
Political Economy of the Greek Crisis

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Abstract

The Greek turmoil commenced as a balance of payments, or “sudden stop,” crisis induced by large current account and primary government deficits. It became an economic and social disturbance of historic proportions. Its proximate cause was loss of competitiveness within the Eurozone due in large part to domestic German wage policies. The bailout policies, imposed by the lenders primarily for reasons of Eurozone stability and adopted by Greece, have had disastrous effects on both economy and society. The “historical bloc” that dominates Greek society willingly submitted to the bailout strategy, losing sovereignty, for reasons including fear and identity.

JEL Classification: E66, F00, F02, F34

Keywords

international monetary arrangements and institutions, economic and financial crises, European economies, political economics

1. Introduction

The Greek turmoil began in 2010 in the form of a balance of payments, or “sudden stop,” crisis, similar to those of developing countries in the 1980s, 1990s, and 2000s; it subsequently became a protracted and deeply destructive disturbance of both economy and society. Moreover, since the end of the sharp phase of the crisis in 2013, the country has been unable to resume sustained growth. Analysis of these complex phenomena requires a political economy approach that places economic processes in their appropriate social and political context.

The point of departure for the required analytical approach is to recognize that Greece has failed to compete successfully with other member states of this Eurozone and has assumed a peripheral place within the monetary union. Section 2 of the paper shows that the most prominent cause of weak Greek competitiveness—and hence much of the virulence of the crisis—lies with domestic German wage suppression. Loss of competitiveness has compounded the long-term structural problems of the Greek economy, which have become worse since entering the European Union (EU) in 1981. This is the fundamental reason why Greece has confronted a turmoil of exceptional severity and protracted nature in the 2010s.

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The true analytical conundrum, however, is posed by the conduct of the lenders to Greece and even more of the Greek policymakers. Summarily put, the lenders have forced Greece to adopt bailout policies that have consistently failed to produce expected results. Greek policymakers have acceded to the policies of the lenders despite the damage inflicted on both economy and society. They have also desisted from proposing, or even advocating, the two policies that could have put the country on a different path, namely, debt write off and exit from the Eurozone. As a result, the country has been subjected to unprecedented economic and social dislocation since early 2010, without an obvious end in sight.

To deal with this conundrum, it is necessary to go beyond strictly economic factors. It is argued in section 4 that the stance of Greece reflects a dramatic loss of sovereignty imposed by foreign lenders within the confines of the Eurozone. Acceptance of the loss of sovereignty in turn reflects fear and concerns about identity in case of exiting the monetary union. These factors are most prominent within the Gramscian “historical bloc” that holds power in the country but have also spread across society. By submitting to the lenders and accepting loss of sovereignty, the Greek historical bloc has also weakened the country’s long-term growth prospects, as is briefly argued in section 5. The Greek crisis thus casts a harsh light on the nature of the Eurozone and its implications for other peripheral countries of the monetary union.

2. Facing a Balance of Payments Crisis within the Eurozone

2.1. A Greek sudden stop

It is increasingly accepted in the mainstream economic literature that the Eurozone crisis of 2010 to 2012—and thus also the Greek crisis—was fundamentally a balance of payments crisis, of the sudden stop variety, involving a sudden reversal of capital flows from abroad, as has happened frequently in developing countries in the 1980s, 1990s, and 2000s.¹ This is without denying the deficiencies of the so-called architecture of the monetary union, for instance, the absence of a fiscal and banking union to supplement the monetary union (see Pisani-Ferry 2011). Deficiencies in the architecture of the Economic and Monetary Union (EMU) of the EU are unable by themselves to account for the outbreak of a crisis: a specific mechanism is necessary, and that is what the sudden stop analysis offers.

Balance of payments crises come in a variety of forms but tend to break out as private capital flows to private or sovereign borrowers suddenly dry up in international markets. Inability to borrow by private or sovereign borrowers sets off a train of events: fall of the exchange rate, shrinkage of domestic credit, inability to make payments to exporters from abroad and to domestic suppliers, and eventually a recession with falling output and rising unemployment.

Since sudden stop crises break out in the international financial markets, their immediate causes tend to be associated with the current and the capital account. In the post-Bretton-Woods world of floating exchange rates and free capital flows, a current account deficit can generally be made good through a capital account surplus. Developing countries typically try to peg their exchange rates, often by “shadowing” a major currency, with the aim of stabilizing trading conditions. For the peg to be maintained, a current account deficit would have to be balanced reasonably quickly by a surplus on capital account. A threat to the ability to borrow abroad would soon place a deficit country at risk of exchange rate collapse.

¹The literature on sudden reversals in foreign lending is extensive. Calvo, Izquierdo, and Talvi (2006) provide a taxonomy of such crises, mostly in developing countries; see also Calvo (2007). For the EMU, Merler and Pisani-Ferry (2012) have stressed the importance of interrupted cross-border capital flows; see also Baldwin and Giavazzi (2015).

From the perspective of international lenders, a growing current account deficit in a developing country is an indicator of increasing reliance on external borrowing. In this connection, both domestic fiscal policy and the public debt acquire exceptional importance because sustained fiscal deficits absorb domestic loanable capital, encouraging both private and public borrowers to seek funds abroad. If a country has recorded large fiscal deficits and its public debt has risen substantially, international lenders would face an increased risk of default, other things equal. A sustained current account deficit thus becomes a major concern for policymakers.

The realization that the Greek crisis was initially a balance of payments crisis came neither easily, nor naturally, to the policy-making apparatus of the EU. The official response in early 2010 was that the Eurozone turmoil had been caused by Greek dishonesty, incompetence, and the like. Lack of understanding made for considerable vindictiveness toward Greece, and even led to the imposition of absurdly punitive interest rates on the initial loans, presumably to deal with “moral hazard.”² Only a few voices at the time pointed to the underlying nature of the Eurozone crisis, and these typically came from outside the economics mainstream.³

There are no mysteries about the fundamental components of the Greek balance of payments crisis in 2010. The current account exhibited an enormous deficit by 2008, apparent in Figure 1; the fiscal primary balance recorded huge deficits by the late 2000s, shown in Figure 2, although it had appeared to stabilize in the mid-2000s, perhaps partly due to creative use of statistics by the Greek authorities; and the ratio of public debt to GDP reached very high levels in the late 2000s, as is shown in Figure 3. Indeed, it is remarkable that Greece had avoided the outburst of a crisis in its external transactions in 2009.

There are, however, two issues that have not been adequately addressed in the economic literature on this issue, both mainstream and heterodox. The first concerns the underlying causes of the enormous Greek current account deficit that has catalyzed the sudden stop; the second refers

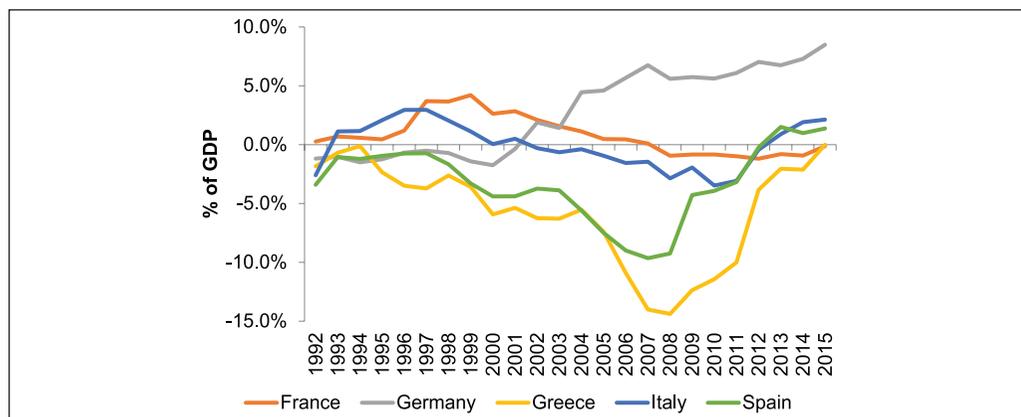


Figure 1. Current Account Balance as Percent of GDP.

Source: Constructed from AMECO data. AMECO is the annual macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs.

²Noted with some despair by De Grauwe (2011).

³An early analysis of the Eurozone crisis as a balance of payments, or sudden stop crisis, even though the term was not actually deployed, was by Lapavitsas, Kaltenbrunner, Lindo et al. (2010), which has subsequently appeared in Lapavitsas et al. (2012). Note that recognition of the specific form of sudden stop crises is not at all the same as accepting a neoclassical analysis of such crises. The dumb fact of capitalist turmoil is (usually) evident to all economists; the analytics deployed to account for it are quite another matter. The present article relies heavily, if implicitly, on the theoretical armory of Classical and Marxist political economy.

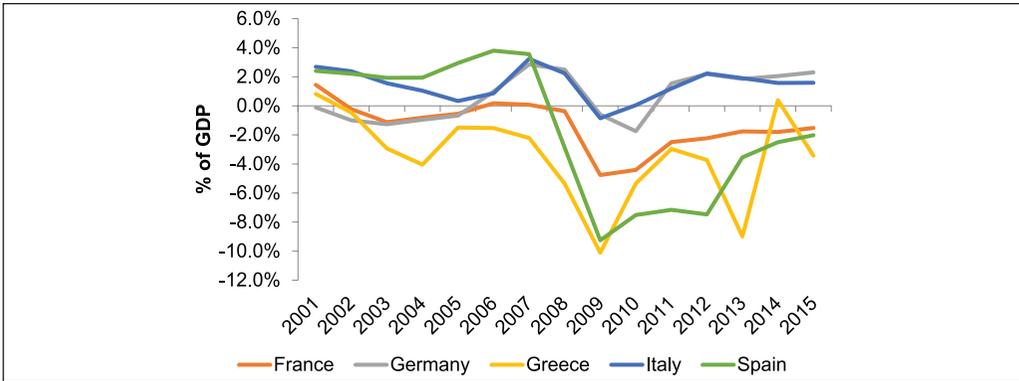


Figure 2. Primary Balance as Percent of GDP.
Source: Constructed from AMECO data.

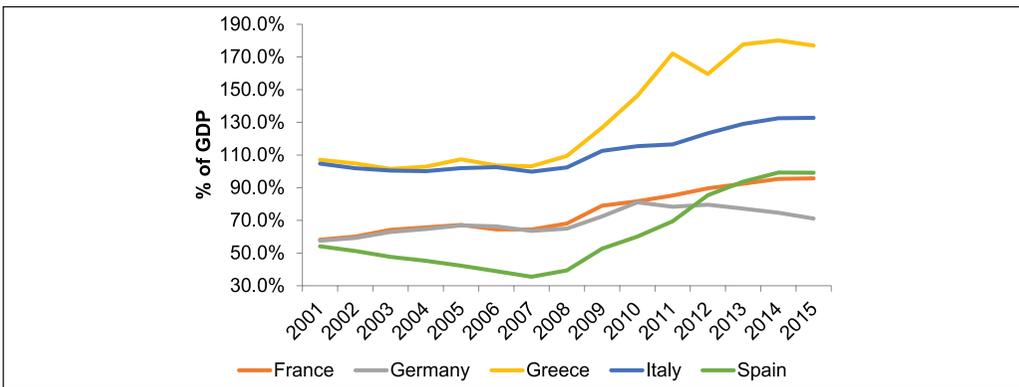


Figure 3. Gross Public Debt as Percent of GDP.
Source: Constructed from AMECO data.

to the composition of the aggregate Greek debt—private and public, internal and external—which has dictated the path of subsequent events. It is not accidental that both issues are directly related to Greek participation in the Eurozone because the Greek balance of payments crisis was ultimately an outcome of the country's membership of the monetary union.

2.2. Loss of competitiveness and the Greek crisis

There are two fundamental approaches to explaining the huge external deficit of Greece in the late 2000s.

The first approach to the deficit stresses the loss of competitiveness by Greece and other countries in the periphery in the preceding years but contains two very different currents within it. There is a dominant current, which is characteristic of the European Commission, and attributes the loss of competitiveness primarily to domestic causes, namely, the frictions, institutional weaknesses, and inefficiencies of Greek economy and society.⁴ By this token, a policy of structural reform in Greece, typically of a neoliberal character, would be necessary to restore competitiveness.

There is, however, a further current that attributes the loss of competitiveness by Greece (and much of the periphery of the Eurozone) essentially to German wage policies. It was originally put

⁴See, for instance, Sinn (2014), who puts this argument across clearly, although he has disagreed with the Commission's policies.

forth by broadly heterodox economists and provides the analytical basis for this paper.⁵ The contrast with the dominant current is clear, since the latter downplays, or even completely ignores, the import of German wages and prices for the trajectory of competitiveness within the EMU.⁶

The second approach to the deficit focuses on the flows of bank lending from core to peripheral EMU countries in the 2000s. Presumably, these flows encouraged rapid growth of credit in the periphery, thus boosting consumption and real estate speculation and leading to current account deficits. This approach lays much of the blame for the crisis on banks operating from the core to the periphery, and thus ostensibly opposes the policies of the European Commission. It is shown in section 2.3 that this approach is unsatisfactory, both theoretically and empirically, particularly for Greece. That is not to deny the problematic role of banks in the Eurozone crisis, which is also broadly appreciated by mainstream economists (see, for instance, Lane 2012).

To be more specific, at the root of the Eurozone—and the Greek—crisis lie divergences in competitiveness driven fundamentally by domestic German wage policies, that is, by the trajectory of capital-labor relations in Germany. International competitiveness is usually measured by nominal unit labor cost, C , defined as the nominal remuneration of labor, W , divided by real output, Y/P . If the total number of hours worked, L , was taken into account, C could be further written as the nominal remuneration of labor per hour worked, W/L , divided by the productivity of labor, Y/PL . Thus,

$$C = \frac{W}{Y/P} = \frac{W/L}{Y/PL} .$$

It is apparent that, other things equal, a rise in the nominal remuneration of labor would raise C , thus lowering competitiveness, while a rise in the productivity of labor would reduce C , thus raising competitiveness. Note that, C tends to be closely correlated with inflation.

On this basis, the decline in Greek national competitiveness in the 2000s is not hard to establish: nominal unit labor costs rose fast, and indeed much faster than in Germany, as is shown in Figure 4 for a group of core and peripheral Eurozone countries.

This was certainly not due to weak growth in Greek labor productivity, which actually rose quite rapidly within the Eurozone, and indeed faster than German labor productivity, as is shown in Figure 5.

There is no doubt that Greek competitiveness within the Eurozone declined essentially because the nominal remuneration of Greek labor rose faster than that of German labor, the latter remaining essentially frozen throughout the 2000s.

The real outlier in the Eurozone in this respect was not Greece but Germany, which has applied extraordinary wage restraint on its own workers since the end of the 1990s. The resulting divergences in unit labor costs (and correlated inflation) could not be offset through the adjustment of exchange rates because the EMU has eliminated that option. Put differently, the EMU became a trap for its members, since in the 2000s unit labor costs diverged systematically among a group of countries that have historically had dense trade relations, which used to be adjusted typically through exchange rate realignments. In the absence of adjustment, the loss of competitiveness by one has tended to be reflected in the gain of competitiveness by another.

Essentially the same point could also be made in terms of the “real exchange rate” of Greece, which has recorded a substantial real appreciation from the late 1990s to the late 2000s (see Nikiforos, Papadimitriou, and Zezza 2016). The main factors making for appreciation in the 2000s were, first, the higher rate of inflation compared with Germany and, second, the nominal appreciation of the

⁵See Lapavitsas, Kaltenbrunner, Lindo et al. (2010) and Flassbeck and Lapavitsas (2013, 2015); see also Bibow (2012).

⁶Note that there are also mainstream expositions of the approach to competitiveness that stresses the problematic nature of German wage policies; see Bofinger (2015) and Wren-Lewis (2015).

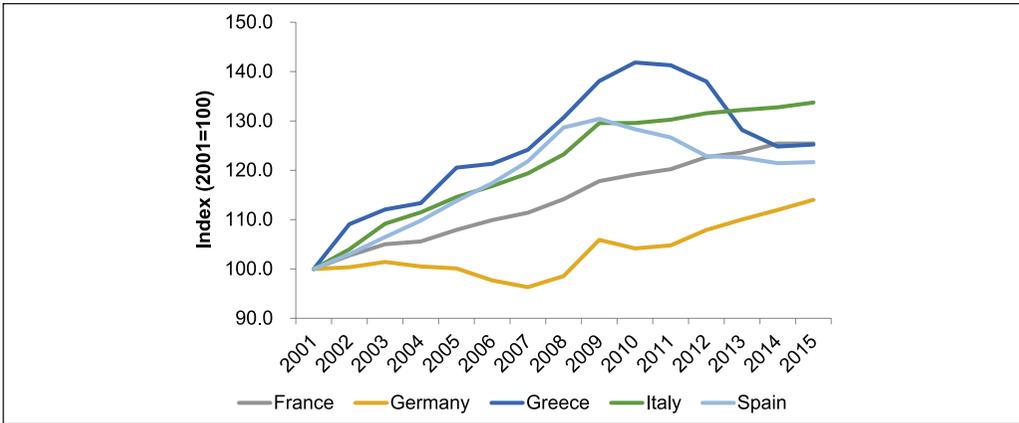


Figure 4. Nominal Unit Labor Costs.

Source: Constructed from AMECO data.

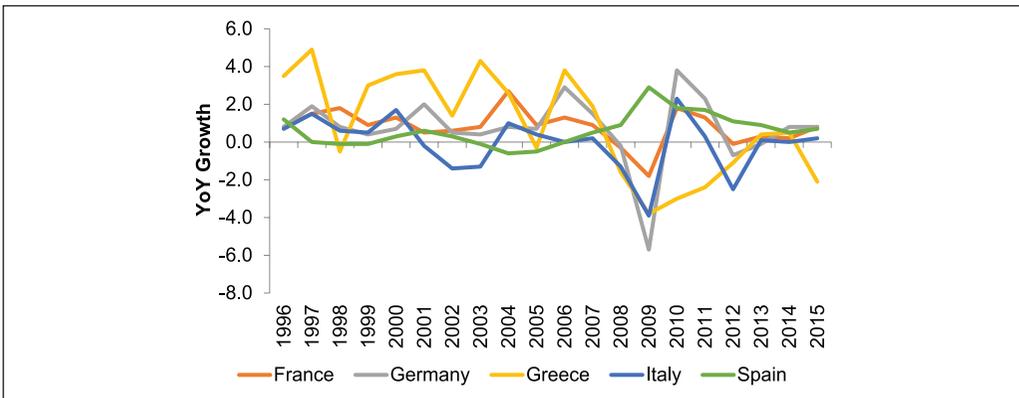


Figure 5. Labor Productivity Growth. YoY = Year on Year.

Source: Constructed from AMECO data.

euro compared with the dollar. Considering that the Greek current account deficit was mostly with its trade partners within the EMU, the rise of the euro relative to the dollar was not particularly significant. The paramount factor was, rather, higher Greek inflation relative to Germany. This development is correlated to diverging nominal unit labor costs in the two countries.

The secret of German competitive success in the Eurozone has been the essential freezing of nominal wages in the 2000s. Wage freeze was a direct outcome of altered relations among capital and labor (mediated by the state). In the late 1990s, the postwar practice of sharing productivity gains via the intervention of the German state was abandoned in favor of capital. The ostensible logic was that labor costs had to be restrained to protect employment.⁷ The justification was provided by the approaching monetary union, the difficulty of absorbing the German Democratic Republic, and the persistence of unemployment. The changes were actually introduced by the

⁷See Flassbeck and Lapavistas (2015). Perhaps the most sustained examination of the transformation of the European Union (EU) in view of developments in Germany has been undertaken at the Max Planck Institute in Cologne. See in particular Streeck (2016), whose work on the disintegrating effect of neoliberalism in the EU and the reassertion of the nation state has had the widest impact. See also Scharpf (2010, 2016), who has also analyzed the rise of neoliberalism in the EU, and more recently examined the rise of German domination and the resulting stratification of the EU. Further incisive political economy analysis of the EU and the euro along similar lines has been undertaken by Hoepner (2014).

Social Democratic government of the late 1990s and early 2000s with the full connivance of the labor unions. Although there was no grand German plan to dominate the EMU, the outcome was an accretion of competitiveness that has transformed Germany into a gigantic exporter within the EU and more generally.

Germany has emerged as the most powerful country in the EU through a peculiar “neomercantilism” that has restrained nominal wages, and thus domestic demand, with the aim of boosting exports. This point is of critical importance to the Eurozone crisis, though it remains poorly appreciated in policy making in Europe. It is important in this connection to stress the following:

First, the argument refers to national rather than enterprise competitiveness. National competitiveness relates fundamentally to the operations of the world market and is ultimately a matter of relative prices in the aggregate.⁸ Enterprise competitiveness is a microeconomic concept that also reflects the quality of management, the intensity of labor, and so on.

Second, it is misleading to estimate the proportions of Greek trade with Germany with the aim of demonstrating that the losses of one were (or were not) directly the gains of the other.⁹ Greece lost competitiveness relative to Germany and to the rest of the Eurozone; in contrast, Germany gained competitiveness relative to both Greece and the Eurozone. As both countries trade widely with other Eurozone countries, the divergence in competitiveness has made for a current account deficit for Greece, and a surplus in Germany, both in the aggregate. Furthermore, loss or gain of competitiveness did not translate simply into, respectively, decline or rise of exports; it was also reflected in the fall or increase in imports, respectively.

Third, the argument pivots on changes in and not levels of competitiveness. It is trivially true that Germany is more competitive than Greece. However, there is no need for countries to have similar levels of competitiveness to be able to have balanced trade with each other or even to be members of the same monetary union. The real issue is the evolution of competitiveness over time.

Fourth, in sharp contrast to the approach of the European Commission, the causes of the divergence of competitiveness did not lie primarily in the domestic economy of Greece or indeed other peripheral countries. It is no great discovery that Greek capitalism has been marked by a variety of deeply problematic practices, some of which are considered below. The point is that competitiveness is inherently a relative concept and, in the context of the Eurozone, this implies focusing on the domestic policies of Germany, the dominant country.

Fifth, the analytical stress on competitiveness aims at identifying the underlying economic tendencies and has nothing to do with “blaming workers” or similarly fanciful notions. If a country lost competitiveness in the world market, there would inevitably be implications for its economy that must be assessed rationally. Moral concern can wait.

To recap, there is no doubt that Greek competitiveness within the Eurozone declined heavily in the 2000s, contributing to a vast current account deficit, which eventually ushered in a balance of

⁸In political economy terms, the “law of value” does not hold in the world market, as has been known since the days of Ricardo ([1817] 1951).

⁹There is a sizable literature that engages in precisely such exercises. Thus, Felipe and Kumar (2011), keen to argue that wage reductions would not improve competitiveness, conflated national and enterprise competitiveness. Gabrisch and Staehr (2014), wishing to claim that causality runs from capital flows to unit labour costs—a direction of causation for which there is no coherent argument—ran a series of Granger causality tests, the meaning of which is entirely unclear. Storm and Naastepad (2015), on the contrary, in an effort to reject the nominal unit labor cost argument, invented an entirely fictitious German productivity miracle. It is interesting to note in this connection that Wyplosz (2013), after doing his best to measure away the divergence of nominal unit labor costs in the Eurozone, concluded that the true cause of the crisis has been booming domestic demand that was either due to credit or due to fiscal deficits.

payments crisis. The fundamental reason for the loss of competitiveness, however, was a German wage freeze during the same period, which also propelled Germany to the dominant position within the Eurozone.

This argument remains fully aware of the structural weaknesses of the Greek economy as well as of the strong growth in domestic demand and credit that occurred in Greece prior to the crisis. The Greek economy recorded rapid rates of growth in the 2000s, often exceeding 4 percent, faster than Spain and Portugal (see Lapavitsas, Kaltenbrunner, Lindo et al. 2010). Investment rose in the late 1990s and continued to rise in the 2000s, though it never reached the levels of Spain and Ireland (see Lapavitsas, Kaltenbrunner, Lindo et al. 2010). Moreover, Greece has never had a real estate “bubble” marked by a rise in residential investment similar to Spain and Ireland. Furthermore, the levels of Greek corporate investment in GDP have remained systematically lower than other peripheral countries throughout the period (see Gourinehas, Philippon, and Vayanos 2016). The relative weakness of Greek investment has also been reflected in the strength of consumption, which rose systematically in the 2000s, though always in line with GDP growth. The striking aspect of Greek consumption was not its growth but its high proportion relative to GDP: it stood above 70 percent, almost 10 percent higher than Portugal and even more compared with Spain, Italy, and Germany see Lapavitsas, Kaltenbrunner, Lindo et al. 2010).

Investment and consumption weakness aside, the Greek economy has been marked by a profound shift in its structure since the early 1980s in favor of services and at the expense of the secondary sector. Production of internationally tradable goods has suffered accordingly, and the Greek economy has turned toward nontradable activities, thus becoming relatively inward looking (see Vavouras 2013). This prominent shift in the structure of the Greek economy was the background against which the loss of competitiveness in the 2000s led to the huge deficit on current account.¹⁰

Finally, a boost of aggregate demand did take place in the 2000s drawing on credit growth, as is discussed in the next section. Note that credit grew while aggregate saving has disappeared; net national saving in Greece has been systematically negative since the country’s entry into the Eurozone.¹¹ By implication, foreign borrowing has been essential to supporting the country’s relatively high rates of growth and investment in the 2000s. Equivalently, when foreign borrowing became impossible after the outbreak of crisis in 2010, both growth and investment collapsed.

2.3. *The aggregate indebtedness of Greece*

Aggregate Greek debt—private and public, internal and external—increased rapidly in the 2000s. The more the country failed to compete within the Eurozone, the more its debt increased, both domestically and abroad. Increasing volumes of aggregate debt, needless to say, are not necessarily a sign of an economy about to enter crisis; that depends on the uses of the accumulated debt. However, in the case of Greece, the accumulation of debt was a sign of fundamental weakness and loss of competitiveness.

Aggregate debt in Greece increased from roughly 150 percent to a little less than 300 percent of GDP in, respectively, 1997 and 2009; nonetheless, in 2009, it was proportionately lower than in Spain and Portugal.¹² The composition of debt for 2009 showed: public debt at 42 percent, or

¹⁰Aliber (2010) was one of the first to stress the importance of the structural shift in the Greek economy together with the deleterious impact of capital flows and the euro.

¹¹See Mariolis (2016); see also Lapavitsas, Kaltenbrunner, Lambrinidis et al. (2010), which has subsequently appeared in Lapavitsas et al. (2012). Greek saving is further analyzed by Katsimi and Moutos (2010).

¹²All figures on Greek debt come from Lapavitsas, Kaltenbrunner, Lambrinidis et al. (2010), one of the earliest decompositions of Greek debt following the outbreak of the crisis.

296 billion; nonfinancial corporation debt at 23 percent, or 165 billion; financial corporation debt at 17 percent, or 120 billion; and household debt at 17 percent, or 123 billion. About three-quarters of aggregate debt was long term and the rest short term. Equally important is that externally owed debt came to 385 billion, of which 206 billion was owed abroad by the state and 112 billion by financial corporations.

The trajectory of aggregate Greek debt indicates that there was no credit bubble in the 2000s. The fastest growing component of aggregate debt in the 2000s was private debt, in particular debt by financial corporations and households, both of which increased markedly. There was certainly strong growth of credit by banks directed toward households and (less) toward nonfinancial enterprises. Greek banks borrowed abroad for liquidity but relied heavily on domestic deposits and kept well away from derivatives and other forms of financial engineering.

Credit expansion occurred as nominal and real interest rates declined rapidly in the periphery after the adoption of the euro. In that environment, Greek banks were able to fund themselves in the interbank markets to support the domestic expansion of credit, though not nearly as heavily as in Spain and Portugal.¹³ This observation alone would suffice to negate the second approach to explaining the Greek external deficit, namely, the view that stresses the putative role of foreign bank lending from core to periphery, mentioned in section 2.2, thus assigning the prime explanatory role for the crisis to financial activities.¹⁴

The stress on finance is theoretically problematic because financial flows are ultimately secondary to the fundamental productive processes in a capitalist economy.¹⁵ Be that as it may, emphasizing the role of foreign financial capital in the Greek crisis is empirically unsatisfactory because the expansion of demand in Greece in the 2000s relied on growth of credit that was strongly driven by domestic banks.

It is a fallacy to conflate the domestic expansion of credit with an inflow of loanable capital from abroad that, presumably, led to domestic credit expansion while increasing external indebtedness. Nominal interest rates converged dramatically across the EMU as the European Central Bank (ECB) coordinated the provision of liquidity across the union. However, the divergence in inflation rates (and of nominal unit labor costs) meant that real rates of interest were higher in the core than the periphery, as is shown in Figure 6. It would have been a very strange type of financial capital that actively sought to move from a high to a low interest environment.

There is no doubt that Greece, similarly to other peripheral countries, borrowed heavily from abroad during the 2000s. The flows were spurred by Greek borrowers, primarily the state and the banks. The macroeconomic functioning of the borrowing was to finance the huge deficit on current account, also reflecting the country's negative saving. Foreign banks did not lead the process of credit growth in Greece; rather, the catalyst was burgeoning domestic credit expansion by Greek banks, which took advantage of the relatively homogeneous interbank market in the Eurozone in the 2000s to obtain liquidity cheaply. In a country that had for decades deployed high interest rates as an instrument to defend the exchange rate, the low interest rate environment offered unprecedented scope for credit expansion to banks, much of it directed toward households. Historically and culturally, household debt has been frowned upon in Greece, but in the

¹³On this point, see also Gourinchas, Philippon, and Vayanos (2016).

¹⁴This view has been prominent among heterodox economists, drawing on post-Keynesian analysis of "finance-led" capitalism, but has also found resonance among mainstream economists, for instance, Wyplosz (2013). A variant of it has been strongly put across by Storm and Naastepad (2015).

¹⁵The explosive growth of financial markets and the expansion of international financial flows do not negate this analytical principle of political economy but simply give it more complex forms, some of which are concretely discussed in this article in relation to the Eurozone. In contemporary financialized capitalism, the penetration of finance in the activities of productive capital adds still further complexity; see Lapavitsas (2013).

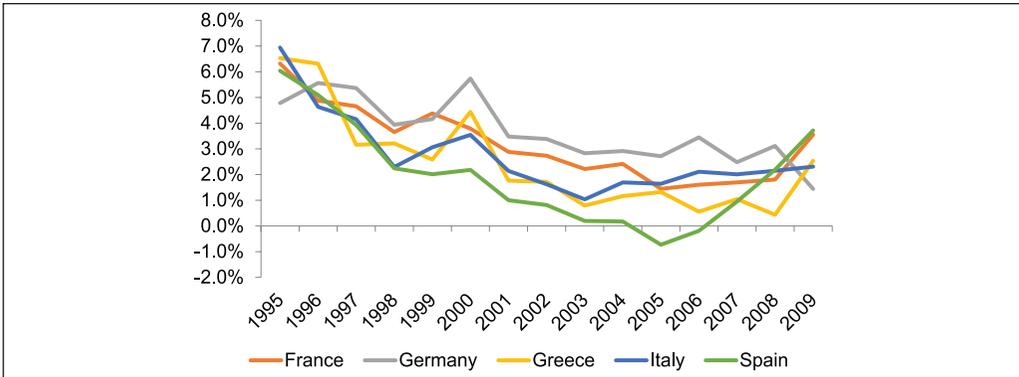


Figure 6. Real Interest Rates in the Eurozone.

Source: Constructed from AMECO data.

late 1990s and the 2000s, households borrowed heavily to finance house purchases and consumption. The accumulation of household debt proved a major problem in the 2010s, once the economy had been subjected to bailout policies.

Public debt rose proportionately less than other parts of aggregate debt in the 2000s, but from an already high base compared to other peripheral countries. Relatively high public debt in Greece has its roots in the 1980s, reflecting in part the expansion of welfare provision and in part the sustained weaknesses of the tax system. To be specific, welfare provision in Greece has always been modest by Western European standards, and there has long been systematic tax evasion. The economic and political power of large nonfinancial corporations and banks has ensured relative tax immunity for the upper echelons of the economy. Significant tax evasion by the upper layers of self-employed professionals and small and medium enterprises has also been widely tolerated.¹⁶ Farmers, meanwhile, have historically been given strong tax exemptions ostensibly for reasons of social policy.

The crisis faced by the Greek state in the 2010s came less from the increase in public debt in the 2000s, as is shown in Figure 3, and more from the change in the composition of public debt that, following the country's accession to the Eurozone, became heavily skewed toward foreign lenders. In 2009, the Greek state owed more than 200 billion out of a total of nearly 300 billion to foreign lenders, among which French and German banks were prominent; much of the remaining balance was owed to Greek banks. Interest rates had become remarkably low by Greek standards, and the country had suddenly acquired a putative creditworthiness as a member of the monetary union. European banks were prepared to lend to the Greek state, allowing it to replenish its stock of debt as well as to borrow afresh.

It is undeniable that these banks failed in the most elementary functions of screening and monitoring of borrowers¹⁷ because a further remarkable aspect of Greek public debt in 2009 was that it was overwhelmingly bond-based, denominated in euro and governed by Greek law.¹⁸ The lenders had not done their work properly. As the specter of default arose in 2010, the Greek state held a strong bargaining chip in its hands. Unfortunately, it never used it.

¹⁶See Artavanis, Morse, and Tsoutsoura (2012), who estimate that in 2009 there was at least 28 billion of unreported income by self-employed professionals, a tremendous sum by Greek standards.

¹⁷For an acknowledgment of this point from the mainstream, see Buti and Carnot (2012) and Obstfeld (2013).

¹⁸As was pointed out by Buchheit and Gulati (2010) in one of the earliest and most penetrating analyses of Greek public debt.

3. Responding to the Crisis: The Iron Cage of the Euro

There is a standard response to balance of payments crises developed by multilateral organizations and forming a part of the so-called Washington Consensus.¹⁹ Still, the Greek crisis offers fresh insight into the response because it was tried for the first time within a powerful monetary union such as the EMU.

The first step is to deal with the interruption of financial flows from abroad. Typically, this translates into restoring the interrupted flows to the private banks, thus preventing a collapse of credit, as well as restoring the interrupted flows to the state, thus preventing a formal default. The difficulty is that there are no formal mechanisms in the world market to restore these flows. Thus, the typical practice has been to form ad hoc coalitions of lenders from abroad, including private banks, public institutions, and, crucially, the International Monetary Fund (IMF) as coordinator and policy specialist. Funding would typically be provided on the basis of “conditionality,” namely, a series of policy changes and structural reforms to be implemented by the recipient, often designed by the IMF and monitored through the gradual release of funds. Conditionality normally revolves around the following two issues.

The first is stabilization of external and internal imbalances, usually to be achieved by reducing domestic demand, that is, via austerity. Specifically, public deficits are reduced through higher taxes and/or lower expenditure, and domestic credit would be constrained through interest rate increases. The resulting contraction in aggregate demand eventually leads to current account rebalancing. The cost in terms of unemployment, disrupted welfare provision, loss of income, and so on, would depend on the extent of the decline of output.

The second issue is restoring growth, which would typically be achieved by improving competitiveness. Thus, wages and salaries would face downward pressure, partly through rising unemployment and partly through labor “reforms” that would limit trade union rights, ease dismissals, intensify the precariousness of employment, and so on. Deregulation of markets is also promoted, including of financial markets, often in the hope of encouraging inward flows of foreign capital. Finally, privatization is advocated on the grounds that it would result in greater efficiency.

The “stabilization and growth” approach was applied in its essentials to the Greek crisis. The results of this approach for output, employment, income, and the productive structure of crisis-stricken countries have historically been negative. In the case of Greece, three features deriving from the country’s membership of the Eurozone have made it entirely lethal.

The first, and less conspicuous, was the availability of liquidity support for the Greek banking system. In a sudden stop crisis, the domestic banking system tends to face liquidity pressure that cannot be easily managed by the central bank, particularly if there is a heavy drain on deposits and if there are large volumes of bank liabilities denominated in a foreign currency. Additional strain on the banking system could also emerge from bad debts, as the economy would begin to contract, thus forcing domestic banks to buttress capital adequacy.

For Greek banks, the problem of a liquidity was confronted by the ECB and the Eurosystem providing facilities through the Long-Term Refinancing Operations, Emergency Liquidity Assistance, and Trans-European Automated Real-time Gross Settlement Express Transfer System (TARGET2). The dangerous link between a worsening current account and an ensuing lack of domestic liquidity was thus broken (see also Pisani-Ferry, Sapir, and Wolff 2013). During its sharpest phase from 2010 to 2012, the Greek crisis never acquired the acute banking aspect that the huge external deficit of the country would have fully justified, other things equal. At the same time, however, liquidity provision became the most decisive lever for the lenders to blackmail successive Greek governments. By controlling liquidity, the lenders allowed the country to remain in the Eurozone but only on condition of submitting to bailout conditionality. Additional

¹⁹Various aspects of which are discussed in Fine, Lapavitsas, and Pincus (2001).

leverage was afforded to the lenders by providing funds, borrowed by the Greek state, to strengthen the capital adequacy of Greek banks.

The second, and very visible, difference was the absence of an exchange rate that could absorb some of the shock of the sudden stop through devaluation. Stabilization programs typically, though not always, involve devaluation of the domestic currency, which changes the terms of trade and thus rebalances the external deficit in the short term. The impact on domestic inflation depends on the “pass through” from import prices to domestic production. Devaluation cannot be a long-term solution to competitiveness problems, as its impact would eventually pass onto domestic prices, but in the short term it could lessen the pressure on the domestic economy, especially if measures were also taken to support workers and enterprises.²⁰ Even in the long run, moreover, devaluation could create fresh fields for investment and production by sharply changing relative prices. None of these options were available to Greece within the Eurozone.

The third difference was the difficulty of Greece faced in lowering the burden of public debt through restructuring. Typical methods of reducing the cost of servicing the debt include lowering interest rates and extending the maturity of debt. These measures increase the fiscal space available to the government, thus ameliorating austerity. A more decisive method of reducing the burden of debt would be to write off some of the principal of the loans, thus also reducing the pressure of refinancing the debt.²¹

Restructuring inevitably entails losses for the lenders—typically private bondholders and banks—thus raising the issue of lender recompense. As there are no formal international bankruptcy procedures to deal with public debt, its restructuring typically relies on the balance of sovereign power in the world economy. A sovereign state could always default, assuming that the country would be prepared to shoulder the cost of legal proceedings and its exclusion from the financial markets for a period. Equally, the sovereign states of the lenders would seek either to prevent default and restructuring or at least to limit the incidence on their lending institutions and individuals.

In the case of Greece there is undeniable evidence that the IMF was fully aware of the importance of devaluation and debt restructuring already in 2010 (International Monetary Fund and Independent Evaluation Office 2016). However, EMU membership made formal devaluation impossible, and debt relief was bluntly rejected by Eurozone lenders. Thus, the IMF laid great stress on “internal devaluation” pivoting essentially on wage reductions. There is, however, no evidence that the beneficial impact of devaluation and debt relief could be replicated internally, within a reasonable range of values for economic magnitudes. By its own admission, the IMF ignored its research and simply kowtowed to political pressure from the lenders to Greece, who were among its major shareholders (see International Monetary Fund and Independent Evaluation Office 2016: 28). In 2010, a Greek default, or even major debt restructuring, accompanied by Greek exit from the EMU would have posed grave risks not only for the banks of the lenders but also for the very survival of the monetary union. From the perspective of the lenders, Greece had to be kept in the EMU. It also had to bear the brunt of the adjustment without debt restructuring or devaluation. The EMU had placed the country in an iron cage, and the results would soon show.

In 2010, Greece received its first bailout, the EU and the IMF jointly providing funds to replace the interrupted private capital flows and thus allowing the Greek state to continue to meet its payment obligations. Needless to say, the main obligation of the Greek state was to keep servicing its existing debt, thus avoiding default.²² It was understood that the ECB would continue

²⁰For the likely implications of devaluation for the Greek economy, see Katsinos and Mariolis (2012), one of the few careful empirical studies of the issue.

²¹For the likely impact on fiscal space of various measures to restructure Greek public debt, see Lapavistas and Munevar (2014).

²²It has been estimated that out of the funds provided to Greece by the first and the second bailouts, which have together exceeded 215 billion, only 9.7 billion, or 4.5 percent, have actually gone to financing primary deficits; the rest have covered the needs of servicing the public debt, that is, protecting the interests of foreign lenders in the first instance; see Rocholl and Stahmer (2016).

to provide liquidity to keep the Greek banks afloat. The program was “frontloaded,” meaning that the fiscal adjustment would involve cuts in public expenditure for the initial period, followed by increases in taxes. A full set of conditionality conditions were also specified, along the general lines indicated above. If Greece wished to remain in the Eurozone, there would be no devaluation and no debt restructuring.

The Greek bailout agreement of 2010 is arguably one of the worst documents on economic policy ever drafted. The bailout agreement bore no relation to the realities of the Greek economy, nor to the likely impact of the proposed policies because the magnitude of the putative fiscal adjustment was enormous, the external deficit huge, and the competitiveness gap gigantic—and the adjustment had to occur within the iron cage of the EMU. IMF economists have officially admitted that their estimates of the multipliers of the Greek economy were low, and thus their assessment of contractionary effect of austerity was very optimistic (see Blanchard and Leigh 2013). Disaster duly followed.

Aggregate demand contracted violently, and output fell by nearly 7 percent in both 2011 and 2012, the total contraction exceeding 25 percent in 2008 to 2016. The most profound fall has been in investment not only as enterprises reacted to the decline in demand but also as credit conditions became tighter, with banks facing large volumes of problematic public debt on their balance sheets. Equally bad for enterprises, but much less noticed, has been the effective disappearance of commercial credit among buyers and sellers. The collapse in output dramatically increased adult unemployment, which exceeded 27 percent in 2013.

It was apparent already by the middle of 2011 that the first bailout program had backfired badly. Above all, the recession had worsened the ratio of public debt to GDP, as is shown in Figure 3, and Greece continued to face severe difficulties in servicing its debt. The country needed a new bailout and urgent debt restructuring. By that time, furthermore, the balance of political forces in Europe had been significantly altered since early 2010. For one thing, European banks had begun substantially to disengage themselves from Greece already in 2010. For another, the EU had begun to establish a panoply of institutions to confront sovereign debt problems, including the European Financial Stability Fund, which eventually became the European Stability Mechanism, the European Financial Stabilization Mechanism, the Securities Markets Programme, and Outright Monetary Transactions by the ECB. The risks arising from a Greek default and exit had been attenuated.

In 2012, Greece received a second bailout with attached conditionality. During 2011 to 2012, furthermore, the country benefited from some debt relief, which was, however, remarkable for its one-sided and limited nature. Debt relief offered to Greece included extended periods of grace on the bailout loans, a reduction in average interest rates by granting the fresh funds at concessional rates, and a lengthening of the average maturity of debt (see Greek Public Debt Management Agency n.d.). There was also debt restructuring—the so-called Private Sector Involvement—which effectively wrote off some of the principal of Greek debt. In 2012, Greece implemented a bond swap and subsequently a debt buy-back that resulted in nominal debt relief of more than 100 billion (see Zettelmeyer, Trebesch, and Gulati 2013).

Unfortunately for Greece, the losses fell on disproportionately domestic rather than foreign lenders, the latter escaping with little damage. Greek banks in particular were badly hit, and the country was forced to use a large part of the bailout funds for bank recapitalization. There cannot have been many other historical instances of sovereign default that have hurt domestic far more than foreign lenders. Moreover, the bailout funds eventually changed the composition of Greek public debt, which by 2012 had become mainly bilateral or multilateral state debt, governed by international law.²³ Greece had lost its main bargaining chip without ever using it.

²³Wyplosz and Sgherri (2016: 41) call it “the most dramatic credit migration from private into official hands in the history of sovereign debt.” It was not a “migration” that benefited the Greek people.

Finally, in 2015, Greece needed a third bailout, following significant political upheavals and the imposition of capital controls, which are considered in the following section. The underlying cause of the third bailout was much the same: the economy had contracted enormously, and public debt was impossible to service. The conditionality attached to the third bailout was of similar nature, but by 2015 much of the fiscal and the external adjustment of the country had already been accomplished. The pressing problem for Greece had become the achievement of sustainable growth and development rather than stabilization. Before considering this issue, however, it is necessary to examine more closely the social and political forces that have kept Greece within the Eurozone at such tremendous cost to its economy and society.

4. The Social and Political Setting of the Greek Crisis

The outlook of the lenders—represented by the “troika” of the EU, the IMF, and the ECB—toward Greece presents few analytical difficulties. The Washington Consensus has held powerful ideological sway among the international organizations. To make matters worse, European policymakers initially perceived the crisis as the result of Greek fiscal mismanagement and “dressing up” the official statistics. Only gradually did the realization emerge that a full-blown Eurozone crisis was actually unfolding, which required a more coherent policy response.

The dominant role in devising the new policy approach of the Eurozone was played by Germany, a country in which there is an entrenched ideological belief that success in the 2000s has been due to painful reforms in the late 1990s. There is no powerful domestic constituency in Germany pushing for a program to rebalance the entire Eurozone by shifting Germany away from its neomercantilism. The political message emanating from the country’s establishment was—and remains—that Germany is the model for the EMU, and therefore austerity is the appropriate policy for the periphery and elsewhere (see Flassbeck and Lapavistas 2013 and 2014).

In the realm of material interests the first priority of the troika was to protect the lenders from losses and the Eurozone from the threat of a major rupture, as the IMF has openly admitted.²⁴ If Greece had been offered an alternative program in 2010, there could have been major material damage to the Eurozone and its core states. Thus, Greece had to be prevented from defaulting and exiting the EMU, while submitting to a program along the lines of the Washington Consensus.

As the crisis has unfolded, the attitude of the EU toward Greece changed considerably, not least because of the raft of institutions that have been created—above all the European Stability Mechanism—and which appear capable of dealing with balance of payments crises in the future. At the same time, the EU has instituted a permanent regime of fiscal discipline including penalties for “delinquent” countries through the Fiscal Compact of 2012. In essence, the Stability and Growth Pact that had formally supported the introduction of the euro has been restrengthened in the direction of institutionalized austerity under EU surveillance. Steps have also been taken to create a Banking Union, above all, by giving the ECB the right to monitor banks and their capital adequacy. The Greek crisis has acted as a catalyst for these developments, which have strengthened the position of the lenders relative to Greece. Already by 2012, the EU could contemplate with considerable equanimity the prospect of a Greek default and exit from the EMU.

The position of the IMF toward Greece also changed significantly in the course of the crisis. The Greek program was rightly perceived as a failure, which moreover led to substantial exposure by the Fund to Greece. The IMF has clashed with the EU on the question of conditionality, which the EU bureaucrats intended to make highly intrusive, attempting to reshape Greek society and the Greek state; the IMF, in contrast, has aimed primarily at achieving macroeconomic targets. The

²⁴This is one of the most striking aspects of the Fund’s internal review; see IMF and IEO (2016).

EU has largely prevailed in this confrontation, and a welter of reform measures have been directed toward the periphery, often creating confusion for national authorities (see International Monetary Fund and Independent Evaluation Office 2016: 31).

The shifting attitude of the IMF became apparent in the third Greek bailout in 2015, in which the Fund did not participate officially as a lender. The sticking point was the sustainability of Greek debt in conjunction with the policy of austerity. The IMF has advocated significant debt relief with a concomitant relaxation of fiscal austerity in the medium term. The EU would not concur because losses on Greek debt would be borne directly by public institutions in Europe, thus creating political and electoral repercussions.

The attitude of the lenders in the Greek crisis is thus relatively complex. However, the attitude of the borrower presents a real conundrum. Why did Greece in 2010 accept a program that was manifestly defective, and why has it persevered with bailout policies for several years in spite of the damage wrought to economy and society? To find an answer, it is important to stretch the analysis by focusing on the outlook of the Greek “historical bloc,” to use the well-known term by Gramsci referring to an alliance of dominant sections of the capitalist class with lower classes, which plays a hegemonic role in the economy, politics, and culture of a country.²⁵

It is not necessary here to engage in a sociological description of the Greek historical bloc in the decades following the country’s accession to the EU in 1981. Suffice it to state that the dominant bourgeois elements of the bloc have included ship-owning, banking, construction, and manufacturing, which have also had widespread ownership and control over the mass media. These elements have had considerable influence over the state machine translating into privileged access to public procurement and institutionalized tax avoidance. The Greek state in the postwar decades has followed its own long historical tradition of deploying the forms of a democratic polity, while in practice treating society as an occupied foreign territory for the purposes of tax and welfare provision.²⁶ The resulting mechanisms of integration and social control have had a strong admixture of electoral party politics, a characteristic feature of the Greek social formation. The historical bloc that has thus emerged has also included layers of the professional self-employed, elements of small and medium businesses, and larger agrarian landholders, all of whom have secured variable tax and other privileges through a complex electoral machinery connected to the state.

The point to grasp about the Greek historical bloc in the face of the crisis of 2010 was not what it decided *to do* but rather what it has been absolutely determined *not to do*. And that is to exit the EMU. There can be no doubt on this score, as it has been restated countless times by government officials and others, not to mention being confirmed by the practice of several Greek governments. For the Greek historical bloc, staying in the EMU became an article of faith.

Successive Greek governments have thus accepted confronting the crisis without having command over monetary and exchange rate policy. By the same token, fiscal policy was rigidly determined by the troika, credit policy was increasingly set by the Banking Union, and trade policy was shaped by a series of EU directives. The vicious nature of the Greek crisis has resulted largely from this dramatic loss of sovereignty and lack of command over economic policy instruments. The only option available to Greek governments since 2010 has been to attempt to tweak particular details of the bailout programs, while complaining about the attitude of the troika. The exception was the first SYRIZA government, elected in January 2015 on a platform of radical policy change. When that government capitulated and signed the third bailout in August 2015, Greece returned to its usual stance.

²⁵For a penetrating discussion of Gramsci’s concept and its usefulness in analyzing the Eurozone crisis, see Sotiris (2013).

²⁶The predatory attitude of the Greek state toward society and its importance in sustaining the power of the historical bloc since independence in 1830 have been discussed by Kostis (2015), though certainly not in the same terms, or from the same standpoint, as in this article.

Why, then, has the Greek historical bloc acceded to a program that has profoundly damaged the country? What explains the extraordinary—and extraordinarily destructive—determination to remain in the iron cage of the euro almost regardless of economic and political cost?

Part of the explanation relates to sectional economic interests within the bloc, notably the Greek banks. Without sustained ECB liquidity provision and without access to bailout funds for recapitalization, Greek banks would have been forced to suspend operations as well as face possible nationalization. Quite naturally, banks have been the strongest and most unwavering supporters of bailout programs in Greece. However, the acquiescence of the Greek industrial and manufacturing capital, particularly of the construction sector, is harder to explain. As investment collapsed, the productive sector of Greece faced a level of destruction of historic dimensions. Accounting for the acquiescence of productive capitalists to bailout policies requires broader arguments regarding the power structures of Greek society as well as the political outlook and culture of the Greek people.

One factor has been plain fear because default and exit would have led to economic and social turmoil in the short term likely to generate political unrest. In such circumstances there could be no guarantees of which political forces would emerge to challenge for power. The political risk for the Greek historical bloc was simply too great. From this perspective, it was a rational decision to accept the path of the bailouts and the attendant loss of sovereignty rather than risk profound social and political unrest. Moreover, in 2010, it was not easy for many to discern the trajectory of destruction that the bailouts would entail. Once the grim reality had begun to emerge in 2011 to 2012, it was still easier for the historical bloc to continue with the bailouts in the forlorn hope that each step would be the last. Fear of default and exit became an entrenched part of Greek public debate, cultivated assiduously by mass media outlets that typically owned by powerful business interests. Outlandish claims were continually made of the destruction that was likely to follow, including food shortages, lack of medicines, and violent unrest in the streets with looting and arson.

The fears of the Greek historical bloc were not without real foundation. Mass reaction to the bailout measures did occur in 2011 to 2012, subsequently taking overtly political forms as the electorate turned to SYRIZA, until then a tiny and untried party of the Left. SYRIZA had only very limited connections to the established mechanisms of power in Greek politics and the state, and spoke the language of wholesale reform and even rebellion in Greece and Europe. The leadership of SYRIZA never explicitly promised unilateral default and exit from the Eurozone, although it hinted that it would consider both options. Its strategy was to achieve the lifting of austerity and substantial debt restructuring through “tough negotiations” with the European lenders, who would presumably relent in the face of the democratic legitimacy of a new SYRIZA government. At the same time, the party contained a vocal minority (effectively the party’s left wing) that advocated unilateral default and exit from the EMU. The threat to the Greek historical bloc was real and present.

SYRIZA won power in January 2015, and the strategy of its leadership was tested in protracted negotiations with the lenders. It became rapidly apparent that the leadership’s approach was completely unrealistic. Debacle followed as the ECB limited the provision of liquidity to Greek banks, thus causing a gradual disruption of economic activity and eventually forcing the government to impose banking and capital controls in July 2015. The SYRIZA leadership had not prepared for, and also lacked the will to take, the path of default and exit, the only option that could have provided the country with some leverage against the lenders. It surrendered in August 2015, signing up the third bailout, and Greek politics returned to normality.

In explaining the attitude of Greece, however, even more important than fear is the notion of identity attached to the euro. Money is an integral part of national and social identity.²⁷ The euro

²⁷For further discussion of the broader social role of money, see Lapavitsas (2013).

in Greece has come to symbolize a “European” identity that overcomes national divisions and is associated with modernity, forward thrust, and capturing the future. In a small peripheral country that has historically identified “progress” with developments in Western Europe, these were very powerful ideological factors. Abandoning the euro and reintroducing a national currency could easily appear to be a backward step that weakened the “European” identity of the Greek people.²⁸ These arguments, relentlessly cultivated by the intellectual elite, acquired extraordinary purchase, leading to an astonishing uniformity of thought in the public domain.²⁹

Fear and identity backed by powerful material interests have proven a potent mix that has succeeded in keeping Greece within the framework of bailout policies, and thus in the EMU. The Greek historical bloc has preferred to accept a substantial loss of sovereignty and the destruction of much domestic economic activity rather than adopt the path of default and exit. This momentous choice, quite apart from the damage it has entailed for the country hitherto, has also raised the specter of long-term economic and social decline, as is briefly discussed in the following section.

5. Whither Greece?

By 2016, six years after adopting bailout policies, Greece had already achieved a degree of stabilization. The competitiveness gap was partly closed chiefly through the collapse of Greek nominal (and real) wages in 2010 to 2013, as is shown in Figure 4. However, as is also clear from Figure 4, the gap effectively stopped narrowing after 2014. The competitive weakness of Greece in the Eurozone has not been fundamentally eliminated.

The problem that this poses for the country is immediately apparent: competitiveness could be further raised either through more wage reductions, or through a rapid and sustained rise in productivity. The former runs the risk of generating intolerable social and political pressures, given the state of economy and society. As for the latter, there is no evidence at all that it could occur within the framework of the Washington Consensus stressing deregulation and privatization. In short, without devaluation, Greece is likely to remain in a competitive mire for the foreseeable future.

The continuing weakness of the Greek economy is apparent for several more specific reasons:

- i. The deficit on current account has been effectively eliminated, as is shown in Figure 1, but mostly through a collapse of imports due to the contraction of the economy. Greek exports have shown little or no dynamism over time.
- ii. The fiscal primary deficit has also been largely eliminated, as is shown in Figure 2, through deep reductions in expenditure and substantial increases in taxation. However, tax income has consistently failed to meet targets, and a huge backlog of unpaid obligations by the public to the state has emerged. This is matched by the backlog of delayed payments by the state to the public. Meanwhile, the Third bailout has obliged the country to adopt a policy of extreme fiscal austerity stretching to 2022 and for decades after that.
- iii. Public debt stands in the vicinity of 180 percent of GDP, as is shown in Figure 3, and is unsustainable.
- iv. Investment has collapsed, standing at barely above 10 percent of GDP and matching the negative net saving of the country.

²⁸Greece has been very similar to Italy in this respect. The ideological role of the euro in Italy, particularly its association with progress, modernity, efficiency, and overcoming various putative national weaknesses, has been extensively documented by Giurlando (2016).

²⁹Exceptions, especially among economists, were remarkably few. Prominent among these were Mariolis (2016)—as well as in several other publications—and Skaperdas (2011).

- v. Unemployment rose to above 27 percent in 2014 and in the following years has declined gently to just over 20 percent, partly as a result of rapid growth in part-time precarious employment and partly due to large-scale emigration by trained youth. Greece faces substantial long-term unemployment.
- v. The Greek banking system has become heavily concentrated in the course of the bailouts, and four “systemic” banks have come to control the bulk of deposits and loans. Banks have suffered a sustained loss of deposits, on which they have historically relied for liquidity. Banks also face a tremendous accumulation of nonperforming exposure, and although they appear to be well capitalized, a large proportion of their capital comprises deferred tax liabilities. The imposition of capital controls in 2015 has prevented a banking collapse, but at the same time, it has meant that deposits are unlikely to return en masse to Greek banks in the foreseeable future. Moreover, in November 2015, the four systemic Greek banks engaged in large-scale equity issue to buttress their capital adequacy in line with EU directives on the Banking Union. As a result, public ownership of banks has been dramatically reduced, the public sums previously given to banks for recapitalization have effectively evaporated, and international hedge funds have acquired significant equity stakes in Greek banks. Under these conditions, it is highly unlikely that there would be a strong revival of bank credit in the foreseeable future.

In sum, in the late 2010s, Greece finds itself in a position similar to that of Germany immediately after the First World War. As Keynes famously argued, the victors’ peace at Versailles had forced Germany to pay huge reparations, while precluding it from securing the external surplus that would allow it to make the payments (see Keynes 1929). In the 2010s, Greece—and much of the Eurozone periphery—is weighed down by enormous debt and is saddled with policies that are unlikely to support growth. German neomercantilism has made it unlikely that Greece will be able to generate the external surpluses necessary to service its debt without significant restructuring.

The social implications of the bailouts, meanwhile, have been exceptionally severe. Greece has suffered from a rapid increase of poverty, there has been a decline in primary health care; primary and secondary education have faced cuts in resources, and homelessness and shared housing have escalated. The contraction of output has also led to a collapse of real estate prices, while taxation on real estate has increased substantially. The result was a trap for real estate owners: able to sell only at substantial loss, they faced significant increases in real estate taxes and declining income.

Furthermore, the administrative capabilities of the Greek state have not substantially improved as a result of the bailouts. Indeed, they might have even declined in some areas, as there has been loss of employment, real wages have declined, and morale is low in the public sector. To make matters worse, the power of the lenders has been consistently manifested through the presence of the troika in several key locations within the state. Not a single economic or social decision could be made by the Greek state without the agreement of the lenders that it complies with fiscal targets.

In sum, the future of Greece in the Eurozone looks bleak. The country will probably face low and unstable growth in the coming years, with large unemployment, persistent poverty, and social dislocation. The political counterpart to economic weakness will be a state incapable of exercising sovereignty over key areas of policy and subservient to the demands of the lenders.

To avoid this path, Greece should consider precisely the policy options that its historical block has consistently evaded, that is, default and exit from the Eurozone. Needless to say, the country would also need a plan for national revival focusing on saving, investment, and targeted industrial policies. The immediate prerequisite for such a change on strategy would be a restoration of sovereignty. It remains to be seen whether the Greek people have the strength to create a new historical bloc that could revamp the prospects of their country.

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