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THE EURO AND GREECE: IS DEPARTURE THE ROAD TO ECONOMIC AND POLITICAL STABILITY?

Bachelor's Thesis

Supervisor: Professor Ton Notermans

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I declare I have written the bachelor's thesis independently.

All works and major viewpoints of the other authors, data from other sources of literature and elsewhere used for writing this paper have been referenced.

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ABSTRACT

The objective of this paper was to find out whether Greece would be better off outside the Eurozone economically and politically. When evaluating the economic policy measures that were imposed on Greece in return for the bailout funds, the conclusion is that the austerity-influenced program has been a failure. Economically Greece is worse off with a 25% reduction in GDP, over 20% unemployment rate and an even bigger government debt than in the beginning of the program. The 2008 financial crisis and the following Euro crisis showed that Greece is domestically poorly equipped to manage the multitude of problems that were materialized. The absence of individual monetary policies in the Eurozone has led to a situation where Greece finds it difficult to catch up with the more competitive countries in the North of Europe. Politically, the Greek state does not have the capacity to acquire far reaching political reforms without compromises that will, in turn, undermine those same reforms. Moreover, managing domestic politics has become increasingly important during the Euro crisis where the economic capability of a Euro country is directly proportional to its ability to acquire a moderate wage policy, restrain government spending and a trade surplus. In all these respects Greece falls short, which makes its membership in the currency union harmful.

Keywords: Greece, Troika, Euro crisis, EMU, Eurozone, austerity

INTRODUCTION

Following the 2008 financial crisis that shook the foundations of, especially, Western economies, in 2010 it was revealed that Greece had severe economic difficulties. Greece's large sovereign debt, which was mostly foreign held, had been used to finance its lavish government spending. The problems of Greece were quickly transformed and multiplied in a European context because of the common currency. Soon Ireland, Italy, Portugal, Spain and Cyprus were faced with their own economic problems that had special individual characteristics rather than being a repetition of the Greek case. The trust in the Eurozone was crumbling under the consecutive crises, demanding swift responses from the European Union.

Eventually, Greece received bailout packages from other Euro-countries and the IMF that kept the country afloat. In return for the money, Greece had to undergo substantial spending cuts and structural reforms. However, the austerity policies have so far managed to make Greece even more indebted and politically unstable, not to mention the record high unemployment rates that weaken the prospects of future economic growth. Moreover, the GDP of Greece has dropped by over 25% in the wake of the austerity policies and is nowhere near the level that it was in 2010. An equally worrisome result of the austerity measures is that half of the youth population in Greece is unemployed, which is a fertile breeding ground for radical movements in a country that is already politically polarized.

The discussion about Greece and, in a broader context, the Eurozone crisis has had a lot of emotional features, resulting in a situation where the core problems of the continuing economic stagnation in Europe have often been sidelined. Therefore, to look more closely at Greece, and find a solution to the Greek problem, would be a first step in seeing the bigger picture of the Eurozone dilemma. Namely, to see what the structure of the monetary union can do to countries that are poorly equipped to implement the measures required by such an institutional setting. The absence of monetary and exchange rate policies is especially harmful for countries like Greece that have maintained their economic competitiveness trough currency devaluations, since centralized wage agreements are not a realistic option.

The research problem of the paper is concerned with the question whether or not Greece would be better off outside the Eurozone economically and politically. The counter argument would be that Greece would fall into an even bigger economic crisis if it were to be outside of the monetary union with its own currency and, eventually, end up as a failed state. The paper will argue that a managed Euro exit is a lesser evil for Greece itself than being a part of the Eurozone where it has a murky future in the sense that catching up to the economic competitiveness of the Northern European countries is a daunting task.

Some of the questions that this paper tries to answer include: Is it realistic to assume that Greece could go trough substantial structural reforms given the political polarization in the country? Will Greece have a better change to develop economically inside of the Eurozone? Or is it destined to remain a country that cannot compete with the Northern European countries? Will a Greece outside of the Eurozone, but not the European Union, be even more of a destabilizing factor for Europe?

Thus, this paper proposes that Greece should leave the Euro, but in a carefully managed way. It is crucial that Greece stays in the European Union and is guided trough a state building process that would make the country more stable politically and economically. From an economic point of view, Greece should default and devalue with the newly introduced drachma. Furthermore, a package of investments would be introduced that would be coupled with necessary reforms. Here, the European Union could assume a supervisory role along with the IMF. Moreover, the investments would be channeled to prospective industries in Greece that would be identified by outside specialists.

Politically, it is necessary that Greece will receive help to undergo these, admittedly, bold changes in order to maintain the political stability in the country and avoid the situation where it might end up as a failed state with even deeper political turmoil. One could compare the situation to post-World War II Europe in the sense that far-reaching investments were crucial for the rebuilding of Europe politically and economically. The same can be said for Greece where the economic and political solutions go hand in hand in providing a better future for the country. Having little positive prospects in the near future can potentially have dangerous consequences, as was seen during the interwar years in Europe.

The theme of “one step back, in order to go two steps forwards” is the mentality that describes this paper’s intentions regarding the solution to Greece’s problems. It should be noted that the political-economic problems of Greece are connected to the European integration process as a whole. The different levels of economic development between EMU countries are now threatening the integration process, as the anti-European parties gather more support amidst the dire economic situation. In addition, imposing a Northern European economic model to countries that are poorly equipped to manage those policies has divided the European Union more than it has unified it. The mind-set of imposing outside restrictions to encourage structural reforms in countries like Greece has not worked as well as hoped.

The paper is constructed as follows: first it will introduce the theoretical part of the paper that will look into the underpinnings that have governed the Troika decision making in regard to Greece, but also the mentality that is characteristic for the European Union as well. The following sub-section will shortly describe the methodology of the paper. The second part will reveal some specifics of the austerity program and also its negative results by using data to support the argument. The third part will be about the alternative solution for Greece, namely its separation from the Euro, although, not the European Union. Two sub-sections will be present here: the first will discuss the structure of the Eurozone while the other will be mostly about politics: the problem of Greece becoming a potential failed state, as it might not be ready to cope with the separation process from the Euro in a politically stable manner. The conclusion of this paper will sum up all the relevant arguments in support for Greece’s managed exit from the Euro.

1. THE THEORETICAL BACKGROUND: PRINCIPLES UNDERLYING THE TROIKAS SOLUTION TOWARDS GREECE

When considering the theoretical framework for this paper, it would seem most natural to start off with the theories from the International Political Economy branch of International Relations-theories. After all, the primary focus of this paper is on the interplay between politics and economics, which has been the main characteristic in the Greek crisis and on the Eurozone crisis overall. To make the theory section as relevant as possible for the purpose of this papers research question, the governing principles behind the decision making of the so-called Troika (European Commission, International Monetary Fund, European Central Bank) shall be put under special scrutiny. Certainly, the Troika's implemented measures, in order to get Greece back on the right track economically, have been key in the current state of Greece. Theories from the IPE side, such as, economic liberalism, will be considered in order to explain the Troika's austerity program for Greece.

Before an evaluation and the comparison of different theoretical approaches, a brief introduction to the relevant IPE-theories is in order. Sorensen and Jackson characterized the theoretical approaches of IPE by saying that: "Ultimately, International Political Economy (IPE) is about wealth and poverty, about who gets what in the international economic and political system." (2013, 159). Perhaps most important for the purpose of this paper, IPE is concerned about the relationship between politics and economics, as well as states and markets, in the international arena. The authors identify three main theoretical frameworks for IPE: mercantilism, economic liberalism and Marxism. They also emphasize the degree of ambiguity concerning the theories because of their broad sense of scope concerning assumptions and values. (Ibid.) One could, though, point out that the aforementioned ambiguity is, more or less, present in other international relations theories as well, since there is no such thing as an all-encompassing and explanatory theory in the field. Theories, in general, can establish a framework and some useful set of analytical tools, but they should not be considered flawless or perfect.

When starting to examine the politico-economic foundations governing the austerity package to Greece, the principles of economic liberalism seem the most obvious starting point. Gilpin defined liberal economics as a doctrine and a set of ideas that are aimed at organizing and managing economic growth as well as individual welfare (1987, 27). The rational behind economic liberalism is one of a market economy that operates automatically according to its own mechanisms or assumed laws. A key principle is the individual as a rational and self-seeking actor, in addition to his/her role as a consumer and a producer at the marketplace. Furthermore, the marketplace is the open arena where individuals exchange goods and services, the result being one of mutual gain and, therefore, a positive-sum game. (Jackson, Sorensen 2013, 165-166)

Overall, economic progress has had a profound meaning for post-war European integration in the sense that economic well-being was crucial for rebuilding Europe, not only economically, but also politically: the Great Depression in the 1930's and the following dictatorships in Europe were an example of the interrelatedness of politics and economics. After a failed attempt to establish a European defense community, the historical integration process of Europe proceeded from the economic sphere. It was assumed that economics would be less of a controversial policy entity than, for example, security and defense policies. The gradually developing integration process in the economy began as a highly interventionist minded in the sense that economic policy making was still very much in control of the states. The distinctive features of economic liberalism, a belief in the functioning of markets and its relative autonomy from political control, began to gain momentum in the 1980's. The European Monetary System was established in 1978 in order to prevent currency fluctuations, which can be seen to pave the way towards the Single European Act in the late 1980's that made a commitment to establish a single market and a monetary union (Bache, George, Bulmer 2011, 404). Establishing and committing to these goals was a significant step towards the ideals of an independent market with little restrictions.

The current European Union represents an area where the ideals of economic liberalism have gradually eroded boundaries between states in favor of a freely operating market economy. The four "freedoms" (free movement of goods, services, labor and capital) were first introduced already in 1985 by the then Commissioner for Trade and Industry, Lord Cockfield from the United Kingdom, in the form of the so-called White Paper on Freeing the Internal Market (Bache, George, Bulmer 2011, 386-387). The papers aim was to abolish the physical, fiscal and technical barriers that included unnecessary border checks, differences in VAT (value added tax) rates and national standards (e.g. the precedent case of *Cassis de Dijon*) (Ibid.). The paper eventually led to the creation of the Single European Act.

The White Paper came as a response to the rapidly changing international economic environment (Bach, George, Bulmer 2011, 386) that was characterized by a resurgence of traditional laissez-faire version of economic liberalism that strived for the freedom of the market from political regulations and restrictions (Jackson, Sorensen 2013, 166). The governments of the US and UK, headed by Ronald Reagan and Margaret Thatcher, were at the forefront of liberal economic policies and the, to-be, European Union followed suit. The commission was the initiator that pushed the values of economic liberalism into a larger European context.

The brief historical preview of the European integration process helps to explain the fundamental beliefs that govern the Troika decision-making. Ultimately, two thirds of the Troika is composed of European Union institutions (the Commission and the ECB) that have a somewhat embedded point of view on economic policy where the functioning of an independent market is key. Indeed, the ECB functions on a liberal economic, or neoliberal, mind-set, which has its basis in principles such as the neutrality of money doctrine, independence of the central bank from political control and the goal of maintaining price stability and low inflation (Korkman 2013, 55). As Korkman noted, it is hard to avoid the impression that the whole institutional framework of the Economic and Monetary Union is inclining towards a disciplined central bank and fiscal policy (2013, 54)

The view that fiscal policy should remain neutral and monetary policy rule-based were part of a monetarist view that became the mainstream view on economics in the 1980's, overshadowing the Keynesian belief of active fiscal policy (i.e. government involvement) (Hall 2012, 356-357). The mainstream economic views in the 1980's, then, left a permanent mark on the institutional setting of the EMU and the rule-based principles were even reinforced by the Maastricht-criteria in the early 1990's. What made the monetarist view liberal was that it considered expansionary fiscal and monetary policies counterproductive for creating growth and employment and would only result in unnecessary inflation. Therefore, state involvement in monetary and fiscal policies was only a nuisance for the markets.

The goals of the ECB are an example of fostering an economic environment where the interference of governments is minimized so that the markets could function at their full potential. The states in the EU only provide the minimum amount of interference with the necessary legal framework that is needed to establish a functioning market. Moreover, from the point of-view of the ECB much of the problems in Greece were a result of too much government interference in the markets.

Put in more concrete terms, the liberal elements in the EU institutions can be summarized in two core values. The first is the unconditional belief in the independence of markets leading to optimal outcomes. The second is that states are the main source of disturbance to the markets. The way that these two principles are visible in the current European Union are the restrictions to government interference. On the monetary policy side, power has been transferred into supranational hands (the ECB), which is independent from government influence. On the fiscal policy side, agreements such as the Stability and Growth Pact and the Maastricht-criteria are examples of how government spending is being controlled by rules. According to these principles, the change of a market failure is nonexistent and considerable efforts have been made to allow the independent functioning of the markets in a truly economic liberal way. Against this background one can see the rational behind the Greek austerity program: austerity in the form of spending cuts and structural reforms that aim to improve the functioning of the markets and limit government interference.

Since the underlining principles of the European branch of the Troika composition have been examined, it is necessary to look at the remaining one third: the IMF. The International Monetary Fund has it roots in the post-World War II Bretton Woods system, which was established in order to rebuild the world's economic capability. Formerly, the common denominator for the IMF and the other two Troika institutions would have been the principles that are know collectively as the Washington consensus. In principle, the Washington consensus is composed of measures that are based on the positive expectations of a freely operating market without unnecessary constraints, i.e. on a neoliberal, or liberal economic, view of economic policies. From the three institutions that form the Troika, the IMF is the least economic liberal minded.

Some of the Washington consensus principles, which were originally summarized and "branded" by John Williamson, included: fiscal discipline, deregulation, privatization and trade liberalization among six other measures. Originally, Williamson composed the list for a conference on development economics for the purpose of summarizing policy recommendations that everyone in Washington presumably agreed on and thought were needed to be implemented in Latin America in the late 1980's. (Williamson 2004, 1-3) The Washington consensus, deriving much of its principles from the same ideological pool as the European institutions, had a severe setback when the financial crisis hit in 2008. An official of the World Bank, which was established under the same principles as the IMF, was even quoted of saying: "There's no question the Washington consensus is dead." referring to the free-market principles of the consensus (Cooper, Savage 2008).

The actual setback for the IMF came already before the 2008 financial crisis. There were diverging views about the effectiveness of IMF's measures in the context of the Asian Financial Crisis in 1997. Feldstein has argued that the IMF should concentrate on its original purpose of helping countries with temporary shortages of foreign exchange and trade deficits, rather than demanding structural and institutional changes (i.e. in the spirit of the Washington consensus) in exchange for the money being lent (Feldstein 1998). Fischer, First Deputy Managing Director of IMF at the time, defended the IMF conditionality by saying that urging, for instance, trade-liberalization and integration to the world economy is beneficial (Fischer 1998). Such a positive view on trade-liberalization is a traditional value of economic liberalism, which emphasizes the positive-sum game of the markets.

In essence, two thirds of the Troika institutions represent economic policy views that are more related to the economic liberal branch than any other of the two governing IPE-theories. The European Commission and the European Central Bank are institutions that have a solid foundation on the principles that are closely related to the economic liberal doctrine. Although previously belonging to the same Washington Consensus front as the European institutions, the IMF has recently toned down its liberal doctrine. Indeed, Kranke and Lütz argue that currently Europe is the main proponent of the Washington Consensus principles (2010, 30). The EU and IMF have even had disagreements in managing other financial crises such as the Latvian case has shown (Ibid.). As European institutions are forming the majority in the Troika composition, it is not a surprise what form of a remedy Greece has been offered for its economic crisis: structural changes, spending cuts and privatization to name a few.

But could the other IPE-theories explain something about the Troika's fundamental values? When making a comparison between the theories, it becomes apparent that they overlap each other to some extent. The importance of the economy, when compared to politics, is a common characteristic with economic liberalism and Marxism. Though, Marxism highlights the exploitative and unequal nature of the economy where as economic liberalism sees it as a positive-sum game with mutual benefits to actors who participate in it. Mercantilism, in turn, highlights the decisive nature of politics over economics and sees, together with Marxism, that the nature of economic relations is always a zero-sum game. Moreover, the theories point out different actors that are decisive for those theoretical frameworks, namely, states (mercantilism), individuals (economic liberalism) and classes (Marxism). (Jackson, Sorensen 2013, 173-174)

As mentioned, at the heart of the mercantilist approach is the decisive role of the state. The economy should serve the state, which means that state intervention in economic practices is substantial. The concept of economic interaction being a mutually beneficial relationship is not part of the Mercantilist approach: there are only gains and losses. For the purpose of this papers discussion, mercantilism can shed a light to the structural nature of the EMU. Some have argued that the economic policies of the Northern European countries, especially Germany, resemble mercantilist policy strategies with the accumulation of significant trade surpluses, resembling a beggar-thy-neighbor policy (Sauramo 2015, 411). Furthermore, the structure of the EMU, with restrictions in monetary and fiscal policies, has allowed some countries to pursue their mercantilist tendencies to such extremes that the Eurozone has split into a core and a periphery. The advantage of Germany, along with the Netherlands and Austria, in wage-restraint policies gradually increased their competitive edge, their current account surpluses and enabled them to acquire a creditor position vis-à-vis the periphery countries in Southern Europe. One could follow this argument to the conclusion that the mercantilist behavior of the creditor countries also established them at a considerable power position, which can be seen in the austerity policies of Greece.

When it comes to Marxism, the theory is perhaps best suited for a critique against, especially, the principles of economic liberalism. For the purpose of examining the Troika, the possible unit of analysis would be class influence. The class in question could be the “financial-elite” that has significant influence in political decisions simply by the lobbying power that they have. For instance, the Corporate Europe Observatory, an NGO, examined the meetings that were being held by civil servants of the Directorate General of the Single Market and industry representatives. Between early 2013 and mid 2014, the organization concluded: “..at least one meeting per working day with either a bank, an association of banks, or an investment fund” (Corporate Europe Observatory 2014). Furthermore, the financial industry of the European Union spends more than 120 million euros and employs more than 1,700 lobbyists to work in the EU institutions (EUobserver 2014). Therefore, the “class” of the financial industry should be taken into account when examining the actors that influence its decision-making.

Surely, one can criticize such lobbying practices of the financial industry without being a Marxist. To expand more on the Marxist critique, one could argue that the current policies of the European Union favor the “financial-elite” to a large extent, since concepts like wage-flexibility and austerity policies come at the cost of the working class people who have less money to spend and fewer social benefits while the profits from the cuts go to the wealthy business class. Moreover, the insistence of the ECB to keep the Greek default out of the discussion favors the rich bondholders that want to make a profit from the debt despite of the harsh circumstances that are being imposed on the Greek people. In principal, this point of view would represent a class warfare type of a situation where the business elite is the bourgeoisie and the working class people the proletariat, the former having the economic power to influence political decisions.

The three IPE-theories, as noted by Jackson and Sorensen, are individually not enough to explain the multitude of ideas, actors and relations that constitute the reality, which they try to examine (Jackson, Sorensen 2013, 206). To a certain degree, this notion can be applied to the theoretical foundations of the Troika as well. Even though economic liberalism might be the most relevant theoretical point of reference for this threefold supervisory body, mercantilism and Marxism have also some contributions to make. Nevertheless, economic liberalism is the simplest way to explain the Troika’s rational behind the economic remedy that was offered to Greece. Mercantilism and Marxism then have a complementary role in, especially, highlighting some of the other key actors and circumstances that affect the whole Greek crisis, namely states (e.g. German influence in economic decisions) and class influence (e.g. the "financial-elite") that are not included in the liberal economic view.

To make a concluding remark to this theoretical section, the biggest fallacy of the Troika's rationale has been the thought that the economic principles of the austerity program would not pose a political conundrum for Greece, nor that it would affect, in the long run, the successful handling of the economic crisis. The failure of the austerity measures has much to do with the general economic liberal logic that politics and economics can operate on distinctive levels without affecting each other. Moreover, the practical aspect of imposing an institutional setting into a country with a distinctively different institutional framework is anything but an easy task. In more concrete terms, imposing a Northern European economic model, with centralized and moderate wage agreements, to Greece that has no capability, or history, of acquiring such a setting is quite unrealistic. Even if such a setting would be desirable, it would need more support to be executed in a politically polarized country like Greece. Otherwise, as has now occurred, harsh economic reforms will change the political climate in the country, which then might erode any progress that has been made for the economic competitiveness of Greece.

1.1 METHODOLOGY

A short description of the methodology of the paper is necessary before proceeding to the more tangible part of the thesis, i.e. the Troika-program and its implications to Greece. To reiterate, the research object presented here concerned the feasibility of a Greek departure from the Eurozone. Furthermore, special attention was given to the possibility that a carefully managed Greek exit would present a better future for Greece than staying in the monetary union. The research object presented an interesting opportunity to, not only, explore the much-discussed Greek exit but also some of the controversies related to the usual discussion of the Greek economic crisis.

The main argumentation method is qualitative in nature as the paper attempts to explore the questions of "why" and "how" Greece was put under such harsh economic policy measures. After examining these questions the paper will look at the consequences of the economic policies to Greece. Examining the Troika managed program is the clearest way to establish why the given economic policies were imposed and how they were done while at the same time evaluating their impact on Greece.

A few quantitative statistic figures are also used in order to illustrate the consequences of the austerity policies in Greece. Although the main emphasis of the paper is on the qualitative side, the quantitative figures emphasize the point that the papers arguments are trying to make: the unsuccessful nature of the economic policies imposed on Greece and their destructive nature.

2. THE TROIKA RECIPE: WHAT IT IS AND WHAT WERE THE CONSEQUENCES OF ITS IMPLEMENTATION FOR GREECE?

As was examined in the theoretical section, the Troika's remedy for Greece has been influenced by a specific set of economic principles that have their base in the general belief that markets should function independently with few restrictions and regulations. This chapter will now introduce the Troika measures in more detail. Moreover, the negative implications of the austerity package for Greece will be highlighted and supported by data along with reports that have evaluated the austerity measures.

First, it is important to note that much of the trouble in the 2010 Euro crisis was about the fact that the Eurozone did not have a credible crisis management framework, i.e. a backup plan to counter the evolving crisis. The focus was more on the prevention of potential crises trough surveillance mechanisms, such as the Stability and Growth Pact, than on crisis management (Pisani-Ferry, Sapir, Wolff 2013, 8). The no-bail-out clause, Article 125 of the Treaty on the Functioning of the European Union (European Central Bank), was perhaps politically viable, but in an economic sense it did not provide a credible safeguard against an asymmetric crisis. To put it in more concrete terms, when the financial difficulties of Greece were imminent in 2010, there was a swift reaction from the markets, which resulted in the depreciation of the Euro, rising government bond prices and an overall distrust in the Eurozone. Therefore, a crisis in Greece affected all of the common currency members and demanded an immediate response from them, eventually taking the form of the Troika-led financial assistance under the conditionality of an austerity program.

Certainly, it is reasonable to establish the origins of the Troika and the measures that have been taken to fix Greece. Pisani-Ferry, Sapir and Wolff provide a good picture about the functionalities of the Troika. By and large, the Troika is a body of financial evaluation and negotiation, but not a lender or a decision-maker per se: the lending procedure is conducted by the IMF (part of the Troika) and the ESM (European Stability Mechanism). In the ESM, which was preceded by the European Financial Stability Facility, the decisions are made by the finance ministers of the participating countries. Thus, the ESM is basically another incarnation of the Eurogroup. To be clear, the IMF is not bound by decision of the Eurozone finance ministers and is an independent institutional actor in the Troika. Interestingly enough, IMF assistance to euro-area countries has some amendments and additions, such as an additional Memorandum of Understanding on specific economic policy conditionality, that are not demanded from countries outside the Eurozone. The European conditionality is therefore broader than the IMF's, because of the special conditions, which include some structural demands that are absent from the usual IMF conditionality. (Pisani-Ferry, Sapir, Wolff 2013, 20-23)

As the multitude of different mechanisms (e.g. the EFSF, EFSM and ESM) suggests, the initial response to the crisis in Europe was all but easy. It seems that the urgency to calm the market forces dictated the harsh measures for Greece, which were stricter than those offered to Portugal for example. Hall points out that: "…Greece was forced to attempt one of the most drastic programs of fiscal austerity in modern history…"(Hall 2012, 363). Indeed, Greece was required to reduce its budget deficit by eleven percentage points of GDP in three years while Portugal was required only six percentage points in the same time period (Ibid.). Featherstone made a similar remark by saying that a 14,5% adjustment in Greek primary government balance in five years is extreme and without a clear precedent case (201, 205). One could argue that European leaders were eager to put a hefty price on Greece's lavish government spending because they wanted to make Greece an example of what would happen if the rules of the Stability and Growth Pact were not followed. In addition, the fear was that the rising government bond prices of larger Eurozone economies, Spain and Italy in particular, would drive them to a state of insolvency that would require bailout packages for them as well. Greece, along with Portugal and Ireland, were manageable but Spain and Italy would be too big to bailout.

Along with the austerity measures, the conditionality required Greece to implement structural reforms in its economy to boost growth and partly offset the effects of the spending cuts. Like many parts of the Troika program, there were some heavily optimistic assumptions in play. In general, there was an asymmetry about the measures being implemented: while there was a clearly defined set of instruments for correcting the fiscal imbalances, the same was not true for the structural reforms (Pisani-Ferry, Sapir, Wolff 2013, 72). Therefore the initial target of reforms leading to increased price competitiveness did not materialize, which then led to the reliance of the export sector to deliver the desired growth. Factors such as indirect taxes, administrative prices and rent seeking in protected sectors contributed to the high prices as well (Ibid.). As a result, the failure to push trough necessary reforms and enhance competitiveness was met with lowering levels of purchasing power that undermined economic performance. This meant that Greece was still uncompetitive but also lacking domestic demand, which meant a bigger than expected reduction of economic activity.

As the crisis unfolded, Greece was eventually offered a €110 billion rescue package by the Eurozone countries and the IMF in the spring of 2010. Following the conditionality requirements of the loan package, Prime Minister Papandreou announced further austerity measures, which (along with the austerity policies announced prior to the bailout package) prompted a general strike by the trade unions. (BBC News) What was then required from Greece? In general, the conditionality of the loans required Greece to implement privatizations, spending cuts and structural changes to its economy. As a result, several austerity packages were passed in the Greek parliament, which were often accompanied or followed by protests and strikes.

The austerity budget of 2011, which was approved in 2010, included spending cuts of €14 billion that were composed from: lowering pensions and wages; gaining more income by increasing the lowest sales tax-rate from 11% to 13%; boosting growth by reducing the tax from 24% to 20% of non-distributed corporate profits and cutting the valued added tax in the tourism industry from 11% to 6,5% (Bensasson, Weeks 2010). In July of 2010, the Greek parliament passed a pension bill that unified the retirement age to 65 for men and women alike. Before the bill, some Greeks could retire as early as 50. Moreover, the bill made it possible for Greek companies to fire employees easier than before (Thomas, Kitsantonis 2010).

Another austerity package was passed in 2011 that included 15% cuts to public sector wages (and the aim to cut 150,000 public sector jobs trough a hiring freeze and abolition of temporary contracts), €850 million reduction in new infrastructure spending and cutting social benefits. Furthermore, privatizations were to be applied for the Hellenic Telecom (10% of it being sold to Deutsche Bank) and two port operators (in Piraeus and Thessaloniki) along with the betting monopoly of OPAP and Thessaloniki Water (Wearden 2011). The austerity measures gradually started to take its toll as politicians in Greece became more wary of passing new cuts in parliament in fear of the public's reactions. Consequently, in the 2012 parliament vote, the austerity cuts passed narrowly. Another new round of cuts saw pensions being reduced between 5% and 15% along with another rise in retirement age, from 65 to 67, and some salaries in the public sector were being cut by a third (Labropoulou, Smith-Park 2012).

Martin Wolff highlighted that one of the myths about Greece is that it has done nothing to fix its fiscal imbalances. On the contrary, Greece has actually done more than is usually believed. Between the years 2009 and 2014 the primary fiscal balance was tightened by 12% of GDP, the structural fiscal deficit by 20% of GDP and current account balance by 12% of GDP. Excessive spending fell also. (Wolf 2015) All of this is an impressive achievement in the light of a shrinking GDP, which was shrinking faster than expected and thus lowering the revenue base. The smaller revenue base meant that further cuts had to be made in public spending. (Sapir, de Sousa, Terzi, Wolff 2014, 24-25) It is then a peculiar situation where Greece now stands: the necessary cuts have been made in order to make the balance sheet acceptable for a Euro-country.

However, despite of the cuts, the debt burden of Greece is still huge, which makes the economic future of the country gloomy. Here, the discussion of fiscal multipliers should be presented. With fiscal multipliers the intention is to describe the relationship of what government spending has on the national income. For Greece, the point is crucial because the estimates on spending cuts and their effects on national income are an important aspect of the Troika led austerity program. In an IMF evaluation paper it was noted that fiscal multipliers were underestimated when making growth forecasts (Blanchard, Leigh 2012, 41-43). From the Greek perspective this means that the effects of the government spending cuts were miscalculated, resulting in bigger than expected negative effects on the national income. To put it bluntly, the austerity policies of the Troika were too harsh and as a consequence poor economic growth has contributed to the rising debt burden. Overall, with record high unemployment rates, future economic growth in Greece seems anything but certain, let alone when combined to Europe’s uncertain economic future with deflation and low demand. Deflation is especially harmful for Greece for one core reason: as the value of money keeps increasing, it means that the debt burden of Greece will “appreciate”.

To expand on the deflation dilemma in regard to Greece, it can have serious negative consequences now and in the future. As the Troika policies are concentrated on spending cuts to a large extent, it has meant that wages have also been cut. In principal, this should mean that firms would start cutting prices, as the labor costs have gone down. Therefore, the overall price level keeps decreasing because of the incremental effect of low purchasing power and cuts in commodity prices by firms. The situation now is one of deflation, which can be the first phase of a vicious circle for the economy. Here, consumers will postpone consumption, as they wait for the price level to drop even further (their money keeps appreciating). Since people keep postponing consumption, it will affect the profits of businesses. The dual problem of decreasing profits and the appreciation of debt (that the businesses might have) means that some firms will go bankrupt while others postpone further investments because of the negative economic environment that does not create enough revenue. Moreover, it does not encourage businesses to take loans, since deflation would just make those loans more expensive in the long run. In addition, the increased risk of lending in the bankrupt ridden economic environment makes loaning money risky for banks even if there were firms that would like to fund themselves with loans. The vicious circle described above is the problem that the Greek economy is having as a result of the austerity policies. At the same time though, the ECB (one of the Troika institutions) keeps pushing more money to Europe in fear of continuing deflation, thus, negating the effect of it by demanding harsh austerity policies that hamper economic growth prospects in Greece (and other Southern European countries).

To come back to the topic of Greece's huge debt burden, the great concern was, along with fears of continuing bond yield spreads, of Greece defaulting its debt. Since some of the European countries had significant investments in Greece, a Greek default would be a highly undesirable scenario. Indeed, the countries that were most exposed to Greek debt were France and Germany: France had a €56,7 billion total lending exposure and €14,96 billion in total government debt exposure, while Germany had €33,97 billion exposure in total lending and €22,65 billion in total government debt exposure (The Telegraph 2011). With such significant amounts of debt being held by the two biggest economies in Europe, a default would pose a danger for the German and French banking sector. As Featherstone noted, the choice was between bailing out Greece or bailing out French and German bank systems (2011, 203). Moreover, there was a certain amount of double-dealing in the way that the debt payments were being conducted. In essence, the Troika institutions that lend the money (IMF and ESM) wired the bailout payments to Greece and after a few days much of the money was sent back as interest payments and principals for the loans. Especially for the European Central Bank, Greek government bonds were a rather profitable investment, since the ECB bought them at a considerable discount and then required the Greek government to pay a comfortable interest rate of 10%. (Alderman, Ewing 2012). Though, the interest rate has been changed since and stands now at 2,6% of GDP (Khan 2015).

Certainly, it was politically easier to impose drastic austerity measures on Greece rather than explain why German and French banks had made risky investments into a country like Greece whose track record included successive deficits. In the eyes of the public (or the voters) in the Northern creditor countries, the Greek economy seemed like a big bubble that eventually had to burst at some point. Even though the prevailing view of Greece was as described in the North of Europe, much of the discussion about Greece and its excessive government spending did not usually disclose the rampant lending by German and French banks that fuelled the crisis in the first place. Thus, austerity measures seemed logical, from the perspective of Northern Europeans, as Greece was ushered to reform its economy that was partly built on foreign debt. Eventually, the narrative of Greece, and Southern Europe as a whole, evolved to one that revolved around national stereotypes. Moreover, these stereotypes played a role in the overkills that were seen on both sides of the North-South spectrum: in Germany two members of the parliament suggested Greece to sell its islands to pay off its debts (Inman, Smith 2010) and in Greece German chancellor Angela Merkel was pictured along with Nazi symbols (Flock 2012). Such demonstrations showed that there was still a long way to go before achieving European solidarity, which is something that would have been needed after 2010.

The military expenditures of Greece have also added an additional twist to the austerity program discussion. At the same time when Greece is undergoing significant spending cuts and trying to turns its deficit into a surplus, its military expenditures constitute 4% of its GDP. There is an element of hypocrisy to the defense spending as well: a little under 15% of Germany's total arms exports head to Greece, which is its biggest market in Europe. France is another beneficiary of Greece's excessive defense spending with 10% of its total arms exports going to the country. It is equally of concern that some German arms exporters were found to have bribed Greek officials in order to secure arms deals. (Smith 2012) Admittedly, Greece's defense spending is not on a sustainable level at all, especially in its current economic situation. It is still questionable to keep selling Greece new weaponry as it is struggling to stabilize its economy by, basically, worsening the living standards of its people trough internal devaluation. Furthermore, exploiting a flawed and corrupted sector, knowingly, for profit is a significant moral hazard. Surely, from the Troika's point of view, cutting the military spending of Greece would be a high priority–unless there are underlying interests in play.

In the heated discussions about Greece, it is easy to forget that there were other actors outside of Europe that had a contribution to the situation as well. What is sometimes difficult to understand about the crisis is that it includes several different aspects: a national (the apparent problems of the Greek state and economy), a regional (the Eurozone and its skewed institutional framework) and a global (failure of the international financial system) aspect.
The interconnectedness of the regional and global aspects is an important one to address. In principle, the EMU rational of rule-based surveillance and national self-responsibility eventually failed, because, ultimately, the evaluation of a Euro-country's economic performance was in the hands of the international markets (Featherstone 2011, 211). Put in another way, the view of rationally operating markets did not include the possibility that those same markets could cause imbalances despite the countries following the EU criteria (not in the case of Greece but with Spain and Ireland). Attempts were made afterwards to fix the imbalance problem by the Excessive Imbalance Procedure, which aimed to solve the problems of both excessive deficits and surpluses. Interestingly, the latest report puts Germany in the category of which requires monitoring and decisive policy action (European Commission).

It should also be noted that the international markets, such as the infamous Goldman Sachs, helped to mask the government debt of Greece (Story, Thomas, Schwartz, 2010). Therefore, the mismanagement of the Greek domestic economy, being a tiny proportion of the total economic output of the Eurozone, suddenly affected every other Eurozone country. The significant impact of Europe in the international financial markets meant that the state of the Greek economy was of global interest, as the system was still recovering from the 2008 financial crisis. Therefore, the crisis is much more than a simple failure of the Greek economy, which is why the repercussions were as big as they were.

For the remainder of this chapter, it is necessary to progress to the phase were the Troika policies are evaluated. A study by the European Parliament's Economic and Monetary Affairs Committee noted that one of the key failures in the austerity measures has been over-confidence in the initial conditions. The report also pointed out that the Troika expectations about the effectiveness of the Greek government system were too optimistic (Sapir, de Sousa, Terzi, Wolff 2014, 26). The report specifically mentioned Greece, together with Portugal, suffering from weak structural conditions when compared to Ireland and Cyprus. Furthermore, it was noted that the structural weaknesses make it difficult to assess the sufficiency of the reforms. (Sapir, de Sousa, Terzi, Wolff 2014, 5) In general, the report found the Troika program in Greece to be the least successful one (Sapir, de Sousa, Terzi, Wolff 2014, 23). The reports comments support the general argument of this paper that Greece is not politically as developed as the Eurozone's Northern counterparts imagined it to be.

In a 2014 spring report, the IMF saw glimpses of positivity in the Greek economy. As already highlighted, the IMF recognized that Greece had made significant progress in rebalancing its economy. Progress, the report mentions, had also been made in implementing product and service market liberalization, which had been previously lagging behind. Though, the initial success of labor market reforms was reported to be falling behind the wanted targets. On public administration reform the progress was depicted as mixed. Furthermore, the report makes an excellent point in noting that the authorities need to be cautious against any pressure to rewind the progress that had been made on reforms. (IMF 2014, 1)

Here lies the real danger of the severe austerity program. Although necessary reforms might have been achieved, the protest mentality against the program might lead to a situation where the next government might be so radical that it could negate the reforms. Indeed, the current left-wing government, headed by Prime Minister Alexis Tsipras, of Greece rose to power by promising to end the austerity measures (BBC News). Given Greece's weak administrative system, the political pressure from the government would be too much for the officials in the ministries. It is crucial that there is a sufficient amount of public support for the reforms. Indeed, to IMF's credit, it did notice this dilemma about the Greek crisis: "There are also political economy lessons to be learned. Greece's recent experience demonstrates the importance of spreading the burden of adjustment across different strata of society in order to build support for a program." (IMF 2013, 2).

Pisani-Ferry, Sapir and Wolff have made remarks on some of the reasons why the Troika-program has been so unsuccessful. They highlight six possible factors affecting the negative outcome: the external environment, Euro-area policies, insufficient implementation by Greek authorities, debt restructuring, excessive fiscal austerity and the limited weight given to structural reform and competitiveness. (Pisani-Ferry, Sapir, Wolff 2013, 64) The underlying problem with the Troika-program has been its nature as a double-edged sword:

acquiring fiscal stability goes against the other target of acquiring competitiveness (Pisani-Ferry, Sapir, Wolff 2013, 72). More specifically, as the economy's inclination is to correct its competitiveness trough wage and price cuts, it will result in a recession. This, then, goes against the aim to acquire financial stability, since cuts in wages undermine economic performance by decreasing demand. Though, wage cuts and structural reforms did not boost export rates as much as it was originally assumed. Within the Eurozone, the possibility of devaluing the currency is impossible meaning that the competitiveness dilemma, vis-à-vis fiscal balance, will persist. Therefore it seems that the Troika greatly overestimated the competitiveness of the Greek export sector and the effect that the structural reforms would have in making it more competitive (Pisani-Ferry, Sapir, Wolff 2013, 72). As the export sector provided less help to Greece than initially supposed, it is no wonder that the Greek economy has spiraled into a deep recession given the considerable cuts in wages that undermine demand. Fiscal balance might have been achieved, but one could question its sustainability with huge unemployment rates and a massive debt burden looming in the background.

From a purely macroeconomic data perspective, the solutions of the Troika have been unsuccessful. Government debt, unemployment rates and the GDP of Greece are all examples of poor economic performance. Trade balance has improved, but it was mostly driven by the collapse of imports resulting from decreasing demand in the domestic market (Sapir, de Sousa, Terzi, Wolff, 25). In regard to government debt, it has risen from 171,3% of GDP in 2011 to 177,1% of GDP in 2014, despite there being a debt haircut in 2012 that saw the debt ratio decrease temporarily to 156,9% (Eurostat 2015). In 2013 the debt level had already gone over the 2011 level. The rapid rebound from the 2012 level can be seen clearly in Figure 1.

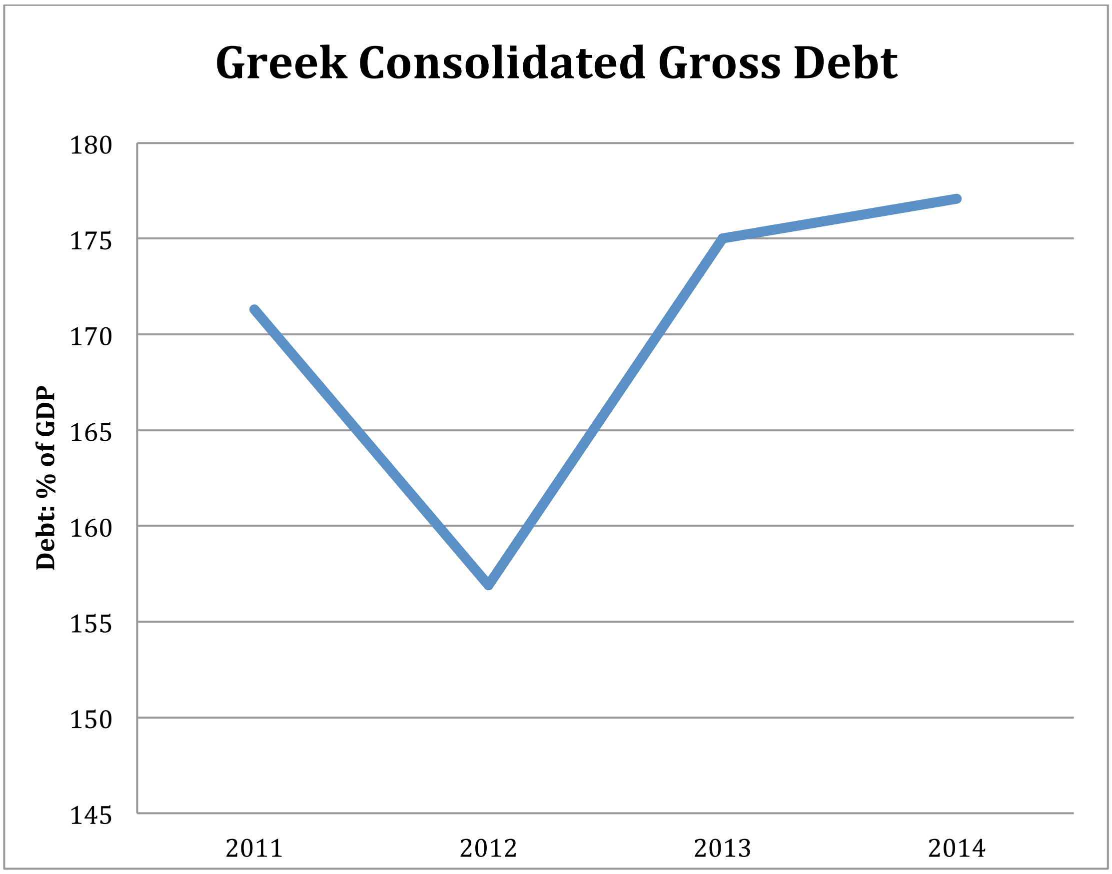

Figure 1. Greek consolidated gross debt
Source: (Eurostat 2015)

Furthermore, the unemployment rate in Greece has risen from 11,2% in 2010 to 24,8% in 2014 in the age group of 25 to 74 year olds. (Eurostat 2015) The rather stable unemployment rate that was present in Greece from 2002 to 2009 rapidly increased from 2010 onwards and has not decreased since then. This long-term progression can be seen in Figure 2. Youth unemployment continued on the same negative trend and seemed to peak in 2013 at 58,3%. It even started decreasing and stood at 52,4% in 2014. (Eurostat 2015) Though, one should be aware that the decrease in youth unemployment could simply be that there is an amount of “brain-drain” as young people move to foreign countries in search for a better future. Otherwise the number does not match with the overall increase in unemployment rates. Figure 3 shows youth unemployment, i.e. the age group of less than 25 years, following Figure 2’s curve.

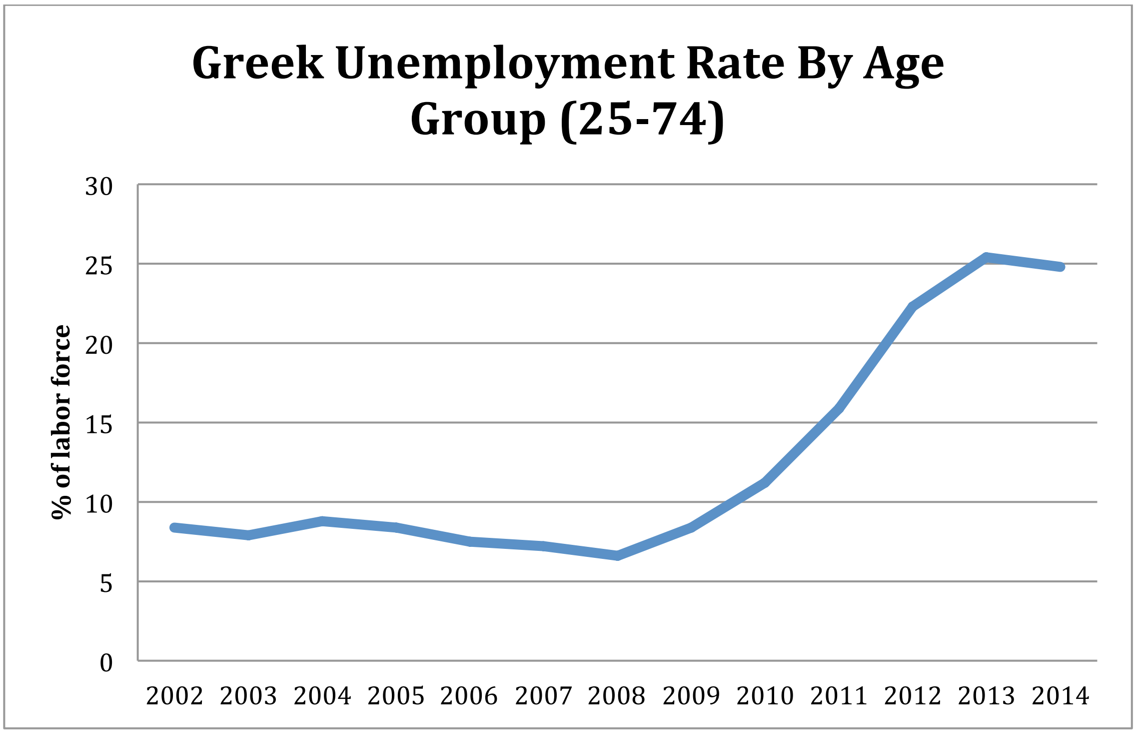

Figure 2. Greek unemployment rate by age group from 25-74
Source: (Eurostat 2015)

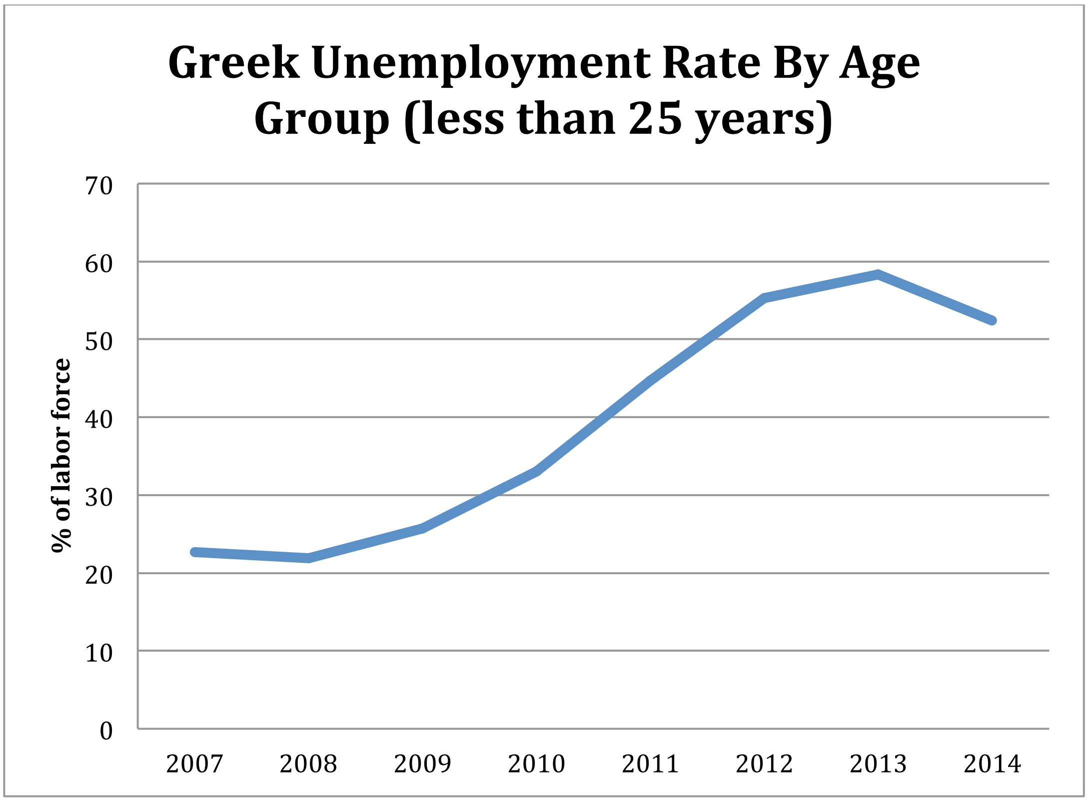

Figure 3. Greek unemployment rate by age group, less than 25 years
Source: (Eurostat 2015)

When it comes to gross domestic product of Greece, it is no wonder that it has decreased in the light of rising unemployment rates. From 2010 to 2014 the reduction in GDP was about 25% (from €226,2 Mrd euros to 180,2 Mrd euros). Figure 4 shows the steep angle of decreasing Gross Domestic Product, showing little positive prospects for the future.

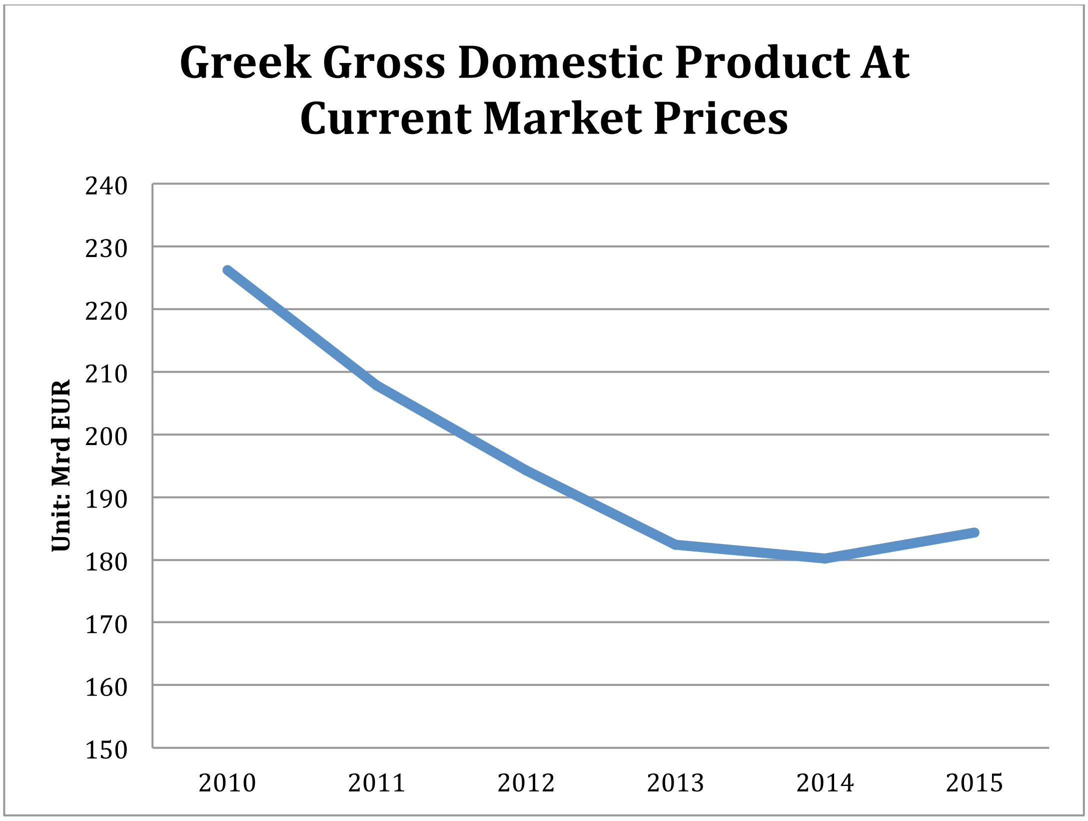

Figure 4. Greek gross domestic product at current prices. Years from 2011-2015 are provisional numbers
Source: (Eurostat 2015)

The conclusion of the Troika program is that it has been a clear failure. Of course, one cannot understate the difficult conditions that the Troika program had to answer in 2010. Greece, by no means, was an easy case to solve, since it was riddled with several economic problems: a massive fiscal imbalance and an uncompetitive economy, which was less open than other European economies of similar size (Pisani-Ferry, Sapir, Wolff 2013, 54). Nevertheless, the orthodox stance on the Greek program can be, in part, explained by the underlining philosophy that seems to be entrenched in the Troika. It can mostly be summarized to a firm belief that spending cuts and structural changes will lead to a healthy economy, despite the governing circumstances in the country. Of course, reforming the Greek economy would be beneficial in the long run, but it should take another form that the current austerity program. The problem is that with a massive unemployment rate and a negative business environment in the European context, such measures seem highly unrealistic to lead to economic growth. After five years of harsh austerity, it is difficult to convince the Greek public of a better future with the rational of further cuts and structural reforms. For them, the message has not changed since 2010.

Finally, it should not be underestimated how difficult and unprecedented these reforms are for the country in question. In the case of Greece, the pension age was transformed in a couple of years from 50 years (though not universal) to 67 years, along with continuing cuts in wages and pensions. To have changes of this magnitude and expect that it would not have any consequences in the political front is baffling. Coupling these changes to negative economic growth and a general sense of hopelessness in the economy is a toxic combination for future prospects. After all, economic performance is also about what is expected about the future.

3. THE DEPARTURE: WHY AND HOW GREECE SHOULD LEAVE THE EURO

Up to this point the paper has presented a critique of the austerity measures and argued that it has had dire consequences for Greece. Furthermore, the simplistic ideology to fix the Greek economy by making structural reforms and ignoring several other factors shows how little knowledge there was about Greece in general or that any such knowledge was deemed unnecessary. It is imperative to understand that Greece is not a Northern European country and measures that might have worked in the North do not automatically translate into successful policies in Greece. Following the critique, a solution to the problem will be proposed: the managed exit of Greece from the Euro. This paper does realize the difficulty of such action and its unknown implications. Nevertheless, outside of the Eurozone, Greece could potentially be more effective in gaining competitiveness.

3.1 THE STRUCTURAL PROBLEMS OF THE EUROZONE

It is necessary to discuss some of the structural problems of the Eurozone in more detail. Especially for Greece, the structure of the EMU is key in understanding the future difficulties that Greece will face if it stays in the Eurozone. From the very beginning of the Economic and Monetary Union, debate has been ongoing on the viability of such a union in a European context. After all, Europe is a collection of very different political and economic cultures, which poses challenges to a union like EMU. Questions about taxes, wages and investments are of great importance to states, not to mention trying to harmonize these among a varying set of different interests. One of the core questions in the field of IPE is the relation between states and the markets and precisely this relationship is one that is of great importance to the EMU as well. In Europe, there are states with varying degrees of state-market relationship in the sense how close they are to each other. It ranges from the very liberal market economy views of the UK to the heavily state influenced policies of Greece while having the Nordic model economies somewhere in the middle. To find a common interest among these views is a difficult task to say the least.

In recent history, Europe has had a tendency to favor fixed exchange rates, since experiences of unstable monetary policies in the interwar years left unpleasant memories. After the collapse of the Bretton Woods-system, it did not take Europe long to come up with a framework that tried to harmonize the exchange rates of different national currencies. The "currency snake" and EMS (European Monetary System) were seen as safeguards against currency speculations that were seen harmful for the functioning of the European market. Although, a functioning market does not necessarily need a common currency nor a fixed exchange rate: NAFTA (North American Free Trade Area) is a well functioning market among the US, Canada and Mexico despite the countries having their own currencies. In Europe, Great Britain, Sweden and Norway are examples of successful economies that do not pose a major problem for the functioning of the single European market even if they have floating national currencies. (Korkman 2013, 40-41)

The critique against the EMU's structure, and the Euro currency, has come in many forms: some have described the Euro, as a gold standard that pretends not to be one (Blyth, Ban 2015). Another often repeated critique, that economists especially emphasize, is that the Eurozone is not an optimal currency area. Typically, an optimal currency area is one where the principles of perfect labor mobility, perfect wage flexibility and a risk-sharing system (i.e. a system where fiscal transfers can be made to support a troubled region or a member country) are present (Subacchi 2015). The Eurozone does not fulfill any of these criteria, not even labor mobility. Despite the effortless travelling from country to country, there are some simple barriers that can make it difficult to achieve true labor mobility. For instance, language and culture barriers should not be underestimated, since the differences inside of Europe can be notable, not to mention the differences in social security systems. Therefore, moving from New York to Florida is potentially less of an effort than moving from Finland to Greece where one will face a different language, a different set of cultural values and a considerably different social security system that in Finland is more state managed while in Greece the emphasis is more on the support of the family than the state.

One could also highlight the absence of a risk-sharing system in the context of the Euro crisis. The panic and distrust that culminated in the first Greek bailout package might have been avoided if Greece could have received some form of a fiscal transfer. The initial problem of the Greek government was that it could not receive cheap credit anymore, as the distrust about its repayment capabilities came into question. The very notion of a risk-sharing frameworks existence might have eased the distrust in the markets. In the post-Euro crisis discussion, various risk-sharing systems have been proposed such as Eurobonds (a shared government bond system between all of the Eurozone members) and a common fiscal policy authority (a fiscal policy equivalent to the ECB). Indeed, the theory of an optimal currency area requires coordinated fiscal policies from the national governments within the monetary union to offset the effects of a common monetary policy (Financial Times). With a coordinated fiscal policy, decision about spending and taxation can be used to balance the rigid monetary policy, as countries might be in differing economic situations (Ibid.). Prior to the 2008 financial crisis Tett observed well the reality of the likelihood of any policy cooperation: "…when it comes to the crunch, European governments are truly hopeless at co-ordinating themselves." (2008).

An important part of the structural discussion of EMU has been the argument of Europe being separated into an economic core and a periphery. In essence, the core is constituted of Eurozone's Northern countries (Germany, the Netherlands, Austria and Finland) while the periphery countries are primarily the troubled countries of southern Europe (Greece, Spain, Portugal and Italy). For Greek competitiveness, this point is highly relevant. The problem that is often highlighted is that Germany's competitiveness has negative effects to other Eurozone members. Terms such as "wageless productivity growth" have been used to describe the German competitiveness that is driving the less competitive Southern countries to bankruptcy (Blankenburg, King, Konzelmann, Wilkinson 2013, 465). Outside of the Eurozone, countries like Greece would have devalued its currency in order to catch up with the German competitiveness. Since devaluation is not a possibility, Germany's strong wage-restraint policies, and its traditional strength in high-technology infrastructure, drives down the unit labor costs of the country so significantly that it undermined the traditional low labor-cost advantage of Southern Europe. (Ibid.)

This unequal competitiveness formulated imbalances in the Eurozone that were most evident in the trade imbalances in the less competitive south. In more concrete terms, more imports were coming to the south than exports were going to the north. The cheap credit that was available (in the case of Greece it was financing both the public and private sector) boosted wages in the periphery and thus increased the flow of imports. As wages kept on growing and devaluation was not an option, the competitiveness of the South shrunk gradually. Though, it did not come up as an issue until the credit crunch arrived in 2008 as a result of the global financial crisis. When examining Greece, in 2010, the trade balance of the country was -22,5 billion euros, being less than the -34,8 billion euros in 2008 (Eurostat 2105).

The problem with these balances is that it creates an unsustainable situation to the Eurozone where countries have uneven starting points to enhance their competitiveness. It should be noted that the German policy of maximizing trade surpluses is actually harmful for the countries in the periphery. As Chovanec perceptively notes, the euro crisis should be seen trough a bigger lens than the usual debt focused one: “German surpluses and mounting debt in Europe’s periphery were two sides of the same coin.” (2015). In 2014, Germany had a €217 billion surplus that mostly consisted of the trade deficits of Southern Europe. Basically, German loans were financing the periphery to buy German goods (Ibid.). Perhaps more political pressure to raise German wages will be ahead in the future, but as long as the rest of Europe is doing poorly there will be little effort to boost German domestic demand. It should be noted here that despite Germany’s decisive role in the surplus accumulation in Europe, countries such as Austria and the Netherlands pursue similar policies in trade. It is also interesting to note that even the traditionally German-minded economy of Finland is experiencing troubles because of the harsh competition coming from Germany.

With the absence of exchange rate policies, the situation is such that for Germany the Euro is cheaper than its own national currency, the Deutsche Mark, would be. However, for the countries in Southern Europe, the Euro is overvalued in regard to what would be needed for them to be competitive enough. In addition, when considering that the whole structure of the EMU is such that emphasizes economic policies of budget surpluses and low government debt, it seems like a bleak place for a country like Greece. One needs to consider the fact that Greece, among its southern counterparts, has an institutional structure that has operated along a demand led economic principle (Hall 2012, 359). To completely reverse it and turn it into a mirror image of Germany’s economic framework is a process that takes more than an austerity program and a few reforms. It would, therefore, seem a more efficient way for Greece to pursue growth outside of the Eurozone. Indeed, the institutional setting of the EMU favors private sector dominance over state intervention, more so than in any other advanced economy (Blankenburg, King, Konzelmann, Wilkinson 2013, 465-466).

For a concluding remark on the structural discussion of the Eurozone, the current surplus led economic doctrine undermines the potential of the European market as a whole. Europe could aspire to even greater growth if the demand side of the economy was working properly, e.g. the way of the US economy. As the second largest economic area in the world, Europe is wasting its full potential. Moreover, the current economic troubles of Europe seem to be connected, in part, to the general absence of demand in the economy that consequently affects investments and economic growth.

3.2 THE FAILED STATE PROBLEM

What is perhaps the biggest problem with a Greek exit from the Eurozone is that the consequences of it would be unpredictable, not only to other Euro-countries, but for especially Greece itself. It is unclear whether the Greek society would find the necessary cohesion to go trough the unavoidable turbulence that the departure from the Eurozone would cause. After all, demonstrations and protests have been a continuous state of affairs since the very beginning of the austerity program. Therefore, before addressing the solution part of this paper, the problematic nature of the Greek executive governance will be highlighted, as it is a highly important factor when considering the validity of a Greek exit. Indeed, with a rather dysfunctional bureaucratic system it is debatable whether Greece could implement reforms that have been difficult even in the current circumstances.

Featherstone and Papadimitriou provide an extensive look to the basis of Greek executive governance. They examine the developments of Greek executive governance after the military junta was abolished in 1974. What seems to be an underlying development in Greek executive governance is that it is still very much a work in progress. Certain elements of governance have only recently been properly institutionalized. For example, it was not until Konstantinos Mitsotakis term in office as Prime Minister, in 1990-1993, that the Ministerial Council was properly institutionalized with a clear set of operational procedures and regular meetings (Featherstone, Papadimitriou 2013, 538). Until Mitsotakis, the Ministerial Council was an elusive entity in the Greek executive.

In a way, the tone was already set during the first Prime Ministers term. Under Karamanlis, the government operated under his personal authority and hands-on management style with a small-circle of competent officials being the main unit of decision-making (Featherstone, Papadimitriou 2013, 533). In essence, Karamanlis led Greece back on a democratic path with his strong leadership capabilities, rather than establishing an institutional framework that would be the backbone and continuity of the state. Following Karamanlis as Prime Minister was Andreas Papandreou in 1981. Papandreou's term was characterized by his lack of interest in organizational matters, frequent government reshuffles and a dislike towards the Ministerial Council (Featherstone, Papadimitriou 2013, 535-536). Overall, one can see that between the years of 1974 and 1989 Greece was still lacking a bureaucratic system that could operate independently without government control.

The terms of Konstantinos Mitsotakis and Kostas Simitis somewhat improved the situation of the bureaucratic system. As already mentioned, Mitsotakis strengthened the institutional base by introducing a code of operation for the ministerial council, indicating rules on drafting and distributing its agenda as well as recording and transcribing its proceedings. Simitis, in turn, was successful in pursuing an institutional reform and establishing a more collective model of decision-making. Despite of his success, Simitis was not able to complete transform the executive governance into a fully functional entity. This was vividly displayed by his continuous presence in the Olympic Games Inter-Ministerial Committee in order to make sure that the projects were progressing in a timely manner. (Featherstone, Papadimitriou 2013, 537-541)

The Greek way of managing a government entity and its bureaucratic functions seems still to require a form of hands-on supervision to make sure that the necessary policy targets are met. One can see the immediate problem here: not even the most productive individual could supervise every aspect of the Greek government. Furthermore, the Prime Minister has a limited amount of influence on reluctant ministers (low concentration of horizontal power) and, within ministries, a lower level official can block orders coming from above (low concentration of vertical power) (Wade 2012). As can be interpreted from the above remarks, Greece's institutional structure does not support the implementation of ambitious political reforms. What would be needed for such reforms to go trough would be a reform minded Prime Minister who would be willing, and able, to push trough those reforms. As if this was not enough, the Prime Minister should also enjoy a government wide trust on his political agenda so that a reluctant minister would not block policy reforms on the ministerial level. Against this background it is no wonder why policy reforms have been so unsuccessful during the Troika program.

The overall problem is that the constitutionally powerful role of the Prime Minister is diametrically opposed to his actual power to push trough reforms. The Prime Minsters office in Greece has a limited amounted of resources (the Irish counterpart has twice the amount of staff) and is also hindered by the independence of the ministries (having authority in their own right rather than being delegated by the Cabinet). Moreover, what is concerning for the day-to-day functioning of the bureaucratic system is the lack of coordination, monitoring and planning present. (Featherstone, Papadimitriou 2013, 525) Thus, the Greek style of governance raises questions about the successful management of a post-Euro Greece without outside assistance. Moreover, the inefficiency of the core executive functions also sheds a light to the problematic implementation of the Troika reforms.

To put the apparent lack of progress into perspective, it should be remembered that Greece has not been democratically ruled for that long: the first democratic handover of power was in 1981(Featherstone, Papadimitriou 2013, 534). Certainly, the political question about Greece and the Euro is less clear than the economic one. Nevertheless, a Greek exit from the Eurozone could be done in a managed way. This would ensure a more effective way of gaining a competitive economy, but also provide the necessary external supervision and guidance to reform the political sphere that is ineffective. Under the current circumstances, where the economic future looks bleak and the supranational supervision has considerable power over Greek politics, the consequences can be unpredictable. In the 2014 conflict barometer, Greece was the only EU country (along with Northern Ireland in the UK) that had cases of violent conflicts in the country (Conflict barometer 2014, 32). Indeed, bomb attacks and paramilitary trainings hold by radical groups on the left and right side of the political spectrum (Ibid.) paint an image of country that is a powder keg ready to explode. Furthermore, high unemployment rates are a fertile ground for radical groups to prosper even further.

3.3 THE MANAGED EXIT OF GREECE

The intention of this paper has been to point out that the austerity policies, which were imposed on Greece in return for the bailout packages, have largely been unsuccessful. Moreover, the paper has tried to explain some of the reasons why the austerity measures have failed. The problematic structure of the Eurozone, from Greece's point of view, has also been highlighted in support of the argument of a Greek departure from the currency union. Although the political problem of leaving the EMU might be more substantial than initially assumed by the paper, it still does not rule out Greece's a managed exit from the Euro. Indeed, the following section argues that the managed exit of Greece can be done if there is a carefully formulated plan for it. To emphasize one point in particular, Greece's departure from the currency union does not mean that it would go out of the European Union. It is highly relevant for Greece to stay in the EU to limit the political implications of the departure.

Most importantly, the exit should be a joint operation of Greece and an external institutional actor, which would fulfill the role of a supervisor and an advisor. As there has been a five-year learning curve in the working relationship of the Troika and the Greek state, it would provide a good starting point for cooperation. Moreover, the new plan for Greece would emphasize more the institutional reforms of Greek governance and the reformation of the economy than prioritizing the balance sheet (admittedly needed balancing post-2010, though, the timetable should have been more reasonable). A reference point to this type of a managed politico-economic state reform would be the policies that the US was advocating after World War II. The investment led policies, referred sometimes as the "Marshall plan", was aimed at rebuilding Europe both economically and politically, since economic growth was crucial in reconstructing the war torn societies. A similar interconnectedness of economic growth and political stability is present in Greece. Certainly, this reference point is just to highlight that a new approach towards Greece should occur on more equal grounds. This is important because the magnitude of reforms that Greece should go trough is notable and requires efforts from the whole society.

Currently problematic for the European Union is that the Troika process is quite ambiguous in nature and puts Greece on a state of a victim, which can be used to fuel anti-European sentiments in the country. If the whole process would then be reframed to give Greece more of an equal stance on the process, it could encourage Greek efforts to push trough reforms. With the current state of affairs, it seems more that outside actors are imposing measures on Greece while the Greek people suffer. In addition, the measures are conducted for the sake of promises of a better future, though, the public not seeing such progress after four years of spending cuts. The key is to acquire public support for the reforms and such support seems more likely to materialize if the public recognizes that the future of their country is in their own hands. Above all, the program for Greece should be spearheaded by measures that would create jobs and acquire a stable rate of economic growth.

When considering the interconnectedness of the economy and the political climate in Greece, it would be easier to reform Greece if it could have the necessary monetary policy measures to improve its competitiveness. To continue on the negative growth path and high unemployment rates is a political kingmaker to radical parties in the country. Thus, with a newly introduced drachma, Greece could again devalue its currency and close the competitiveness gap that has emerged since it entered the Eurozone. If Greece stays in the EMU, the probable scenario will be that the unit labor costs of Greece will again rise above the ones in the more competitive Northern Europe. This is because the absence of a centralized wage bargaining system in Greece will ensure that wages will again start to rise, which will erode the competitiveness yet again. However, the rise would not be as fast as before, since excess capital would not be flowing into the country at the same amount than prior to the 2008 financial crisis. Nevertheless, Greece (along with Spain, Portugal and Italy) has inherited unmanageable labor movements that make wage co-ordination difficult (Hall 2012, 359). This domestic environment is problematic for Greek competitiveness when compared to Germany for instance. The nominal unit labor costs reveal that the afore-described competitiveness loss was a statistical fact prior to 2010. A graphical representation of the nominal unit labor costs between Greece and other relevant countries (Spain, Portugal, Italy and Germany) is represented in Figure 5. Here one can see the significant gap between Greece and Germany before the 2010 crash in unit labor costs in Greece.

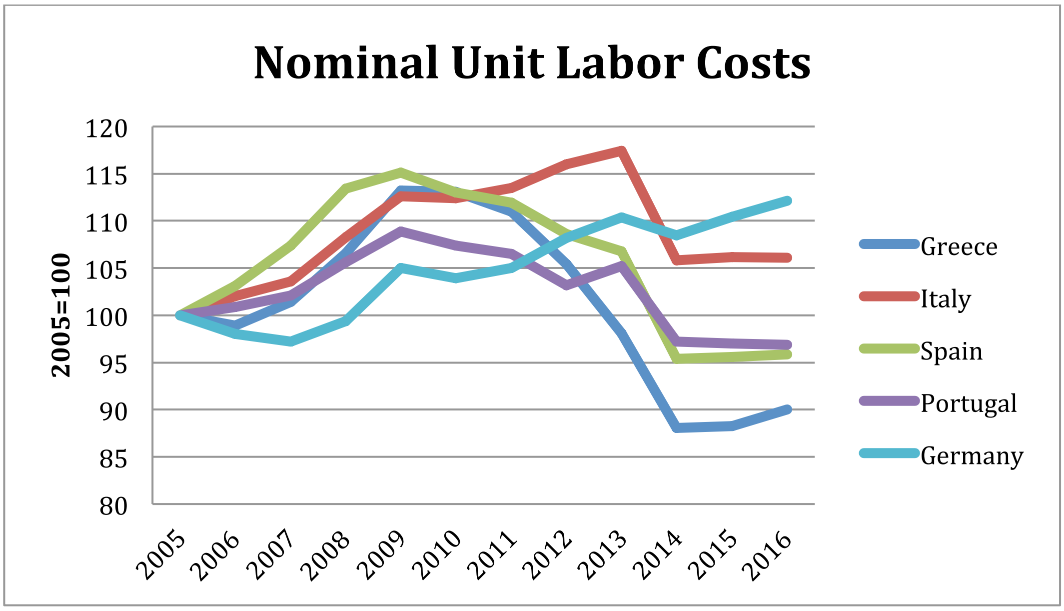

Figure 5. Nominal unit labor costs of Greece, Italy, Spain, Portugal and Germany
Source: (Eurostat 2015, AMECO)

Without the possibility to devalue, Greece would again face the harsh circumstances of an internal devaluation, i.e. mass unemployment, which would have unpredictable consequences. More precisely, one can see the consequences of the inner devaluation in Greece currently with record high unemployment rates and radical parties, such as the neo-Nazi Golden Dawn, gaining support. In the long run, this is not a sustainable solution for Greece, since it hampers any prospects of credibly reforming the society. Moreover, it would be in the interest of the European Union to find a lasting solution to the Greek crisis. With the new left-wing government in Greece approaching Moscow for solidarity that it is not receiving from Europe (Walker 2015), it clearly signals that all is not well in the working relationship between the Troika and Greece. Even if the approach was only a political maneuver to pressure the Troika to relax its tough stance on the conditionality requirements, it does not bode well for the future. Europe should also be aware of the growing Chinese presence in Greece, which is evident by the lease agreement that the Chinese government owned business made to acquire half of the port of Piraeus (Alderman 2012).

A Greek departure from the Euro would undoubtedly raise concerns in the markets. The volatile nature of the departure could somewhat be overcome with a careful management of it. If the departure has the consent of all parties involved and a clear objective, it might ease the transitional phase. Still, capital controls should be imposed, since a bank run would be inevitable after a Greek exit. In addition, the Euro would appreciate as a result of the Greek departure and the debt burden of Greece would become unmanageable, though one might argue the case being so already.

When considering the significance of the debt, Alcidi, Giovannini and Gros provide an interesting comparison study between Argentina and Greece. The study highlights the unsustainability of large debt burdens by giving an example of Argentina, which had a similar situation as Greece now has. Furthermore, the authors highlighted the unsuccessful nature of austerity measures to resolve the debt burden issue in Argentina (2011, 1-8). Therefore, it seems only a matter of time when the debt burden will have to be resolved on a permanent matter: at some point the creditors of Greece will probably decide that it is not realistic for Greece to pay the debts, as the economic growth is insufficient. A debt default would therefore be needed. Moreover, for Greece, the EMU's structure concerning debt payment is unfavorable because it tends to prioritize the interest of private bondholders over states (Blankenburg, King, Konzelmann, Wilkinson 2013, 466).

An ambitious investment program should be initiated as part of the Greek exit to make it evident that there is a real tangible growth plan for Greece. The investment plan would include long-term programs for investments to potential industries in Greece. The way this would work would be that a body of outside specialists would investigate the potential industries in Greece where investments would be made. These investments would also be part of the program to not only broaden the Greek export base, but also create jobs and economic growth. Such investments efforts are crucial if there is to be a credible growth plan for Greece, and Europe, in the future. Consequently, a European Union managed investment package would encourage further investment from reluctant businesses. This is especially true in the case of Greece. Whatever strategic plans the Chinese might have in Greece, by simply updating some of the infrastructure in the Piraeus port it managed to improve its effectiveness considerably (Alderman 2012).

In order for the current bailout program to work, the Troika-policies should do a complete about-face. Based on the notion of how much time and effort has been dedicated to formulate the current institutional setting of EMU, it is highly unlikely that policies would be reconsidered simply because they do not seem to work for Greece. The narrative in the Northern European creditor countries of reckless government spending, surely a part of the problem, being the fundamental problem in Greece misses a relevant part of the general discussion of the uneven structure of the Eurozone. Above all, the lack of solidarity is a lasting problem in the Eurozone and will hinder effective solution making. Asymmetric shocks will likely happen in the future also and the absence of an effective risk-sharing system will make it difficult to control such shocks. As Tett insightfully noted, economic nationalism is likely to prevail when financial crises are considered (2008). All of the above considered, Greece could develop more effectively outside of the Eurozone, though remaining part of the European Union to limit the political repercussions.

CONCLUSION

The objective of this paper has been to examine if Greece would be better off outside the Eurozone economically and politically. The conclusion is that Greece should go out of the Eurozone in order to develop its economy and political governance more efficiently. The departure should be done in a managed way to ensure that Greece does not end up as a failed state. A better economic future is essential for the country to move forward and such a future is unlikely to happen under the current circumstances. It is highly doubtful that Greece could go trough significant structural reforms under the governing economic environment. Furthermore, the inefficient executive branch and the lack of social cohesion are noteworthy obstacles for reforms. Most importantly, Greece is a unique case with problems that are deeply rooted in the functions of the society. It is therefore important to distinguish it from the other troubled European economies in Southern Europe.

In essence, the current solution offered to Greece has lead to a dead-end: the Troika managed austerity policies imposed on Greece have not resolved the problems of the Greek economy. In addition, the current program has been a failure because it has concentrated on the wrong measures, namely, spending cuts and structural reforms instead of creating jobs and economic growth. Moreover, the program has not addressed the urgent need of state reform that would enhance the capability of the Greek government to tackle problems such as tax evasion and vested interests in the economy. The underlying belief in a freely operating market economy, that is rational and perfect, has guided the logic of the Greek bailout program alongside the desire to have Greece repay its debts. This simplistic line of economic thought eventually clashed against the harsh reality present in Greece. The dysfunctional executive governance and the uncompetitive economy are of greater concern than the balance sheet. Without addressing these core problems of Greece the Troika program was doomed to fail from the start.

The unequal structure of the Eurozone has been brought into the discussion to highlight its negative implications to Greece in the form of poor economic competitiveness now and in the future. The absence of individual monetary policies in the currency union will ensure that Greece cannot shrink its competitiveness gap by means of devaluation nor does it have the necessary domestic framework to implement wage-restraint policies that would be needed. Indeed, Greece is currently without credible options, which makes the membership in the Eurozone unreasonable.

Politically, a Greek departure from the Euro would have unpredictable consequences. The paper has pointed out that it is uncertain whether Greece could cope with the, admittedly, challenging circumstances after a departure from the Eurozone, since social cohesion is weak in the country. After closer examination, this political dilemma proved to be somewhat more problematic than initially supposed. However, the managed exit of Greece addresses this political conundrum sufficiently because Greece would stay as a part of the European Union and there would be a supervisory role for the current institutional setting, i.e. the Troika. External supervision and guidance is important for Greece to start from a clean slate.

Above all, Greece needs a new plan that is very different from the current austerity minded one. Emphasis should be put on investments that would create jobs thus lowering unemployment rate and securing a better economic future. After being on a stable growth path, the reforms of the society would start to take place. Securing domestic support is vital if any reforms are to be made and such solidarity cannot be achieved under the current economic environment. Understanding the interconnectedness of the economic and political sphere is key in resolving the Greek crisis that has reached inhumane levels. The lack of positive expectations in the economy can create a vicious circle that affects the economic and political spheres of the society and lead to unexpected consequences.

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