we got here? We are talking about a case in which traditionally in Greece, Europe has seen as synonymous with modernity, progress, good governance. Greece has had very high levels of support for European integration historically. More recently, we've seen one of the biggest falls of support for EU membership, in Greece, to be experienced anywhere in the European Union. By the same token, for the European Union, we have the EU drawn into an unprecedented domestic intervention in a member state. The troika and the EU task force provoking new questions in this relationship of the EU and a member state – of legitimacy, of credibility and indeed of capacity.

Perhaps the crisis has emphasized to us a lesson that we perhaps should have learned earlier – that is, the European Union having too long neglected its own dependence and vulnerability in the face of the differences, the divergences, of domestic governance, the quality of domestic institutions, the effectiveness of public administration to deliver on EU policies, and more generally, the variations in the capacity to reform. In this context, the role of the troika, on behalf of the creditors for Greece, has then had to face some of the problems domestically in the Greek context: the rigidities, the lack of knowledge, the low skills, some corruption in Greek public administration. We have a clash then between the unprecedented intervention, the creation of a new mechanism for trying to provide more effective implementation and adaptation, with a clash of domestic governance institutions which pose rigidities and questions of dysfunctionality.

Partly in consequence of that, I think we've also then been led to a situation where within Greece, to some extent as a result of this clash, we've had an austerity programme which is focused very much on horizontal cuts, spreading the misery, as it were, of adaptation across the system – a mechanism which is unsuited to questions of how to remodel, how to set priorities for longer-term development. In other words, enabling a debate about choice of the future direction or the remodelling of Greece. That strategy, that role of the troika and of the domestic intervention, has emphasized short-term horizons and the impossibility of a sensible debate about adjustment, remodelling, destination.

But at the same time, the clumsiness has undermined a domestic reform coalition. No government in Athens since the start of the crisis has received Europe's full backing. The effect of the troika mechanism has contributed to the demise of the centre-left, the PASOK party. In parallel, in party politics, we've seen a fracturing of existing political parties, the rise of the extreme right, but also a new narrative that I would suggest is a populist narrative of blame shift from the mass to the elite, to the political class, the kleptocracy, etc., associated with a hesitation or ambiguity in condoning street protests, demonstrations, riots, within universities and on the streets. It's also associated with a vilification of a previous political class, previous political elites.

It comes with a populist narrative about the ability of Greece to renegotiate its position in the eurozone. I was fascinated by an opinion poll five days before the last election, which asked Greek voters: who do you think will blink first, Angela Merkel or Alexis Tsipras? Curiously, 53 per cent of Greeks thought that Angela Merkel would blink first. I'm not implying that 47 per cent thought Athens; if you take account of the 'don't knows', it was 53 versus something like 32 per cent. I think we can accept that this is an opinion poll result which we would be unlikely to get in most of the European countries on the question of Angela Merkel backing down.

But we've got to this position also on the basis of some of the strategic mistakes of previous governments. In particular, Antonis Samaras, the previous prime minister, showed an ambiguous commitment to the reform agenda and to the bailouts programme. The Samaras government too hastily sought the end of the bailout programme. Portugal had achieved the end of the programme; Greece needed to, for political reasons, as well. But it came with hasty, rather clumsy, strategic mistakes.

So we got to the election on the 25th. Yes, of course, the election showed us a mood of tremendous public anger, of exasperation clearly, of the extensive social and economic pain in a recession almost comparable to that of the Wall Street crash. No one can doubt the depth of pain that has been evident in Greek society. But clearly, a desire to try something new, with an anti-bailout cleavage in politics, so that 53 per cent of Greeks voted for parties opposed to the bailout programme. Clearly evidence of a rejection of the austerity measures.

But an underlying constraint here. A desire for change, a desire for a new deal with Europe, but with an underlying constraint: 76 per cent of Greeks still believe that Greece should stay in the eurozone. It limits the negotiating space for the new Syriza government. In the three weeks since the election, we have indeed seen some major shifts on the part of Syriza and the new government. Yanis Varoufakis, the finance minister, has said since the election that something like 70 per cent of the original memorandum is acceptable to him. They now say that privatization is not opposed in principle. There's less talk of wiping out parts of the debt, etc.

So we have a remarkable shift of political position by the Syriza government, in the face of obvious evidence of the toughness of eurozone governments and of the ECB. But I would simply finish by posing the question: in this particular negotiating context, what was not a surprise in our present situation? The toughness of the ECB, the lack of response from other eurozone governments – politically, where's the surprise? I think these are the parameters.

A final point. In the present situation, we therefore domestically have a clash of different narratives: a clash of narrative in terms of the role of democracy and what a national election means; a clash of narrative in terms of responsibility and perhaps the raising of unrealistic expectations; but also, a clash of narrative as to what kind of reform Greece needs.

So I've endeavoured to whet the appetite for the more serious economic presentations, and I'll pass to Vicky to tell us where we are.

Vicky Pryce

Thank you very much, Kevin. Kevin has studied Greece very intently for a number of years and of course he knows the Greeks themselves (of which I am one) are most critical of everything that's been going on in the past, in terms of the way the state was run. It was quite extraordinary, when I was writing this book called *Greekonomics*, reading the OECD report on the Greek public administration system. The report was good but the public administration system was rated as one of the worst they had ever seen, certainly one of the worst in the OECD, and it basically lacked coordination, strategy and so on.

So I think those things are well known. But of course, I've spent quite some time hearing that the Greeks don't like to pay their taxes, they are corrupt, they're lazy, they retire early and all that sort of stuff. Some of that is true but it's not the complete truth, and it's not just the Greeks, as we are hearing from what's going on in the UK as well right now. I think occasionally Greece is misunderstood. I think it's worth reiterating a few of the things Kevin touched on.

First of all, the amount of hardship that Greece had to endure because of the austerity which was imposed on it. Remember that Greece had to go and get the first bailout in May 2010, which was about €80 billion from the eurozone, including the ECB, and €50 billion from the IMF, and then had to have a second one in May 2012 of another €110 billion. So we ended up with a debt from that source of €240 billion, which is huge by any standard. The biggest size that the IMF has ever had to deal with and the biggest bailout that's probably ever been. So it was uncharted territory. To then assume that austerity was going to be the answer, was going to lead to Greece transforming itself from this state of being completely useless in so many areas to being a model economy (à la Germany, possibly) is just not realistic.

What is more, expecting reforms to happen overnight cannot happen when the economy is shrinking and when the social system itself, apart from the family support that exists in Greece, is just not there to help with the unemployment and so on. So the welfare system isn't there, so there isn't a social structure apart from family that can keep people going.

The huge surprise is that there hasn't been a revolution in Greece yet. The one revolution we've seen is the way they voted both in the May European elections and just now at the end of January, which brought in what is the first really for Greece in reality – although Andreas Papandreou a few decades ago was also reasonably left-wing – but the first serious, looking from the outside, left-wing government that Greece has seen probably since the war, which normally would bring in the tanks actually (which is what has happened in the past).

It is quite an extraordinary situation to find oneself in, because the economic situation has been so bad. But what is perhaps often forgotten too is what Greece actually did. All this talk now about conditions that need to be met and how the Greeks are living beyond their means is shown not to be correct if you look at what's happened with Greek fiscal austerity. The deficit to GDP ratio has been reduced from 15 per cent back in 2009 to 2.5 per cent in 2014. Greece achieved a primary surplus bigger than any of the other European countries in 2014, of around 1.5 per cent, which is quite extraordinary.

It's also worth remembering why we got to the position we got in. In addition, of course, to the 25 per cent unemployment – 27 per cent at its height – and 54 per cent youth unemployment and so on. Kevin referred to Samaras and New Democracy wanting to end the memorandum agreements, like Portugal and

Ireland had done. That is interesting in retrospect, and historically would be one of those moments that would be looked at with great interest as bringing a euro crisis so close to proximity, which is exactly what's going on right now.

I think it was perfectly reasonable for Greece, which had achieved all of this, to go and ask for the end of the bailout period, after it had achieved a huge improvement on the deficit and the primary surplus. But Samaras (the previous prime minister) went to the Council of Ministers, and also it was done through the Eurogroup, and presented a 2015 budget which had, again, a primary surplus of 1.5 per cent and huge austerity still attached to it, which was voted in by the parliament. He was sent home, saying: it isn't tight enough. You need to find an extra €1.8 to 2 billion. Which of course he couldn't possibly pass through parliament. He got an extension of two months to come back with the goods, if you like. He could have got six months but there is a conspiracy theory in Greece that he wanted two months in case he lost – it would be a serious problem for the current government, which is precisely what's been going on right now with all these deadlines.

But it is an extraordinary thought that for just that small amount, Greece has been plunged into this crisis that it's finding itself in right now, and has this government which is inexperienced and we don't really know what it's going to come up with in the future. The negotiating tactics have been a little bit weird, to say the least, but you never know, since there seems to be some agreement possibly being put together this week between the Greeks and Europe. We'll see how that develops.

I think that is a point to bear in mind, in terms of how we go forward. This intransigence of the Europeans has been one of the main issues. The longer it lasts, the worse it could be for Greece, because after all, we saw a decline from the previous quarter in the last quarter of 2014 in the economy. We've seen an exodus of money taking place. We've seen the banks being downgraded. There is a meeting with the ECB today to decide whether – it's a periodic review, of course, which happens every week – the ELA (emergency liquidity assistance) for the banks continues, whether it's raised or stays the same level. Of course, they're bound to want more. There is a big issue about non-performing loans in Greece, which have already caused a lot of concern for the European Central Bank when it did a stress test and asked a number of the banks to increase their provisions very significantly.

The truth is that during this uncertainty, and certainly since the election campaign started, the Greeks have not been paying their interest on their debt, have not been paying the debt back. They haven't actually also recently been paying their taxes. One of the things that was debated and actually is being passed, I think, today in parliament in Greece is to allow people who haven't paid their taxes to pay it over 100 different doses of payment, which actually relieves the point considerably.

So what are Greeks therefore asking? I think it's pretty reasonable, since they were voted on a non-austerity platform. It's to have this extension of this debt for a while – whatever you call it, I think it's an issue of semantics. Whether it's just a bridging loan or an extension of a loan or whatever, during which some of these things can happen and during which the programme can be developed. But of course, what is at heart and will remain at heart is the debt to GDP ratio, which is killing Greece at present and which, frankly, is going to be killing a number of other countries. Remember Ireland, Portugal, they may have exited the memorandum agreements but they are actually still having 120-130 per cent debt to GDP ratios, which are absolutely unserviceable over a long period of time.

So what Greece is asking for is a rethinking of the debt, lengthening of maturities, lowering of interest rates, which would mean that it doesn't need to have a primary surplus of 4 or 4.5 per cent, which is what the Europeans wanted and sent Samaras back to achieve, but they could have something less – maybe 1.5, 2, or 3 – which allows for a bit of the elimination of the austerity measures that were so upsetting the population. Without that, I think perhaps we will finally see a proper revolution in Greece.

Holger Schmieding

Thank you. I agree on quite a bit of what I've heard, maybe not on all points, so there is a good thing to discuss.

Greece had the misfortune of being the most troubled of the eurozone members and being the first one to get into serious trouble. That is, when starting to deal with Greece, Europe didn't have much experience of how to do that. So the programme for Greece – fiscal repair and supply-side reforms – was and is basically right, but the dosage was not quite right and the mix was not good. There was initially too much emphasis on short-term austerity and not enough emphasis on the pro-growth structural reforms, the supply-side stuff which Greece really needs. If you have a lot of austerity into one of the least flexible economies in the developed world, what you get is a bigger plunge in GDP than you should have.

So mistakes were made on the European side, on the IMF side and, I must say, on the Greek side, where parliament found it much easier to vote through a hike in the value-added tax than to actually attack the structural rigidities. So it was basically mutual back-slapping, the troika and Greece initially, which got the programme wrong. I don't want to put blame anywhere here, it's just the programme initially was the right elements in the wrong mix and the wrong dosage.

But time has moved on from that. If I look back at where we were last November, the state of information on the Greek economy last November is not that bad. Over years, we (my bank) have tracked adjustment progress in Europe systematically, in a thick book. For the last few years, Greece has been the top adjusting country. They have done a lot, with a lot of pain. As of last November, the data for Greece were: GDP rising for three quarters in a row, at an annualized pace of 2.5 per cent, following a peak to trough drop of 27 per cent. Employment was rising, year over year, 1.6 per cent. Youth unemployment was down from, on some measures, close to 60 per cent to 50 per cent – extremely high, but mind the direction. We had leading indicators projecting significantly more growth for 2015. Primary surplus of about 1, probably a bit above 1 per cent. Exports up 7 per cent in real terms.

So the story that unfolded in Spain and Portugal since the second quarter of 2013 – namely, a major rebound from the pain – was unfolding in Greece. Then came Syriza. An absolute disaster so far. Ever since the threat of Syriza coming to power emerged, we have seen Greek economic data and leading indicators going down. The current story of leading indicators is that we probably are already in the Tsipras recession. That is, over December and January, economic sentiment has fallen a lot. Tax revenues are plunging. The banking system is on life support by the European Central Bank. It is astonishing how much damage left-wing populism can do within ten weeks. I hope that it gets better from here, that it gets better fast, but it's not going to be easy.

I was in Athens two days after the election. I was struck by what I consider the number of delusions circulating in Athens. The first delusion, in my view, is that most people wanted to talk to me about the debt. That is not relevant. Europe has promised long ago: if you fix your economy, we take care of your debt, through low interest rates, grace periods, extended maturities. If you need more of that, we'll do more of that. It is about the supply side, not the debt. It is about the kind of reforms which transformed this country from the pre-Thatcher mess into one of the best economies in the Western world. It's about the reforms which transformed Germany 10 or 15 years ago. It's about the reforms which transformed Scandinavia in the early 1990s, about the reforms which transformed Spain and Portugal about 2012-13.

It's reforms, not the debt. If Greece now insists on raising the minimum wage for young people while youth unemployment is 50 per cent, do not expect the parliament of Finland to fund the consequences of that. Parliament in Finland needs to be elected anew two months from now. Don't think of Schäuble in this debate, think of how you persuade this parliament to actually vote for a programme that will raise the minimum wage, that will restore the lunacy of collective bargaining, that will reverse some of the other supply-side reforms.

Compromise is possible, easy. There are face-saving compromises and, of course, Greece will be given some leeway to do things it politically needs to do, if it comes up with offsetting reforms, if it comes up with offsetting savings. That is all possible. But the general principle has to be that Greece cannot backtrack – that's the creditor view – from the commitments it undertook under the old governments. It can change the nature of the commitments, rearranging within a programme the sums, rearranging – maybe we are a bit more generous here to certain socially disadvantaged groups, and I personally would be very much in favour of that. There are many details I can criticize as to the recent governments. If they then sort of hurt some of the supposed cronies of the old political elite, that can be done. But a significant rise in spending while tax revenues are at the moment collapsing – 18 per cent down, year on year, in January – is not going to work very well.

When in Athens, I think I shocked a few of my Greek listeners when I said the risk of Grexit is 35 per cent. It is high. Europe doesn't want it, because – one of the illusions I also found in Greece is that they think this is about Greece. No. This is not about Greece in the first place. This is about Rome, this is about Paris. Europe has a programme to make itself fit for the globalized world, to compete with China, to compete with the US. We've had the reforms in Spain and Portugal. We are on the way of nudging France and Italy towards reforms ('we' is the European Commission, the northern European countries, the ECB). These institutions will not let Greece get too much in the way by setting a precedent which cannot work.

So if Greece stays roughly on the old course – roughly – there is a lot of leeway here in the details. Of course, Greece will be offered generous conditions, targets for fiscal surpluses will be relaxed, there will be further debt relief. But if Greece insists on getting the labour market wrong – the key element that needs to be reformed in Italy, the key element that needs to be reformed in France – it will be very difficult for the parliaments of northern Europe to actually vote for such a programme.

Ultimately, I think one of the interesting things in the start of the new Greek government was that they seriously seemed to believe they would find a lot of sympathy for their views in places such as Italy or Spain or Portugal. Yes, of course they find some sympathy. But ultimately, the governments in these countries have little interest in letting a double-populist coalition in Greece do weird things which they would then have to explain to their own voters and for which they might have to foot the bill.

My guess remains that Grexit is 35 per cent risk. Much more likely is that the Greek government will come to its senses, will play ball, and then will be given the money it needs for that, and that all this could end rather well. Lula should be the example for Tsipras, the successful Brazilian left-winger who really did his country a favour by modernizing it. But the risk that Tsipras ends up as Chavez, who ruined Venezuela in a populist way, is significant.