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EMU and the Greek crisis: Testing the extreme limits of an asymmetric union

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Abstract

EMU structural asymmetries contributed directly to both procyclical debt-fuelled growth pre-crisis and sharply recessionary adjustment post-crisis. Greece's fiscal and debt crisis represented an 'orthodox' national failure inside EMU, yet the underlying reason for the Euro Area financial crisis was external imbalances generated by EMU asymmetries. Exclusive reliance on internal devaluation, lack of a Euro Area countercyclical response, and financial fragmentation, all accentuated the cost of asymmetric adjustment to crisis. The asymmetric EMU institutional framework also necessitated a greater reliance on intergovernmental activism to engineer ad hoc interventions, at the expense of both the Community method and democratic procedure. Financial markets mispriced sovereign risk, failing to counterbalance EMU asymmetries. The Greek crisis prompted the Euro Area to develop stronger policies and institutions, and to eschew an extreme existential challenge. EMU is stronger at 20, yet with persisting asymmetries, old and new, and insufficiently equipped to face the next major crisis.

Keywords: Economic and Monetary Union; European Union; crisis; Greece; structural asymmetries

Introduction

Of all EMU member states, Greece has been arguably the most profoundly affected by European Economic and Monetary Union (EMU). In the 1990s, the *vincolo esterno* (Dyson and Featherstone, 1996) of EMU nominal convergence targets generated a benign framework of externally induced discipline, which allowed Greece to eradicate double digit inflation and deficits and join the single currency on 1 January 2001, two years later than the first group. In the pre-crisis period under EMU, the single currency combined with financial integration and liberalisation led to massive capital inflows that sowed the seeds of Greece's unsustainable foreign indebtedness and 2010 crash. Under the bailout conditionality programmes, sharp austerity and externally imposed reforms transformed the Greek economy and society like no other Euro Area member state.

But Greece's crisis also triggered a profound transformation of EMU: first, by exposing its construction defects, asymmetries, and failures; second, by accelerating policy initiatives and reforms which, under normal circumstances, would have taken many years or decades to bring about. In that sense, by severely internalizing adjustment to the crisis, and by serving as a catalyst for far-reaching EMU institutional and policy innovation, I would argue that the Greek crisis in effect helped bolster integration in the Euro Area. Third, by demonstrating the inadequacy of the Euro Area crisis management and post-crisis architecture (inter alia, the lack of fiscal capacity and an incomplete Banking Union (see Howarth and Quaglia 2020), the challenges raised by the Greek crisis continue to sustain the argument for additional EMU reforms. This contribution uses the Greek case to build upon and reinterpret existing literature on EMU asymmetries.

With an admitted degree of generalization, explanatory accounts of the Greek crisis have ranged between two opposite poles. The first focus on the structural causes and political factors underlying the Greek crisis, highlighting the explanatory importance of statism, corruption, rent-seeking coalitions, populism (e.g. Sklias and Maris, 2013). These accounts assign responsibility to long-running national historical structural and institutional factors, occasionally giving short shrift to the unsustainable macroeconomic imbalances that were released by specific government choices in the years directly preceding Greece's resort to the 2010 bailout. The second line of approach, heroically popularised by Varoufakis (2017), points the blame to gravely erroneous political choices made by EU policy-makers and their Greek 'accomplices' in handling the crisis. If the first approach is structurally deterministic, leaving little room for policy choice, the second exaggerates the role of agency and heavily underplays the very limited number of choices actually available in heavily constrained (economically, financially, legal-institutionally) political and policy milieus. This contribution treads a middle path of focusing on the EMU construction deficiencies and asymmetries that multiplied the impact of Greek economic and financial vulnerabilities, while raising the multiple costs of asymmetric adjustment.

Pointing to EMU asymmetries, Howarth and Quaglia (2015) summarized the three 'original sins' of EMU. First, the asymmetry between a complete, centralised, monetary union and an incomplete, decentralised, economic union (see Verdun 1996; 2000, 14; Howarth and Verdun 2020). Second, the asymmetry between monetary integration and lack of a centralised function of financial supervision (Dyson and Featherstone 1999) which was later addressed through the introduction of a banking union. And third, the lack of a (benevolent) hegemon in the Euro Area, given Germany's reluctance to assume a hegemonic role (Bulmer and Paterson 2018), leading to a currency for which no one is responsible (Marsh, 2013).

Asymmetries persisted during the first euro decade. Economic policy convergence did not continue after 1999, and the Euro Area economies followed asymmetric paths which led them to policy divergence (Bearce 2009). Divergent fiscal and incomes policies, associated with non-convergent business cycle indicators, among others made it difficult for the ECB to apply a monetary policy appropriate for the entire region (Lane 2006).

EMU embeddedness in liberalised financial markets implied that some of the asymmetries of an incomplete economic union could perhaps be corrected by the debt markets, assumed to exercise a stabilizing and disciplining role upon governments (e.g. Bernoth, von Hagen, and Schuknecht 2012). Yet fiscal divergence prior to the crisis, even excluding Greece's persistent budget deficits (Bearce 2009, 589), seriously undermined this argument, especially if combined with the strong convergence of nominal interest rates on government debt up to at least 2007. Subsequently, following the debt crisis, the large bond spreads in the Euro Area periphery were not just a result of high sovereign debt levels, but more specifically reflecting default risk associated with currency-redenomination risk (Chang and Leblond 2015). Both instances (pre- and post-crisis) suggest that, instead of counterbalancing EMU asymmetries, financial markets further accentuated them (De Grauwe and Ji 2012).

Complacency and destabilisation inside the euro: from debt bubble to crash

In the run up to EMU and in its early years, EMU seemed to offer a much-anticipated framework of imported stability and growth for Greece. Monetary austerity in the 1990s had been a main driver of stabilisation and convergence. Subsequently, the interest rate decline in Greece substantially reduced debt servicing costs, facilitating fiscal consolidation. Elimination of the exchange rate premium and inflation premium allowed Greek governments to borrow at lower interest costs, euro-denominated debt being perceived as sheltered from default risk. The unprecedented low borrowing costs encouraged debt creation on both the demand and supply side of credit. Greek borrowers (government, banks and private sector) were emboldened to take on more debt, while lenders (international and European banks and market investors) were lured to holding Euro Area periphery debt as a safe investment that would earn them an extra margin of return compared to core Euro Area assets. The savings glut in some countries (particularly the German corporate sector) fed investment in the periphery, including Greece.

Ample and cheap investment capital created opportunities to build productive capacity and address structural deficiencies in Greece. However, it mainly financed an expansion of consumption and the non-tradable sectors. The advantage of low-cost government financing was squandered by the lack of fiscal restraint of the Greek authorities up to late 2009. Both public and private sector indebtedness expanded fueling consumption-driven growth. The economy from the late 1990s began to rapidly increase its foreign indebtedness, as recorded in the persistent current account deficits. The high-growth period transpired without any of the necessary structural reforms—which would become unavoidable after 2010.

Inside the euro, Greek fiscal expenditure grew in a heavily procyclical manner. Greece posted a primary budget deficit every single year from 2003 until 2013, despite an average annual GDP growth rate of 4.1 per cent between 2001 and 2007. Contrary to other countries in the past like Belgium, Greece failed to take advantage of the high growth period to lower its debt stock, which remained above GDP levels. Incomes grew faster than productivity. A highly inflated economy by 2009 faced the inevitable correction, which came with significant overshooting.

The 'hard' Maastricht constraint (fiscal divergence carrying the maximum cost of EMU exclusion) was succeeded by a 'softer' Stability and Growth Pact (SGP), more flexible and politicized after 2005 (Blavoukos and Pagoulatos 2008). The Barroso Commission overlooked the fiscal transgressions of a friendly government, and Eurostat lacked the power to independently audit the numbers presented by a Greek Statistical Authority which (until 2010) remained controlled by the government (Savage and Verdun 2016).

Thus, up to 2009, the Greek situation exposed a number of weaknesses of the EMU fiscal governance regime (see Heipertz and Verdun 2010): (a) the EU authorities failed to bring national statistics under Eurostat control; (b) fiscal rules of the SGP were grossly violated; (c) fiscal governance insufficiently focused on fiscal and debt sustainability, which would have imposed a stronger emphasis on sustaining primary budget surpluses and reducing the public debt during the high growth cycle of the economy.

Greece was a poster child of growing intra-euro underlying imbalances during the first euro decade, and the glaring deficiencies on crisis prevention and (subsequently) crisis management. In addition to the obvious fiscal mismanagement, Greece during its first euro decade diverged in terms of a serious erosion of external competitiveness (Pagoulatos 2019, 63). ECB monetary policy was too loose for the overheating economies of the periphery, whose higher inflation rates (compared to the Euro Area core) were sustained by rigidities in labour and product markets, generous incomes policies contrary to the wage deflation exercised in Germany following the Schröder reforms, and especially massive capital inflows fueling credit expansion and asset price inflation. The EU/EMU institutions were agnostic as to the accumulation of large current account deficits. The official view in the early 2000s remained that, under a single currency, balance of payment deficits are immaterial (Mabett and Schelkle 2015).

The asymmetric operation of the Euro Area pre-crisis engendered an inherent procyclicality. Debtor countries in the periphery were subjected to inflationary capital inflows directed largely to investment in non-tradable sectors, notably real estate, public sector and private consumption, where annual credit expansion rates were most pronounced. There is a further procyclical implication of inflation divergence between the creditor economies of the 'core' and the borrower economies of the periphery. Under a centrally determined nominal interest rate same for all, the real interest rate in the peripheral economies is lower, encouraging further borrowing, further inflation, an appreciating real effective exchange rate resulting in the further erosion of competitiveness. The exact opposite effect is triggered for the core creditor countries, where the higher real interest rates induce further saving, and lower inflation leads to real exchange rate depreciation, boosting competitiveness. As a result, the one-size-fits-all monetary policy contributed directly to EMU asymmetries by further accentuating divergence within the Euro Area.

Post-crisis, the Euro Area pursued a renewed focus on macroeconomic imbalances between member states, establishing (in 2011) the Euro-Plus Pact and the Macroeconomic

Imbalance Procedure (MIP). Their record of implementation, however, has been deficient (Darvas and Leandro 2015) and indicative of the constraints placed upon Commission initiatives by forceful intergovernmental dynamics.

Below the surface of a growing economy up to 2008 lay deep structural deficiencies: an unsustainable pension system, a corrupt health sector, rigid markets, inefficient tax administration, a public sector overwhelmed by patronage appointees. Debt-financed economic growth inside the euro generated complacency and an illusion of perpetual prosperity. Fiscal deficit expansion was a major driver, to which growing private sector liabilities were added, both mainly funded by copious capital inflows. The twin deficit (fiscal and current account), which peaked in 2008-09, summarized the profound macroeconomic destabilisation. Contrary to the debt creation of the 1980s (funded mainly by domestic banks and general government entities), debt-driven growth after the late 1990s was financed predominantly by external capital inflows (Pagoulatos 2014). Inside the euro, reflecting the deficient EMU structure, external deficits reached levels hitherto unseen, as they would have otherwise necessitated an adjustment via exchange rate depreciation or devaluation. Indicating the economy's overall net exposure to foreign creditors, net foreign debt/GDP grew from single digit in the mid-1990s to near 100 per cent GDP on the eve of the debt crisis. The Greek state ended up crashing under its own extreme vulnerability, as illustrated in a gaping current account deficit near 15 per cent in 2008, 15 per cent fiscal deficit and 127 per cent public debt to GDP in 2009. The structure of capital inflows pre-crisis (consisting of debt rather than equity) amplified vulnerability.

Thus, overall, prima facie, Greece failed in an ‘orthodox’ and predictable manner, having violated EMU rules of fiscal discipline and debt sustainability. Yet by ending up being bailed out before Ireland, Greece did the Euro Area a disservice: it helped create the false narrative that the Euro Area debt crisis was caused by fiscal irresponsibility and a violation of SGP rules, rather than intra-Euro Area cross-border financial flows and external imbalances. In fact, the Greek sovereign bailouts helped divert attention from (and actually substituted for) the bailouts needed by German and other European banks heavily exposed to Greek sovereign debt. The crucial variable unifying the economies that resorted to a bailout after 2010 was not the large budget deficit and public debt/GDP (a problem for Greece and Portugal but not Ireland or Spain) (Chang, Steinberg, and Torres 2019). The common unifying factor of all four countries and real trigger of the crisis was the buildup of current account deficits (rather than budget deficits) and foreign indebtedness to the rest of the world (net foreign debt rather than just public debt). Investment in these four countries pre-crisis had been predominantly financed by foreign borrowing rather than national savings. The shock, the debt crisis, came in 2010 as a ‘sudden stop’ of private sector financial inflows (Baldwin and Giavazzi 2015), which was compensated for by Eurosystem or official bailout lending. In that sense, the Euro Area crisis was not the exclusive result of national policy failures, but mainly a failure of EMU’s asymmetric structure, institutions, and policies.

The Greek bailouts as an EMU learning process

The Greek crisis management contributed to EMU policy learning, as ‘an updating of beliefs about public policy’ (Dunlop and Radaelli 2018, 53). The bailouts revealed a few things associated with Euro Area asymmetries. First, financial fragmentation settled in, reflecting the risk of euro-exit. Second, market reaction was procyclical and highly destabilizing, necessitating intervention of an institutional lender of last resort. Third, inordinate debt-fueled economic growth pre-crisis engendered equally procyclical and severely recessionary crisis adjustment. Fourth, to preserve irrevocability of the single currency, the Euro Area had to accept a bailout and subsequently an (organised) default of a member state, though not in what would have been their appropriate sequence. Fifth, EMU structural deficiencies (lack of countercyclical fiscal capacity, a bank-sovereign 'doom loop') and the asymmetric policy response allocating the entire adjustment cost to the borrowers, magnified the overall collective costs of the crisis. Sixth, in this incomplete monetary union, next to debt markets, liquidity needs of the banks became a potent force for suasion.

While pre-crisis financial markets had treated all Euro Area economies largely as one area, in crisis every Euro Area country was on its own, with its own economic fundamentals, facing the markets. Following the 2008 global financial crisis, the spread of the 10-year Greek government bond over the German bund went from 10-20 basis points to over 200 bps at the end of 2008 to 300 bps at the end of 2009. The spread exceeded 700 bps in April 2010, signaling that the markets had closed on Greece, anticipating a default. In 2010, markets overcompensated for their pre-crisis complacency (Gibson, Hall, and Tavlas 2011).

Greece showed that when fiscal recklessness is revealed, the severe reaction of debt markets beats Euro Area rules. Yet, markets tend to be procyclical, underestimating risks at the upswing, overrating them at the downswing, notoriously prone to 'manias, panics and crashes' (Aliber and Kindleberger 2015). Markets failed as a pre-crisis warning mechanism, and their crisis overreaction locked the targeted economy into vicious cycles of self-fulfilling prophecies. From the moment an excessive risk premium is attached to the sovereign, any adjustment while relying on market financing becomes impossible. Thus, Greece (and other bailout countries) provided a potent justification for an institutional lender of last resort. Such was the European Stability Mechanism (ESM), which allows the over-indebted sovereign to replace market borrowing at unsustainable rates with low-interest, long-maturity official sector financing, introducing a cross-temporal risk-sharing into the future, to acquire the necessary space and time to put public finances in order without crashing. The bailout countries demonstrated that during debt crisis the 'official sector' should take over, forcing or inciting private creditors to accept reprofiling or restructuring of their debt claims if the sovereign is insolvent, and providing any financing necessary to avert a crash. Justified moral hazard concerns in such an event are cast aside by the fact that the bailout comes under heavy and painful conditionality, forming a path no government would wish to pursue.

To prevent the mutually disastrous outcome of a disorderly Greek default and potential breakup of the Euro Area, the EU extended a financial assistance programme to Greece. Given the large exposure of EU lenders (French and German banks) to Greek debt, a bailout emerged as the only way to avoid catastrophic contagion in a Euro Area lacking substantial crisis management instruments. Greece's first programme was signed in May 2010, containing fiscal austerity measures split between revenue and spending side, and far-reaching structural reforms. Two additional programmes would follow: in March 2012 (packaged together with a 53.5 per cent haircut on the privately held public debt), and in

August 2015. All three programmes aimed to impose fiscal consolidation (through front-loaded spending cuts and tax increases), raise external competitiveness (through internal devaluation and productivity-enhancing structural reforms), and achieve financial stability (recapitalising banks and overhauling non-performing loans –major objective under the third programme).

The Greek crisis challenged the irrevocability of the single currency. It showed not just how a crisis of illiquidity could rapidly turn into a self-fulfilling crisis of insolvency, but also how the threat of sovereign default translated into aggressive speculation of euro exit. Eventually, what at the euro's inception had appeared to be the EMU's 'impossible trinity' (no bailout, no default, no euro-exit) was resolved by giving way on the first two in order to preserve the third.

Under the bailout programmes, the Greek economy was subjected to far-reaching externally forced adjustment. The programme(s) represented the hardest conditionality, each review attached to a tranche disbursement merely sufficient to prevent sovereign default. Failure to adjust in good times necessitated painful and heavily frontloaded adjustment through recession. The harshness was amplified by a somewhat punitive approach of Euro Area lenders, who preferred to view the Greek crash as exclusive result of Greek fiscal recklessness, overlooking creditor flaws and policy omissions.

The Greek economy experienced a highly procyclical policy mix, all main policies being contractionary. A primary fiscal deficit of 10.1 per cent in 2009 became a 0.4 per cent surplus in 2013, one of the fastest episodes of fiscal consolidation in OECD record, implemented through steep pension and public sector wage reductions, welfare spending cuts, and tax hikes. Incomes policy became very restrictive too, aiming to sharply reverse the unit labour cost increases of the previous period. Wages carried the brunt of adjustment, nominal wages declining faster than product prices.

Such simultaneous application of contractionary policies was left without significant offsetting instruments, pointing to lack of a sufficient Euro Area policy response. Through the initial crisis years, creditor economies led by Germany, despite their available fiscal space, refrained from applying any economic stimulus, which would have alleviated the adjustment burden of the peripherals. At the same time, the expansionary monetary policy applied by the ECB failed to make a difference for the periphery – financial fragmentation and the bank-sovereign doom loop had broken monetary transmission. What began as a crisis of Greek public debt became a banking crisis, via channels of portfolio exposure to sovereign debt and the real economy. 'Double drowning' ensued when banks had to be recapitalised with public money, raising the bailout bill, adding to the debt, and so on. Credit contraction made it impossible even for the most efficient Greek firms to access credit at reasonable rates, while the looming country risk (currency redenomination risk, a.k.a. Grexit) drove away prospective investors, froze economic activity, and pushed the economy deeper into the vortex of recession.

Negative inflation and the steep reduction of nominal GDP amounted to debt deflation, raising the sovereign and private sector debt/GDP. Public debt quickly became visibly unsustainable and (from 2012) underwent consecutive rounds of negotiated restructuring and reprofiling. The programme's ambitious targets necessitated such a steep fiscal consolidation path that the tax burden for a wide array of taxpayers became impossible to service. Thus, public debt generated a new mountain of private debt, comprising tax arrears owed by failing enterprises and distressed households, unpaid social security obligations, and non-performing loans.

The Greek experience amply demonstrated the asymmetric Euro Area treatment of what was to a significant extent a systemic crisis of an asymmetric monetary union. Adjustment was overwhelmingly confined to the borrower countries, without a sufficient EMU response or countervailing stimulus on the part of creditor economies. As crisis countries were sharply reducing their deficits through fiscal austerity and internal devaluation, an offsetting stimulus was missing. Universally applied restrictive fiscal policies contributed to a double-dip recession in the Euro Area (output contracting in 2009 and 2012), which delayed recovery of the periphery. Low euro-average inflation (close to 1 per cent) meant the periphery had to adjust cost competitiveness through painful reduction of incomes and wages. The division of labor that emerged allocated the pain of adjustment to the borrowers while lenders undertook the bailout credit risk. Lack of sufficient EMU risk-sharing amplified the crisis impact on the peripherals, raising the overall financial, economic and social cost of their adjustment.

The Greek crisis demonstrated the fragility entailed by the lack of a lender of last resort for an over-indebted sovereign, ECB being prohibited from monetizing government debt. This is how a liquidity crisis mutates into an insolvency crisis. Public debt carries much higher credit risk compared to economies controlling their own currency, as if being denominated in a foreign currency. This known feature of the euro was meant to underwrite national fiscal discipline and ECB monetary credibility, but it became lethal during crisis.

Next to debt markets, the liquidity drain of the banks became a most potent suasion force. In February 2015, the Tsipras government terminated the second programme.

Outside a programme, Greece lost the 'waiver' that allowed ECB to accept Greek bonds (rated below investment grade) as collateral for extending liquidity to Greek banks. Access to Eurosystem financing was lost for the banks, which could only rely on Emergency Liquidity Assistance (ELA). At the peak of the crisis, late June 2015, bank deposits had shrunk below €128bn (from €160bn in December 2014), and bank financing relied on ELA, whose ceiling the ECB regularly raised to reach €83bn (from zero levels in late 2014). The panic run on ATMs that followed the announcement of the July referendum on 26 June 2015 made it impossible to eschew capital controls. Banks did not open on Monday. Finance minister Varoufakis was keen to blame capital controls on the ECB, but it was clearly the inevitable and foreseeable result of his government's actions, under the known framework of Eurosystem rules and procedures.

This brings us to another consequence of the crisis, financial fragmentation of the Euro Area. Pre-crisis it was assumed that the euro would generate an integrated money and capital market of greater depth, liquidity, and efficiency, allowing investment in any EMU country to become increasingly independent of the level of domestic savings. More integrated capital and credit markets were supposed to enhance the capacity of EMU member states to respond to national-level asymmetric shocks by acting as channels of interstate risk sharing. As financial portfolios would begin to contain assets from many Euro Area economies, they could help diffuse the negative effects that may follow national-level asymmetric shocks. This could partly compensate for enhanced international capital mobility tending to accentuate such asymmetric shocks.

The premise of the single currency combined with financial integration was the expectation of improved risk sharing through integrated financial markets. In effect, any risk sharing broke up in crisis, when most needed. Following the 'sudden stop', euro financial markets fragmented again. Post-crisis experience points to the need for deeper risk-sharing through further financial integration, a capital markets union, completion of the banking union, and a common risk-free, 'safe' asset (Howarth and Quaglia 2013; Jones 2016).

Policy innovation, experimentation, and EMU multi-level governance in the Greek bailouts

The Greek crisis launched the Euro Area crisis and both were unprecedented. A great deal of accelerated institutional innovation and policy learning unfolded (Gocaj and Meunier 2013; Verdun 2015). This included introduction of a wide range of new policies (e.g. unconventional interventions by the ECB) and institutions, such as the European Financial Stability Facility (EFSF), which evolved into the European Stability Mechanism (ESM) and became part of the permanent EU institutional apparatus. Most salient was the introduction of the Troika structure, comprising the collaboration of EU institutions (Commission and ECB –to which the ESM was added under the third programme) with the IMF. None of the three EU institutions had any prior experience in drafting, negotiating and monitoring the implementation of a bailout programme for a euro economy, alone or with the IMF. In addition to the Troika, the second programme brought in the European Commission as Task Force (upgraded to a permanent Structural Reform Support Service), to provide technical assistance for reforms. Collaboration between these institutions was not always unseemly, even though intra-troika differences were ironed out vis-à-vis the Greek side.

The IMF itself had not previously handled a similar programme without the instrument of currency devaluation (here mimicked by internal devaluation) and debt restructuring (introduced with the second programme) (Hodson 2015). Ex post, the institutions involved acknowledged policy errors, such as the costly delay in debt restructuring, and the self-defeating magnitude of austerity imposed. The IMF Independent Evaluation Office, the EU Court of Auditors, the Commission, former Eurogroup President Dijsselbloem, all have ex post criticized elements of the programmes, assuming a degree of institutional *mea culpa*. Commissioner Moscovici (2019) called the Eurogroup's handling of the Greek crisis 'a democratic scandal', criticizing its lack of transparency and accountability.

Policy learning involved all four dimensions identified by Dunlop and Radaelli (2018), i.e. assumptions and micro-foundations, conceptual apparatus, observable implications, and normative applications. The crisis conditions of surprise and uncertainty also entailed the kind of contingent learning conceptualized by Kamkhaji and Radaelli (2016), under which lack of experience about cue-outcome relations triggers learning via fast-paced associations.

Overall the governance structure of the three programmes (comprising the Troika, the Eurogroup and European Council, and the national government) represented a new structure of multi-level governance.[2] In that governance structure, two changes stood out. *First*, the crisis altered the interinstitutional power balances. In the intensive and

[2] I owe much of this section to comments by Kevin Featherstone.

asymmetric 'new intergovernmentalism' that emerged (Bickerton, Hodson, and Puetter 2015), Berlin retained the leading role and final say (Bulmer and Paterson 2018). The Commission was weakened vis-à-vis the Council, the EP even more so. The ECB was the only EU institution to be strengthened by the crisis (Brunnermeier, James, and Landau, 2016, 18ff). All crucial matters had to be cleared by the Eurogroup or (if top decision was required) by the Euro Summit, the Troika practically operating as agent of the Council. The so-called Union method replaced the Community method. To a large extent, this was inevitable, given the urgency of circumstances, and also given the institutional gaps, the glaring omissions in the euro architecture that needed to be quickly patched, the lack of stabilisation and crisis management instruments or lender of last resort capabilities. Faced with aggressive national parliaments, EU leaders adopted a negotiating pattern of brinkmanship, reaching the highly unpopular decisions at the eleventh hour, when participants and the public could stare down the abyss. This applied both to creditors and borrower governments. Decisions themselves typically amounted to an incrementalist policy pattern, providing insufficient remedies that failed to fix the problem, deferring bolder acts to the future, while leaving everyone unhappy (Jones, Kelemen, and Meunier 2015). Thus, an asymmetric EMU engendered new asymmetries in decision-making.

Second, the ongoing interaction with the troika strengthened the national 'core executive' (Featherstone and Papadimitriou 2013) at the expense of the legislature, social partners or courts. A qualitative upgrade followed the strengthening of core executive power, as the Greek government apparatus, under Troika pressure, acquired significant know-how in areas such as budgeting, governing by targets and milestones, measuring and evaluating policy implementation. State capacities were strengthened by the introduction of new institutions: inter alia, the Statistical Authority became independent, an Independent Public Revenue Authority was established, a Parliamentary Budgetary Office and Fiscal Council.

The Troika became highly visible in the Greek public sphere. The mission chiefs established regular presence, negotiating, often in a confrontational manner, with ministers, pressing for more painful austerity measures and unpopular reforms. This was not a flattering image for the EU, which was viewed as a dominant force or (for some) as an 'occupation force'. Populists and nationalists thrived, so did the tabloid press, and the popularity of and confidence in the EU, historically high in Greece, declined to all-time lows. The European Commission faced a serious challenge to its political legitimacy, and found itself unprepared to manage the repercussions of this most negative visibility. Only under the Juncker Presidency, after the shift of the Tsipras government into signing a third bailout, did Juncker's 'political' Commission manage to restore a positive image in the Greek public sphere.

The three programmes introduced a momentous scope of measures and reforms. The magnitude and intensity of reforms would have stretched the effectiveness of far more capable state structures. In the case of Greece, the combination of an overwhelmed state machine and reluctant government ministers produced a sense of foot dragging, policy slippage, and diminished national credibility. Poor quality of implementation highlighted the vulnerability of the conditionality process and impacted on the actual adjustment options. For example, horizontal/universal cuts were favored rather than selective targeting in more effectively propping up tradable sectors and exports. There were no winners, only losers – and this impacted negatively on domestic support for the bailouts.

Within the Troika occasional disagreements emerged. A major issue of contention was debt sustainability. From the beginning, the Greek sovereign debt crisis was officially branded a problem of illiquidity rather than insolvency. The distinction is more clear-cut in theory than in practice, but the 2010 debt holders (notably German and French banks) were unwilling to even discuss a mild reprofiling. An admission of insolvency would have required debt restructuring, which European banks and an ECB concerned about systemic stability, fiercely opposed. Moral hazard and financial contagion considerations (ECB firewalls not yet there) prevailed, raising the cost of both the financial envelope and Greece's adjustment. The 2012 debt restructuring, following the Merkel-Sarkozy October 2010 change of heart in Deauville, came late, at the cost of heavier and self-defeating fiscal austerity. An unprepared, asymmetric EMU raised the costs of crisis management.

In many ways, the Greek crisis paved the way for the reforms introduced in EMU. The effort to create a banking union was informed by the bank sovereign doom loop witnessed in Greece, where healthy banks were contaminated by the insolvent sovereign, amplifying state indebtedness by forcing the sovereign to subsequently bail them out (see Howarth and Quaglia 2016; 2020). Other reforms, such as those contained in the package adopted by the Eurogroup in December 2018, were crucially informed by the Greek experience. In December 2018, the Euro Area introduced debt restructuring as prerequisite for ESM bailout. And reform proposals have introduced a regulatory cap on bank holdings of sovereign debt, seeking to increase Euro Area-wide financial risk-sharing and contain bank exposure to sovereign risk.

The Greek crisis was aggravated by EMU asymmetries. A fiscal capacity, targeting investment to Greece, or co-financing part of the unemployment benefits when job losses skyrocketed during the crisis, would have mitigated the more enduring impact of austerity. (Investment support only partly materialized later with the Juncker Plan/ EFSI). Financial support to reforms (as in the EU budget reform support instrument) would have alleviated the cost of socially painful and recessionary adjustment. When Greece needed EU investment the most (at the crisis depth in 2011-12), its non-investment grade prevented the European Investment Bank, itself conscious of the need to sustain its own AAA credit rating, from coming to rescue. In many ways, the experience of Greece demonstrated the extreme limits of viability of the pre-crisis EMU status quo.

Prolonged austerity and economic depression left behind a more enduring impact in terms of a generation of unemployed and of suppressed GDP growth potential. A large investment gap, low employment rate, brain drain, the destruction of physical and human capital, undercuts the ability of the economy to grow for a long time after the crisis (see Blanchard, Cerutti, and Summers 2015). Greece was subjected to a (Keynesian) hysteresis effect of recession, decreasing output in a sustained manner even after recession has ended. Austerity should have been mitigated and employment supported earlier and faster.

We saw in this section how the urge to avert a full-blown disintegration under an unprecedented crisis, given a deficient EMU institutional and policy apparatus, engendered extensive policy innovation and experimentation (Kamkhaji and Radaelli 2016, 2017). We also saw how asymmetries and gaps in the EMU architecture generated new asymmetries and deficiencies in the management of the Greek crisis, undermining policy effectiveness and raising the overall cost of an already recessionary adjustment. We also observed a new asymmetry between an intensified intergovernmental and impositional conditionality policy mode vs the weakening of both countervailing supranationalism and processes of democratic legitimisation. On that, the next section provides more evidence.

A test for democratic legitimacy

The Greek crisis operated as a socio-political laboratory, testing the outer limits of endurance of the political system and social fabric of democracy under severe, prolonged austerity. The Greek economy lost over a quarter of its 2008 GDP, in a modern-day version of a Great Depression. Output contracted every year from 2008 to 2016, except for 2014. Unemployment peaked at 27 per cent, and hovered around 20 per cent in August 2018, when the third bailout ended. Nearly one tenth of the labour force emigrated, and poverty rates became the highest in the Euro Area. Austerity governments were short-lived (except for Tsipras), and an historical party, PASOK, used to ruling with 40+ per cent, shrunk to 6 per cent in 2015. Nationalistic populism became rampant, social tensions grew with frequent violent demonstrations, but the extreme prophecy of a social 'explosion' did not materialize. The rampant anti-austerity movement brought to power in January 2015 the first genuinely populist coalition in Europe, comprising a radical left and an ultra-right nationalist party. Confrontation with the creditors peaked with the July 2015 referendum, when Greece tested the extreme limits of anti-austerity populism, reaching the brink of Grexit, which too did not materialize. Following a rejection of the troika's austerity programme by a 64 per cent in the referendum, Tsipras prioritized the need to keep Greece in the euro (always backed by a solid public opinion and Parliament majority) and implemented his famous U-turn, bypassing the referendum outcome, adopting a third austerity programme, and moving to implement it upon re-election to government in September 2015. Thus, Greece provided the first reality check for political agendas built upon unrealistic promises. It also featured a government, which while originally elected upon a populist agenda ended up being the first to complete any of the three programmes, and subsequently graduate into having earned EU ‘acceptability’. In the Greek case the lesson learned was one of external reality taming the most rampant democratic and populist aspirations. And the threat of euro-exit (waived at the critical Euro Summit of July 2015 that led Tsipras to succumb to a new programme) served as the Euro Area’s ultimate force of compliance.

Yet democratic legitimacy suffered a painful retreat. As viewed from the debtor countries, creditor countries have employed EU institutions as instruments for imposing their will upon borrowers. The Troika was given unprecedented powers –of course, this was an unprecedented crisis. The European Parliament was sidelined in the drafting, application and monitoring of the programmes. National parliaments too were forced under threat of imminent default to vote without sufficient deliberation, without even sufficient time to read hundreds of pages of legislation introducing far-reaching reforms, occasionally eradicating in a few sentences long-standing social acquis. Even though most of the reforms introduced were highly necessary, the collateral damage to the functioning of democratic institutions has been far from negligible (Crum 2018; Crum and Merlo 2020).

The European public sphere also suffered the divisive impact of the crisis. The Euro Area was toxically divided between borrowers and lenders. Moralizing over the Greek case accentuated this division, which led to condescending political statements in creditor countries and resentment against the creditors, especially Germany, in the borrower countries whose societies were undergoing severe austerity. Resentment opened the way to Southern European anti-austerity populism in the form of Syriza and Podemos, and North European Eurosceptic populism in the form of the AfD. Being the first to be bailed out, Greece suffered the additional misfortune of allowing the Euro Area crisis narrative to be framed in terms of the reckless borrowers of the South. Had Ireland preceded, the Euro Area failures would have been more obvious and the rhetoric less toxic and divisive.

The experience of the Greek crisis raised a hard to resolve tension between national democratic orders. What unfolded was the clash of different normative orders (Bellamy and Weale 2015) Euro Area rules and binding agreements (*pacta sunt servanda*) versus democratic popular mandates. As was often rightfully countered, governments in creditor countries also have voters and parliaments. When national electorates clashed, intergovernmental power asymmetries were left to resolve whose popular will would finally get to prevail. The crisis raised a whole new agenda regarding the EU's democratic deficit, the profound tensions between integration and sovereignty, and the distribution of losses in EU games that have no winners.

In sum, EMU asymmetry in the manner the crisis played out and was handled, fundamentally undermined the national democratic process, and raised serious normative questions about the functioning of EU and Euro Area democracy.

Conclusion: EMU asymmetries old and new

The asymmetries in the architecture and functioning of EMU (inter alia the underdeveloped economic pillar, macroeconomic imbalances and asymmetric financial flows) both underlay the Euro Area financial crisis and the asymmetric crisis management. The cost of adjustment fell almost entirely upon the borrowers, without sufficient activation of either a countercyclical stimulus by creditor economies or a commensurate Euro Area-wide policy response. The main exception to a pattern of dealing with a largely systemic crisis through mainly national policy responses was the ECB, which carried the brunt of 'saving the euro'. Yet, financial fragmentation in the Euro Area (itself a result of EMU asymmetries) meant that ECB accommodative or 'unorthodox' policies could not effectively provide the much needed monetary stimulus in the crisis economies of the periphery, being cancelled by the latter's higher 'country risk' -in essence 'currency redenomination risk'.

EMU asymmetries entailed a highly procyclical path: pre-crisis growth, highly leveraged by copious financial inflows, was excessive, inflationary, unsustainable. And the crash, underwritten by the 'sudden stop' and capital flight, massive deleveraging, front-loaded fiscal consolidation and internal devaluation, amounted to steep recession.

The asymmetric EMU institutional framework also necessitated a greater reliance on political activism and policy innovation, to engineer ad hoc crisis management initiatives, some of which eventually became a permanent feature of the beefed-up EMU architecture. Crisis management at the senior executive level in an asymmetric EMU accentuated intergovernmentalism at the expense of both the Community method and democratic procedure. A Euro-Area wide narrative of borrowers versus creditors, framed through mutually resentful stereotyping, bred division and polarisation between 'opposing' groups of Euro Area countries.

It was optimistically assumed that liberalized financial markets would have provided the necessary discipline to governments along with operating as channels of cross-border risk sharing. Thus, it was hoped, they would help counterbalance the asymmetries and gaps of EMU. However, the Greek crisis demonstrated a consistent mispricing of sovereign risk. Markets were complacent between 2001 and 2008, not only failing to discipline but further encouraging fiscal profligacy. Then market overreaction from 2010 reflected and multiplied negative market sentiment, turning the crisis into self-fulfilling prophecy.

This points to another implication of EMU asymmetries: capital flew from core to periphery in the boom period, and back to safety during the crisis. Since the crisis, the peripheral economies have carried a higher risk premium. Such financial fragmentation or division in the Euro Area suggests that at times of trouble capital will tend to move to the core economies; it also suggests financing costs higher for the periphery. Labour flows are not symmetric either. Labour movement and the loss of precious human capital from the peripheral economies to the core, have been a main unemployment adjustment mechanism since the crisis, with lasting negative implications on potential growth. These observed asymmetries suggest that the completion of the economic pillar through EMU financial, fiscal and economic integration is as urgently necessary as ever.

The Greek case testified to the deficient integration in the EMU, amplified by the crisis into acute versions of financial and political asymmetry. Rather than correcting such asymmetries, the specific modality and content of crisis response, nested within pre-existing deficiencies of an imperfect monetary union and aggravated by domestic political failures, further accentuated divergence. As conditionality-driven policy adjustment was completed, the Greek economy had narrowed its divergence in terms of fiscal and current account deficits, and significant structural reforms; but had further diverged in terms of higher stock of debt/GDP, non-performing loans, unemployment, and poverty rates, and a severe decline of national income, investment, overall employment, and potential GDP growth rate.

As Howarth and Verdun (2020) point out, an additional asymmetry emerged, between those member states that pushed for further integration and those which did not, and solutions were found to marginalise foot-draggers and set up intergovernmental structures to manage a range of new policy making functions. To take the point further, the asymmetric intergovernmentalism which carried the day in the decision-making of crisis management, was asymmetric in an additional sense: not all euro member states carried the same weight. The South was not as powerful as the North, and even the historically symmetric Franco-German partnership on the steering wheel of integration post-2010 was skewed in favor of a stronger (albeit reluctant) role of Berlin over critical decisions.

The euro architecture is today more robust than in 2010. But in terms of socio-politics, the EU is more divided internally as a result of the Euro Area crisis. The common pool of integration may have been poisoned irreparably, and the appetite to cede or pool sovereignties for the sake of a closer Economic and Monetary Union is probably weaker than it was pre-crisis, even though the need to do so is far more widely and intensely appreciated.

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