17 Lessons from Greece's sovereign debt crisis

We have identified and analysed in detail the critical vulnerabilities and factors that shaped and exacerbated the sovereign debt crisis. We have explored the vulnerabilities that could accumulate in the run-up to the crisis; until the crisis exploded. We have seen how it unfolded and how the EU institutions and the IMF, as well as Greek authorities have struggled to fight the crisis through the economic adjustment programmes. We have asked ourselves what has worked, what has not, why the ensuing depression has proved so painful and why so long. It is necessary now to consider what lessons can be drawn from the crisis and resulting intervention by the EU institutions and the IMF to forestall any future policy mistakes. This could help to address the challenges that lie ahead – a possible deterioration of residual vulnerabilities or potential risks and, furthermore, provide useful insights, enabling policy makers in the future to identify and correct in good time unsustainable macro imbalances, thus preventing a recurrence of such crises. We hope that an analysis and evaluation of the lived experience before, during and beyond the crisis will help Greece internalise some lessons; keep memories alive; and escape the ravages of a new and damaging crisis in the future.

What then does the lived experience of 2009-2018 teach us about such crises? There are many lessons to be drawn, but the one that is central is this: a financial crisis can prove to be devastating even when the response benefits from generous financial and other support coming from the EU and the IMF. It is widely recognised that *"prevention of a crisis is better than cure"*. Although few crises are truly inevitable, we learn this in retrospect. Danger lies in over-optimism: in inferring what the future will bring from the good times of the past, hoping that they will recur. All solutions carry costs. Although it could have been much worse, the crisis was extremely damaging, for both Greece and the EU. The best way to reduce the damage from a crisis, if we cannot prevent it, is to identify the symptoms of the crisis when it is brewing and to respond *immediately*, *decisively* and *aggressively*; one must raise the alarm and get started with solutions before conditions unravel and things get out of hand.

Experience demonstrates that crises tend to follow a standard pattern. It is possible, therefore, to read the warning signs and start working on solutions before the crisis erupts. One reason why the sovereign debt crisis proved so damaging to Greece was that both the government and the EU lacked the knowledge and the needed tools to attack it with greater force from the beginning. Though there may be no way to stop a crisis once it is under way, there still is a great deal that policymakers can do to allay it or make it less likely to spin out of control. In 2009-2010, both the newly elected government of George Papandreou and the EU institutions failed to detect the risks of the looming crisis. They were not duly prepared for the crisis and rather slow to act. This helps explain why the crisis erupted so fast and why efforts to quell it proved so inadequate. Better preparation and a quicker response could have produced a better outcome.

From the time the enormous fiscal deficit raised questions regarding the sustainability of Greece's high and growing debt, it was clear that the challenge was huge. With a rapidly deteriorating economic crisis, having reached the brink of default, there was very little that Greece could do single-handedly to mend its economy and manage its finances. Manifestly, immediate coordinated action was needed to deal with this conundrum. In the event, very little was done for fully seven months. In fact, both the Greek government and the EU institutions greatly underestimated the growing serious risks of a sovereign default. Few were ready for the crisis or were prepared to respond quickly and decisively – both in identifying the crisis when it was brewing or in helping policymakers with the necessary tools to attack it with overwhelming force, before things deteriorated. Therefore, the initial efforts to contain the crisis proved ineffective. Relying on budget cuts was probably insufficient to put things right. As a result, concerns about fiscal sustainability mounted and market sentiment vis-à-vis Greece deteriorated sharply, triggering a deep confidence crisis.

Initially, as we have seen, the EU institutions were reluctant to intervene. It was only in the face of an impending default that agreement on creating a collective funding mechanism could be reached. The combined efforts of the European institutions, the IMF and of the Greek authorities were ultimately dynamic and effective enough to produce the needed outcome. As the crisis unfolded, so too did their efforts to contain it. But their actions took too long to restore a sound and sustainable economic and financial situation in Greece. As earlier discussed, three Economic Adjustment Programmes were implemented over the period 2010-2018. The three programmes consisted in providing loans, conditionally on implementation of the reforms. A total of 288.7 billion euros were disbursed to the country on favourable terms under various pools of funds.

All programmes had the shared objectives of helping to correct unsustainable imbalances and stabilise the economy, restoring both growth prospects and the country's capacity to finance itself fully on the financial markets. Though eventually successful, the policies were not able to shield hundreds of thousands of people from impoverishment through loss of income, jobs and security. All in all, the Greek economy suffered the deepest and longest economic recession than any advanced economy to date. Because of the crisis, the Greek political system was deeply shaken. Social exclusion soared and scores of highly skilled, mostly young people of promise, left the country for good.

As noted earlier, one reason why the crisis proved so damaging was that the Greek government and its European partners lacked the means required to address it forcefully from the start. A prompt advance of the crisis management and resolution regime of the euro area should have been a strategic priority for the EU. The architecture of the euro area – at least initially – relied on the primacy of crisis prevention (such as prevention and correction of excessive public deficits). By contrast, no procedures were in place for crisis management and resolution.

After eight years and many iterations, involving politically difficult decisions for both Greece and its European partners, Greece ultimately succeeded in stabilising its economy and getting it growing again after a long and deep depression. Imbalances in public finances and the current account were gradually reversed, due to a large fiscal adjustment. These strengthened fiscal credibility and reduced uncertainty. Thus, Greece, with help from the EU institutions and the IMF, managed to limit the extent of the damage to the country. Still, the crisis proved devastating, causing profound and persisting traumas on households, institutions, businesses, as well as on the broader economy. GDP declined by more than a quarter compared to its pre-crisis level. The public debt remains still very high and a source of significant vulnerability. Poverty rose sharply during the crisis and stands at a near-record high. However, the outcome would have been much worse without the joint and determined rescue efforts that the EU and the IMF were eventually able to mobilise. Manifestly, a major lesson that flows from the crisis is that, once it becomes clear that a crisis is systemic, ending it as fast as possible should be the top priority. Crisis managers must do everything within their powers to quell it, regardless of the short-term party-political cost and irrespective of ideological tenets or of the party narratives (e.g. Papandreou's statement in 2009 that "cash is not a problem"). The policies of financial rescue are painful and hard to bear but the consequences of persistent financial and economic crises are much worse.

Unfortunately, contrary to such other crisis-hit countries as Ireland and Portugal, there was in Greece no broad political support for the economic adjustment programme from the outset. From the start, the programme was resisted by the opposition parties, as well as by deeply entrenched vested interests and from the public at large. Of course, one can well imagine why the population at large did not accept the Troika's response to the crisis as either necessary or indeed legitimate. It was unavoidably tough and, in some respects, not well designed. Neither the European institutions nor the Greek authorities had any experience in managing a crisis of this magnitude and complexity. It is hardly an overstatement that both of them reacted to the crisis without a clear road map. They were engaged in a "learning by doing" exercise, having to deal with an unprecedented situation and feeling their way out of the woods. And while it may be impossible to get people to accept wage cuts or a reduction of pensions and other painful measures, the government and institutions did little to explain to those directly affected the merits of their proposals.

In apportioning blame for the crisis, it pays to explore *why*, during the whole decade preceding the crisis, policymakers failed to forestall the impending threat. Running like a thematic thread is the realisation of failure to keep pace with the changing economic realities following Greece's entry into the euro area and the rapid transformation of the business environment in which the Greek economy would henceforth be operating. At this juncture, it is worth recapitulating why the economic situation was so precarious before the 2009-2010 crisis, because it sheds light on a path towards greater safety now. As we have seen, Greece faced a sovereign debt crisis in the aftermath of the global financial and economic crisis of 2008-2009. It was not that Greece was caught up in this major transatlantic crisis. As has been argued earlier, the global crisis was, at best, an indirect contributor to the built-up of systemic risk in Greece. The country suffered less than other European countries from the early consequences of the transatlantic financial turmoil. This was because its banks had mainly operated locally and were not exposed to the toxic assets which lay at the root of the international storm. A conventional business model and large deposit support at home had also been of help to Greek banks. As also argued earlier, the seeds of the disturbing events of 2009-2010 had been sown over decades. The crisis took hold of the country because of the precariousness of its domestic economic position when the world economic crisis struck. The first impact of the crisis was mainly indirect, spurred on by the country's initial conditions and its own long-standing accumulated problems. These stemmed from repeated fiscal slippages and large imbalances on both its fiscal and external accounts.