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How to Damage an Already Fragile Economy

The Rise and Fall of Populism in Greece

After years of high growth driven by debt-fueled consumption¹, Greece suffered a catastrophic loss of investor confidence beginning in late 2009. This led the Greek government to lose market access in the spring of 2010 and to apply for a bailout from its partners in the Eurozone and the International Monetary Fund. The initial bailout program, based on overly optimistic projections about the public sector’s capacity to reform and the resilience of the economy in the face of a major contraction of domestic demand, collapsed within months. The second program, which included a deep restructuring of the country’s debt, also failed to resolve the issue of debt sustainability and structural weakness, and involved fiscal targets that – though not as demanding as those of its predecessor – were widely disparaged as inconsistent with a robust recovery.

In this context SYRIZA, a leftist party committed to the rejection of austerity and of the logic of the bailouts, was catapulted into power in January 2015. SYRIZA allied itself with the Independent Greeks (ANEL, for short), a nationalist right-wing party founded in 2012 by a former deputy of the center-right New Democracy who vehemently opposed the decision by party leader Antonis Samaras to embrace the country’s second bailout.

In the paper below, we attempt to explain the Greek brand of crisis populism and to give an account of its turbulent record in office so far. We also give an account of the economic conditions that allowed this unexpected coalition to take power. Finally, we offer a policy prescription to tackle the flawed aspects of the bailout programs, focusing on freeing up markets and strengthening Greece's weak institutions.

1. The Rise of Crisis Populism

SYRIZA had been a minor force at the margins of Greek parliamentary politics before the crisis. It was led since February 2008 by Alexis Tsipras, an activist and politician since his student days with little experience of the world beyond the narrow universe of the Greek Marxist left. In the October 2009 parliamentary elections, the last before the outbreak of the crisis, SYRIZA got 4.6% of the vote. The winners, the centre-left PASOK, got 43.9%.

However, the deep economic shock which began in 2009 led to major political disruption. SYRIZA's electoral lift-off, and the parallel collapse of PASOK, was fueled by the public's rage at an ever-deepening recession and the humiliation of externally-imposed austerity. SYRIZA, along with other parties of the populist left and right, including future coalition partners ANEL, tapped both these elements of popular disaffection. It insisted that it was the country's official creditors that were to blame for Greece's economic collapse, not the fiscal derailment of the years before 2010. It spoke of a "humanitarian crisis" caused by the measures imposed by the "troika" of the EU, the ECB and the IMF, and portrayed the governments that had signed and implemented the two first bailout agreements as Quisling administrations, subservient to the will of foreign masters.

The severity of the crimes imputed by SYRIZA upon the governing parties led its members to actively participate in violent demonstrations against government policy, campaigns of civil disobedience against unpopular legislation, and occupations of public buildings. When mobs waylaid government ministers and MPs, SYRIZA stalwarts justified the practice, speaking of socially justified violence.

The core message of SYRIZA's nationalist populism, echoing the campaign by Andreas Papandreu that led to the first electoral triumph of PASOK in 1981, was that the party was the true representative of the Greek people against the machinations and institutions of domestic and foreign elites. Therefore, its ascension to power would mean that Greece would regain economic sovereignty and policy would again represent the interests of the many, not the few.

This brand of crisis populism fed on a set of myths, grounding the belief that Greece had a number of options available to escape the troika, if only it elected a government willing to explore them. At the same time, and despite all this, Tsipras and other top SYRIZA cadres maintained that their wholesale rejection of the bailout programs would not endanger the country's position in the Eurozone. The depth of the crisis and the appeal of Tsipras and his nationalist-populist narrative propelled SYRIZA into the mainstream. After twin elections in May and June 2012, the party (still at the time a loose coalition of far-left groupings) became Greece's official opposition, its share of the vote rising to 26.9%.

Entry into the ante-chamber of power did little to dampen SYRIZA's radical rhetoric. As the New Democracy-led government struggled to extract concessions from Greece's official creditors and to drag the economy towards recovery, SYRIZA kept up the pressure, promising to overturn privatization deals and prosecute those who signed off on them, pledging to get rid of a hated new property tax and to increase the minimum wage and pensions for the least well-off. Seen widely as prime-minister-in-waiting after SYRIZA's victory in the European elections in May 2014, Tsipras continued hammering away at the central idea: that the source of all of Greece's ills was the bailout regime, and that he would dismantle it as soon as he came to power.

SYRIZA was a key factor in the early demise of Greece's recovery in 2014. To be sure, the unwillingness of Angela Merkel to fulfill promises of further debt relief, offered to Greece by its Eurozone partners in November 2012 on the condition of achieving a primary surplus and implementing the terms of the second bailout, weakened the ND-led government. Meanwhile the IMF was unheeded in its calls for further debt restructuring and deeply suspicious of the government's commitment

to reform. Consequently, it insisted on ever more demanding shows of compliance from Athens.

But SYRIZA's growing electoral clout, and, by 2015, the looming parliamentary vote for the election of a new president of the Republic, contributed to impasse. Electing a new president required a 3/5 majority in the 300-seat parliament. Failure to reach 180 MPs meant a dissolution of parliament and fresh elections, and Tsipras made it clear that no matter which candidate the government put forth he would withhold support. Key figures among the creditors knew conflict with a SYRIZA-led government was inevitable, and were loath to offer Tsipras the advantage of a completed bailout program and more than 7 billion euros in bailout funds.² In the end, the final review of the second bailout was never completed and early elections were called.

2. Populism in power

On the night of his electoral triumph on January 25, 2015 Tsipras said: "Greece is leaving behind destructive austerity, fear and authoritarianism...The verdict of the Greek people renders the troika a thing of the past for our common European framework."

This proved to be a premature verdict. But it took the young, inexperienced prime minister a long time to realize that fact. In the meantime, political risk reached new heights, taking Greece closer to exiting the euro than ever before. The story of the long and frustrating renegotiation of the bailout terms between January and July is complicated, and creditors bear a large share of the blame for failure to reach a timely, mutually beneficial agreement. But for the purposes of this paper, we will focus on the role of the populist Greek government, a coalition between SYRIZA and ANEL, in the terrible outcome.

The SYRIZA-ANEL coalition, in what on the surface seemed a surprising alliance between the hard left and the nationalist right, was forged overnight and lacked a detailed common policy platform. The two parties came together on the basis of shared abhorrence of the bailout regime imposed on Greece.

The alliance has proved unexpectedly durable, however, even after both parties succumbed to the inevitability of another bailout for Greece in July 2015. The glue that has held them together has been clientelism. The number of political appointments has reached record highs under the SYRIZA-ANEL government. The two parties have done their utmost to get as many loyalists as possible into government jobs. Party membership or ties of friendship with Tsipras and other high-ranking figures, instead of merit, have often been the decisive criterion for appointments, even for strategic positions in the prime minister's office.

In its first six months, the coalition held to its populist-nationalist roots, exploring a number of alternative sources of lending and basic imports (from Russia and China to Venezuela and Iran), and even looking into the possibility of printing a new currency.³ These efforts all came to naught, forcing Tsipras to give in and sign a third bailout – another 86 billion euros in loans from Greece's creditors, in exchange for new austerity measures and structural reforms.

Part of the reason why the negotiation lasted so long and ended so badly for Greece is that the populist-nationalist strain in the government's approach prevented a realistic assessment of the situation. Instead, it led to a ceaseless search for enemies external and internal which were undermining the self-styled "government of national salvation". The effect of this was to create a bunker mentality, a sense that the government was encircled by enemy forces seeking its destruction. This prevented necessary changes in policy and personnel (they were viewed as a form of capitulation to the creditors) and sharpened the authoritarian instincts of the leadership team.

The quest for enemies within also deepened the division in society that the forces of populism had already fostered before January 2015. Government ministers routinely attacked critical voices in parliament, the media and on the streets as, at best, dupes of the oligarchy or, at worst, members of a wide-ranging conspiracy to defeat the coalition and restore the old order.⁴

3. "Everything is a coup"

Even in the aftermath of the July 2015 surrender and later Tsipras's reelection as prime minister in September 2015, the bunker mentality and the divisive rhetoric pitting "the people" against the oligarchic special interests continued to dominate SYRIZA-ANEL communications strategy. The prime minister and his people blamed the intransigent creditors and their supposed allies in media and domestic politics for the poor outcome of the negotiation. Top ministers even spoke of a "coup" against Greece perpetrated by its European partners⁵. The inability to admit strategic error and the tendency to accuse others for its own disasters has been SYRIZA-ANEL's central flaw.

The case of the TV licenses auction illustrates this well. The need for a new, stricter regulatory framework for Greek television was clear, and the issue should have benefitted the government politically. But it soon became evident that, in setting up an auction process to award national TV licenses, the government's goal was to avoid breaking up the so-called "triangle of corruption" between media oligarchs, politicians and banks, but to create a new triangle, made up of networks and businessmen friendlier to the SYRIZA-ANEL government. The clumsy attempt to usurp the authority of a constitutionally mandated independent body to regulate the sector, and to restrict the number of licenses to four, was struck down in October 2016 by the Council of State, Greece's top administrative court. The initial response of the government was to lash out at the court, with one deputy minister speaking of a "judicial coup".

The SYRIZA-ANEL alliance has also displayed a pronounced authoritarian streak. The populist coalition attacked telecoms and energy regulators and referred to the independent tax administration chief as an organ of the creditors (firing her with questionable legality in October 2015).⁶ They have reserved special resources to undermining the governor of the Bank of Greece, Yannis Stournaras (who also served as finance minister between 2012-4 under the ND-led government).⁷ In these and other cases, critics have pointed out a worrisome tendency of government interference in the justice system.

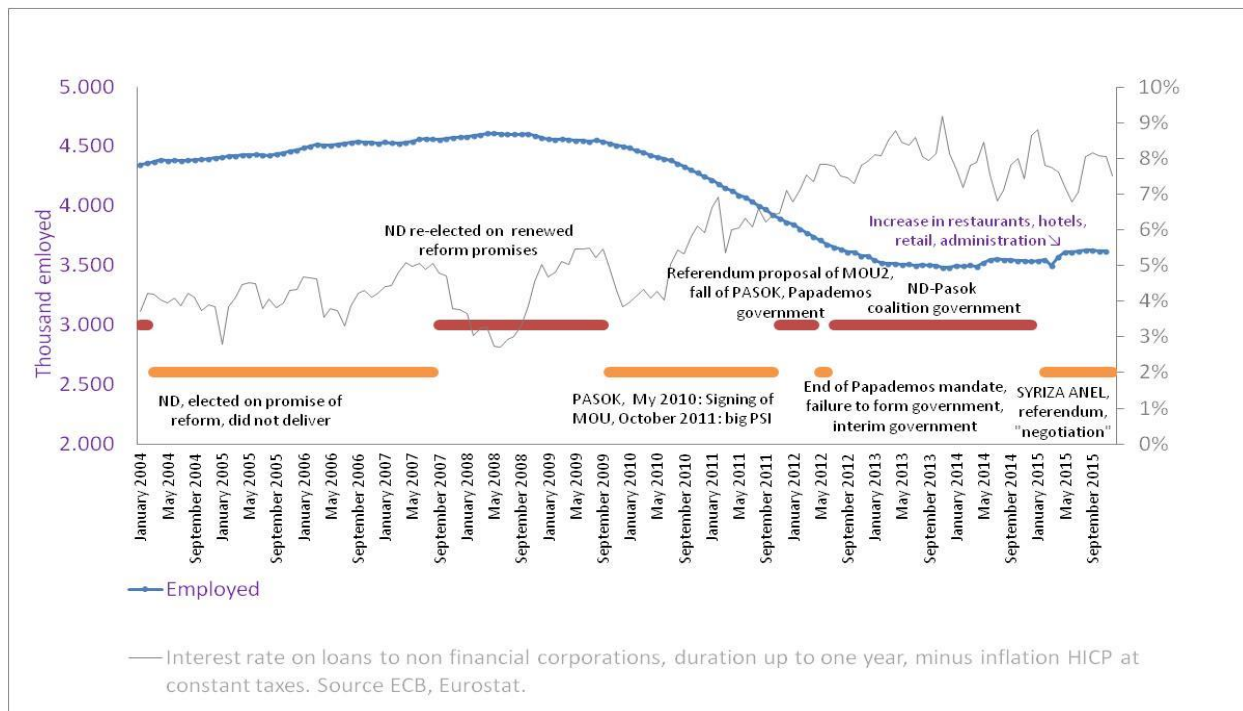
4. Policy context and implications

Greece's crisis was mishandled from the start. The Greek economy was burdened by reluctant promotion of much-needed reforms that would remove supply-side bottlenecks to growth. The official creditors pushed for a large "internal devaluation". Yet they allowed the domestic political system to force the cost of this adjustment mainly onto the private sector, where it was less necessary⁸, and to protect the public sector, which was in most urgent need of radical restructuring. This misguided application of internal devaluation wreaked havoc on the economy, the labor market and society at large, leading to political turbulence.⁹

The "troika" initially sanctioned a policy mix that focused on increasing taxes for the private sector and labor market reforms, while postponing privatization and deep structural reforms in the public administration. Excessive regulation and barriers to entry in key sectors remained in place, as successive governments failed to implement legislation to free up the economy. Meanwhile, high energy prices and the drying up of bank credit created impossible conditions even for well-run, export-driven businesses. The tax hikes and spending cuts, along with the steep drop of private sector wages and the explosive rise in the number of the unemployed, led to a collapse of domestic demand. In an economy so dependent on consumption, this meant that the recession was much deeper and longer than predicted.

Figure 1 shows how employment declined due to this process, with political instability and the lack of reform progress placing a cumulative burden on the private sector. This figure also shows how critical the cost of funding in the private sector is for economic recovery, depicting the positive correlation between high interest rates and the uncertainty they reflect.¹⁰

Figure 1. Political risk and economic performance



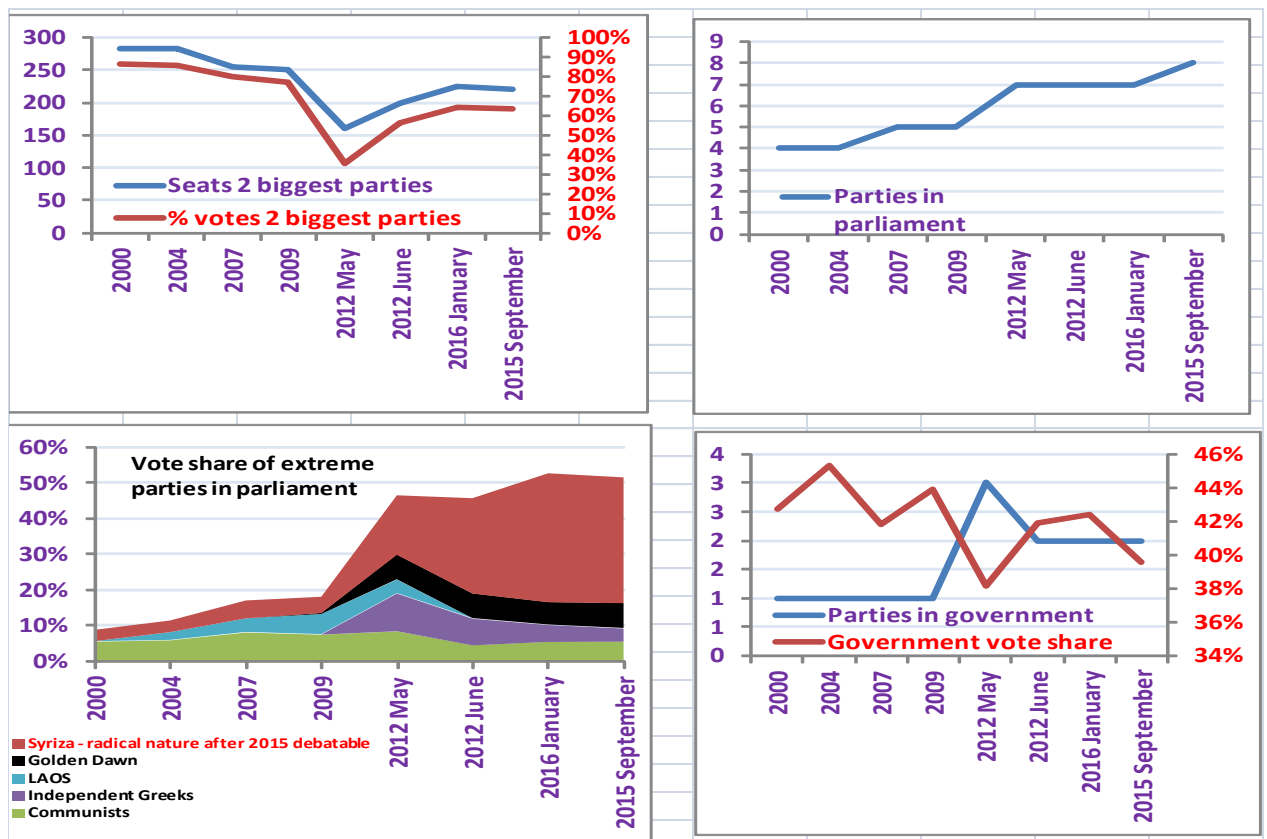
Source: Authors' elaboration from Elstat data on employment and inflation at constant taxes, Ministry of Interior election results, ECB on interest rates for non-financial corporations.

The Greek case shows that political risk is greater when political uncertainty is high, institutions of governance are malfunctioning and economic conditions are weak. The vicious cycle of bad economic conditions and high political risk has stymied Greek recovery and spread political extremism and business uncertainty. What is worse, the disease is contagious: As Kelly, Pastor and Veronesi (2014)¹¹ point-out, shortly before key Greek elections one could find a very high price of political uncertainty across all European countries. Today, with populist forces on the rise throughout Europe, it is important to take a closer look at this phenomenon.

The typical reaction to crises is a significant increase in support for far-right parties, the truncation of governmental majorities and the fragmentation of parliaments, as more parties gain representation¹². These developments tend to hinder crisis resolution and contribute to political gridlock. This hurts growth, incomes, asset prices and employment in the short- and long-term, fostering more political uncertainty and further diminishing capacity for crisis resolution.

This model of the weakening of the political center and the fragmentation of representation perfectly fits the Greek experience from 2010 onwards (see figure 2). Golden Dawn, the neo-fascist party, has seen its share of the vote soar from 0.3% in 2009 to around 7% in all parliamentary elections from 2012 on (in the European election in 2014 it reached as high as 9%). The two largest parties in the current parliament, SYRIZA and New Democracy, together take in between 55-65% of the vote. In the heyday of the pre-crisis two-party system, PASOK and ND combined for more than 80% of voters' preferences. New parties crop up and immediately gain parliamentary representation, often disappearing just as quickly. The last single-party government fell in November 2011, and the average life-span of governments in the last ten years has been no longer than two years. These developments are in line with the decline in Greeks' trust not only in their own political system, but also in EU institutions during the crisis.

Figure 2. Political reactions to extremism in Greece



Source: Greek election results, analysis inspired by Funke, Trebesch, Schularich (2015). LAOS, Independent Greeks are far right and Golden Dawn is a Nazi party. The extremism of all votes that

support Syriza can be credibly questioned, especially after the 2015 referendum and the signing of the 3rd assistance program MoU.

The over-ambitious design and lackluster execution of the initial bailout program has weakened the political forces that strove for reform and fed the fires of populism. The inability of the Eurozone, with its incomplete governance structures and the reassertion of nationalist narratives, to deal effectively with a country with frayed institutions and a deep-rooted unwillingness to reform, led to the short-sighted adoption of the “Grexit” threat. This, in turn, amplified the negative trends that were already in motion. Europe needs to work out a mechanism to handle crises within the euro area in a way that supports “convergence in institutions” among the member-states and eliminates the threat of expulsion.¹³

5. The hard road ahead

Economic history does not hold hopeful lessons for Greece. Even if Greeks do not become further impoverished, empirical evidence of countries in prolonged depressions points to persistent radicalization, populism as the hegemonic worldview and weakened institutions.

Greece today desperately needs lower taxation and a less crushing regulatory and insurance burden on business (a necessary condition of which is further debt relief from official creditors). It requires reform of product and service markets, that will break down barriers to entry and allow competition and new ideas to flourish. More broadly, it is necessary for the country’s rejuvenation that schools and universities be given greater autonomy, to allow them to experiment and innovate free from the asphyxiating hold of the state.

Two areas are particularly critical if any reform project is to achieve long-term success. One is public administration, which must become infused with greater meritocracy and managerial best practices, to put an end to clientilistic practices and to shake up sclerotic processes and ways of thinking. The second is the independence of key institutions, from the regulatory agencies to the courts, which has been badly undermined under the current populist coalition.

Only the emergence of a reform-oriented political entity that receives broad public support for this agenda will lead Greece out of this situation. Unlikely as this may appear, it is not impossible: a party with a liberal platform of reforms and fiscal consolidation won close to 50% of the votes in 1990, a time with somewhat similar political and economic circumstances. Today, New Democracy, the official opposition, is led by Kyriakos Mitsotakis, the son of the man who led that government. Mitsotakis is a keen supporter of the policies outlined above. It remains a question, however, how far his reform priorities are shared by his party.

As insightful students of Greek history have highlighted¹⁴, modern Greece has a long record of being on the front-line of historical developments – from the nationalist self-determination revolutions of the 19th century to the Cold War, and from the democratization wave of the 1970s to the outbreak of the sovereign debt crisis and the rise of populism as a governing force in western politics.

The experience of 2015-6 has been traumatic, but also instructive: the snake-oil promises of the populists were put to the test, and were shown to be based on myths, lies and miscalculations, with terrible consequences for the country. That lesson learned, Greek voters are increasingly likely to vote the populists out in the next election. In much bigger countries that have more recently fallen to the forces of anti-globalization, inwardness and post-truth politics, supporters of liberal economics and the open society will be watching keenly.

Endnotes

¹ See M. Mitsopoulos and T. Pelagidis, *Understanding the Crisis in Greece. From Boom to Bust*, London, Palgrave/MacMillan, 2011 and 2012 2nd edition

² see Marcus Walker & Marianna Kakaounaki, “How Greece and Germany brought Europe’s Long-Simmering Crisis Back to a Boil”, *The Wall Street Journal*, 21.1.2015 (<http://www.wsj.com/articles/how-greece-and-germany-brought-europes-long-simmering-crisis-back-to-a-boil-1421890324>)

³ For a summary of these efforts, see the last chapter of the second of edition of Yannis Palaiologos, *The Thirteenth Labour of Hercules* (Portobello Books, 2016).

⁴ Among a plethora of examples, the use of the phrase “internal troika” by the Finance Minister, Yanis Varoufakis, to describe domestic critics, stands out.

⁵ Panos Kammenos, Defence Minister and leader of ANEL, spoke of a “coup by Germany” on the morning of July 13, 2015, before promptly voting for it in parliament (see <https://www.ft.com/content/159b56be-297f-11e5-8613-e7aedbb7bdb7>). Nikos Filis, parliamentary spokesman and later Education Minister, said that Germany, for the third time in a century, was trying to “destroy Europe”.

⁶ On the tax administration chief, see Yannis Palaiologos, “Tsipras fires his tax chief”, 23.10.2015 (<http://www.politico.eu/article/tsipras-fires-his-tax-chief-greek-government/>)

⁷ Stournaras was frequently attacked during the 5-month negotiation for undermining the position of the government by calling for a swift conclusion of a deal. See Yannis Palaiologos, “A new twist on Greece’s old-style dysfunction”, *Wall Street Journal*, 28.9.2016 (<http://www.wsj.com/articles/a-new-twist-on-greeces-old-style-dysfunction-1475092467>)

⁸ See T. Pelagidis & M. Mitsopoulos (2014), *Greece. From Exit to Recovery?*) Washington D.C., Brookings).

⁹ See for example T. Pelagidis & M. Mitsopoulos (2012), *Understanding the Crisis in Greece* (London, Palgrave/MacMillan).

¹⁰ See for example Bachmann, R., Elstner, S. and E. Sims. 2013. *Uncertainty and Economic Activity: Evidence from Business Survey Data*, *American Economic Journal: Macroeconomics*. 5(2): 217-49, and European Commission 2013. *Assessing the Impact of Uncertainty on Consumption and Investment*. Volume 12 (2013) Issue 2 - Quarterly Report on the Euro Area. (June 2013). Directorate General for Economic and Financial Affairs (ECOFIN).

¹¹ Kelly B., Pastor L. and P. Veronesi (2014), *The price of political uncertainty: Theory and evidence from the option market*, NBER working paper.

¹² See Funke M. Schularich M. and Trebesch C. 2015. *Going to Extremes: Politics after Financial Crisis, 1870-2014*, *CESIFO WORKING PAPER NO. 5553*.

¹³ As analyzed in Pelagidis, T and M. Mitsopoulos (2016), *Who’s to Blame for Greece?* (London, Palgrave/MacMillan).

¹⁴ See Mark Mazower, “Democracy’s Cradle, Rocking the World”, *The New York Times*, 29.6.2011 (<http://www.nytimes.com/2011/06/30/opinion/30mazower.html>). Also the book by Stathis Kalyvas, *Modern Greece: What Everyone Needs to Know* (Oxford University Press, 2015).