EUROPE 05.09.2018 | George Pagoulatos

# Greece: on a new 'mission impossible'?

The crisis has left a crippling impact on Greece's economy and society. The post-bailout path to recovery will be steep

The completion of Greece's bailout programmes leaves no room for celebration. Greece has lost a quarter of its GDP from 2008, unemployment is at 20 per cent, one out of three Greeks are below the poverty threshold, youth unemployment affects four out of ten young Greeks. Over 400,000 people have emigrated, including some of the best and brightest.

Prolonged austerity has left a lasting impact on the economy's productive capacity. Greece was the only OECD economy with a negative labor productivity performance during the timeframe 2010-2016. Fixed capital formation is now at 13 per cent GDP (from 24 per cent pre-crisis), the employment rate below 60 per cent (against 72 per cent EU average). Both disinvestment and low employment undermine the growth potential of the economy.

On the positive side, huge adjustment has taken place. The country has eradicated its twin deficits, restored price competitiveness, and implemented a vast array of structural reforms (in tax administration, pensions, health system, labor market, services and product markets, public administration and so on). Their positive impact will be felt as the economy moves to recovery. The worst outcomes, both for Greece and the eurozone (a disorderly default, a catastrophic Grexit) have been averted. But at a cost unnecessarily severe.

## An extremely ambitious fiscal framework

Greece has committed to sustaining a primary budget surplus of 3.5 per cent of GDP until 2022 and an average 2.2 per cent of GDP for 2023-2060. In addition, Greece will continue and complete reforms enhancing fiscal sustainability and growth. The country's performance

will be closely monitored under the EU Commission's enhanced surveillance framework, even more rigorous than in other post-bailout countries. Some of the measures agreed (return of profits on Greek bonds by Eurosystem central banks) will be conditional upon compliance; so, carrots and sticks are set to ensure adjustment remains on track.

*Political risk has been reduced, and the Grexit speculation has evaporated. The Greek political system is now aligned behind the pro-EU mainstream.*

Importantly, Greece has secured debt sustainability until up to about 2032. The grace period on the European Financial Stability Facility's (EFSF) loans is extended from 2022 to 2032, upon the end of which the Eurogroup will examine whether additional reprofiling measures will be needed (which they will), provided Greece sticks to its commitments. So the runway has been cleared up to 2032 but not beyond, which makes it difficult to regain trust in the longer-term future of the economy.

The weakest link in Greece's post-bailout framework concerns the agreed primary surplus targets. The International Monetary Fund (IMF) has strongly challenged the assumption that any economy can realistically sustain these fiscal targets for such an extended period of time. Examining a sample of 90 countries during 1945–2015, the IMF found only 13 cases where a primary fiscal surplus above 1.5 per cent of GDP could be reached and maintained for ten or more consecutive years. Only three cases can be identified if the primary surplus threshold is increased to 3.5 per cent of GDP; and only one case if resource-rich countries are also excluded.

So international experience suggests Greece has embarked into a near mission impossible. The IMF longer-term projections forecast a more realistic (and desirable) primary surplus of 1.5 per cent. A major disadvantage is that debt payments will be leaving the Greek economy, as the debt is mainly foreign-held. This compares unfavorably with other high-debt countries (Italy, Japan, Belgium) where debt payments largely remained in the economy to become spending and investment.

## Extreme populism and Grexit have left, but challenges remain

Political risk has been reduced, and the Grexit speculation has evaporated. The Greek political system is now aligned behind the pro-EU mainstream. The ruling SYRIZA-ANEL coalition, once the most demagogic one in the eurozone, has now a track record of compliance to

the eurozone rules and the bailout, even though they retain much of their old populist ways. The major opposition, centre-right New Democracy (ND), promises to expand and intensify pro-market reforms (liberalisation and privatisations), to gain fiscal space to reduce taxation, while respecting Greece's obligations.

The next elections can take place in September-October 2019 at the latest. More likely, the Tsipras government will seek to bring the elections forward, to coincide with the European elections of May 2019. A double election (or triple, including local elections) would allow voter discontent to be defused.

*The ND has been leading in the opinion polls, with a comfortable margin from SYRIZA. If the ND rises to power it will face some formidable political challenges of its own.*

A catalyst is the ratification process for the Prespes agreement. The agreement over the name Republic of North Macedonia is backed by SYRIZA but opposed by its junior partner, the ultra-right Independent Greeks (ANEL), as well as ND and the Movement for Change (KINAL). If the agreement is ratified by the Parliament of the neighbouring country, under the assumption of a positive referendum outcome, then Tsipras could bring the agreement to the Greek Parliament in February-March 2019. This would prompt ANEL to theatrically abandon the government coalition, leading to a snap election in May 2019, together with the European Parliament elections.

## The next Greek elections

The Tsipras government is gearing up for a prolonged electoral campaign. The government intends to raise the minimum wage and abolish the subminimum (workers below 25). It is strongly pursuing the Eurogroup's consent for deferring pension cuts legislated for 2019. The IMF has already signalled disagreement. A unilateral government initiative could undermine hard-won external credibility.

The ND has been leading in the opinion polls, with a comfortable margin from SYRIZA. If the ND rises to power it will face some formidable political challenges of its own.

First, obtaining absolute majority in Parliament, or forming a viable government coalition. The obvious candidate for partner would be KINAL, the successor party of the social democratic Panhellenic Socialist Movement (PASOK), which has so far ruled out participation in another

ND-led government.

Second, a 2019 ND-led government could be faced with a new election, by March 2020, if it does not manage to gather 180 out of 300 MPs needed to elect the President of the Republic. These next elections would be held under a new electoral law with simple proportional representation, the only possible majority coalition would then have to comprise both ND and SYRIZA. To avoid this, ND will seek to reinstate the former law of reinforced proportional representation, meaning that the party with the highest total vote is 'reinforced' with a bonus of extra seats to improve its chances of forming a strong government. Thus, it is possible that we will witness a series of consecutive elections until a viable government is formed.

However, at the end of the day, the economy remains the greatest challenge. Shifting to a more export-oriented, higher value-added model able to sustain stronger GDP growth, raising productivity and rendering the economy attractive for foreign investment, remain the country's major challenges on the medium and longer run.

---



**George Pagoulatos**
Athens

George Pagoulatos is a professor of European Politics and Economy at the Athens University of Economics and Business, and a visiting professor at the College of Europe in Bruges. He was senior advisor to two Greek prime ministers in 2011-12.