THE GREEK CRISIS. A NEW, YET OLD UNFORTUNATE EUROPEAN STORY

Title:

THE GREEK CRISIS. A NEW, YET OLD UNFORTUNATE EUROPEAN STORY

Abstract:

Despite the best efforts of the International Monetary Fund, the financial crisis in Europe seems full of suspense. Greece, effectively bankrupt and with a European gun to its head, committed itself initially to years of austerity when it signed, back in the days, a financial bailout deal with the European Union and the International Monetary Fund. The new Greek government, led by the leftist Syriza party, wants to relax austerity measures to ease financial pressure on the public, but its lenders insist that it must cut spending and adhere to austerity measures. As discussions drag on, time is running out. Against this backdrop of pressing repayments, more and more advised voices believe that Greece would still have to default.

Keywords: Greece; European Union; eurozone; financial crisis; bailout; debt

Contact details of the authors:

E-mail: alina.buzaianu@idr.ro

Institutional affiliation of the authors:

Romanian Diplomatic Institute

Institutions address:


Motto: “People haven’t trusted the Greeks since the time of the Trojan war. So this is nothing new”

Yiannis Stournaras, a leading Greek economist and former economic adviser

Greece has been known, in particular, as a country with a low tolerance for change and a high tolerance for protest, which in late 2009 was no easy task for a then, two-month-old Socialist government that said it was committed to sustaining social spending. While convincing European Union leaders in Brussels, the “new” government also had to win over Greece¹. Back then the political and social challenges were intense. And even without the facts and figures of present days, clear minds had spotted the fact that in light of Greece’s political challenges, at some point it will become difficult to see how Greece is going to manage this situation without some kind of fiscal crisis².

¹ After winning by a wide margin in October 2009, the Socialist government of Prime Minister George Papandreou announced that the country’s budget deficit was 12.7 percent of the gross domestic product, more than four times the 3 percent ceiling set by the European Monetary Union. Rachel Donadio, Niki Kitsantonis, Greece Struggles to Stay Afloat as Debts Pile On, “The New York Times”, 11.12.2009, at http://www.nytimes.com/2009/12/12/world/europe/12greece.html?_r=0 (04.07.2015)

By the start of 2010, Greece's debt had hit €300 billion, more than the entire value of its annual GDP. This was very unlikely to fall quickly, as its average budget deficit – how much its borrowing exceeds tax receipts – is running between 12.7-13.6% of its gross domestic product, twice the eurozone average. In addition, Greece's multibillion euros debt is 80% owned by foreigners – mostly pension funds and banks in Germany, Britain and France that are still recovering from the financial crisis. The exposure of U.S. banks to Greek debt stands at about $18 billion 1.

Things have come to a head because the international rating agencies have cut Greece's credit rating, concerned that it will default on its debts. This has the immediate effect – just as when a credit agency cuts a consumer's rating – of pushing up the cost of its borrowing, setting off a vicious spiral. Also, the news sent markets higher. During the year 2010 turmoil and in the immediate aftermath, Dow Jones industrial average rose 1.5%, to close at 10.058%, and Greek bonds and the euro rose as well 2.

European officials have already bailed out Greece twice, in 2010 and 2012, writing off some debt and extending more loans while insisting that the country shrinks its public payrolls and raises its taxes. In retrospect, it's hard to argue that either of those interventions struck the right balance between relief and reform. As badly as the Greek government needed to trim its spending, weed out corruption and crack down on tax evaders, the country also needed to grow its economy. It has not done so. And that task will only be complicated by the creditors' demands for higher tax rates on a broad variety of goods and services, along with reduced subsidies and pension payments 3.

Greece has been since revolving in a vicious circle of insolvency, lack of competitiveness and ever-deepening depression, exacerbated by draconian fiscal austerity that is making the recession much worse. And while fiscal austerity and structural reforms are necessary to restore medium-term debt sustainability and growth, in the short run they will probably lead to an even deeper recession, thus making the deficit and debt even more unsustainable 4.

The dire economic situation has prompted the question of what went wrong in a country that was once seen as a model for European Union membership and that enjoyed 15 years of sustained growth, coming from behind to host the 2004 Summer Olympics.

During all this torment, Greek voters have become increasingly hostile to their lenders' demands, tossing out two successive ruling coalitions that supported the austerity efforts 5.

The stakes for the rest of the world aren't as high as they were five years ago, when the possibility of a Greek failure threatened to set off a cascade of woe across Europe that could have swamped the nascent economic recoveries in the United States and elsewhere. That's due in large measure to the growth outside Greece since then, the reforms enacted by other struggling European nations, and the work by the IMF and other multinational credit agencies to absorb much of Greece's debt from banks and investors 6.

4 It was also the case of Argentina back in 1999-2001, who fell into the same trap of deficit, austerity, deeper recession, depression, higher deficit, greater insolvency. Ibidem
5 Ibidem
6 The Times Editorial Board, Decision time for Greece, and Greeks, "Los Angeles Times", 30.06.2015, at http://www.nytimes.com/2009/12/12/world/europe/ 12greece.html?_r=0 (04.07.2015)


1 Ibidem
2 Ibidem
The charter establishing the euro, while supposedly ruling out any bailouts by the European Central Bank or member governments, also failed to establish any mechanism for providing funds to countries in financial trouble. That is the kind of role normally taken on by the International Monetary Fund, but Europeans are determined to keep the I.M.F. away from nations within the eurozone because of the questions it might raise about the viability of the common currency. For those countries using the euro, the stability pact was charged with monitoring each member country’s finances and was simply thought to be sufficient to keep countries in line. Greece’s consistent and premeditated pattern of skirting the fiscal standards set by the European Commission has dashed those beliefs.

Nevertheless, for Greece’s sake, it would be good to see the country and its creditors unite on a new, pro-growth path out of the debt crisis. The country needs more debt relief than creditors are offering today and dropping the euro would be a torturous way to obtain it.

To prevent a disorderly outcome in the eurozone, today’s fiscal austerity should be much more gradual, a growth compact should complement the EU’s new fiscal compact, and a fiscal union with debt mutualization (Eurobonds) should be implemented. In addition, a full banking union, starting with eurozone-wide deposit insurance, should be initiated, and moves toward greater political integration must be considered, weather Greece will leave the eurozone or not.

Although the subject of Greece's exit is supposedly not a topic of discussion in talks between Athens and Brussels, in reality all are considering the possibility -- either by accident or by dint of a realization that it may be the lesser of two evils. If Greece were to stumble out of the euro, the government would have to circulate a new currency overnight that would immediately depreciate in value against the euro. At least initially, it would result in chaos. Banks would totter dangerously, interest rates would quickly climb and companies would go bankrupt.

According to what some analysts believe, one potential consequence of the devaluation would be that Greek government debt would rise from the current level of 175 percent of gross domestic product to 230 percent. Athens would no longer be able to service the debt on a large portion of its loans and the country would be at least partially insolvent. It's difficult to predict how people would respond to such a situation.

The celebrated French economist Thomas Piketty speaks about the fact that

4 Nouriel Roubini, A Global Perfect Storm; "Project Syndicate", 15.06.2012, at http://www.projectsyndicate.org/commentary/a-global-perfect-storm (10.05.2015)
6 Argentina's declaration of bankruptcy in 2001 was followed by violent riots and looting. The Argentina example also shows how long it can take for an economy to recover from a crisis like that. Tens of thousands of Argentinians, many of them well educated, left their country, and many Greeks would probably do the same, in the event of such an unfortunate outcome. The faith of international investors would also be shaken. It is likely that the Greek government would have trouble raising money for years to come. Ibidem
7 Thomas Piketty, 43, is a shooting star among economists. The Frenchman's book, Capital in the Twenty-First Century, about the widening divide between rich and poor, has sold 1.5 million copies worldwide. Piketty is a professor at the École d'Économie de Paris. He cites “personal and
we may have a common currency for 19 countries, but each of these countries has a different tax system, and fiscal policy was never harmonized in Europe. It can't work. In creating the euro zone, we have created a monster. Before there was a common currency, the countries could simply devalue their currencies to become more competitive. As a member of the euro zone, Greece was barred from using this established and effective concept.

Greece alone won't be able to do anything. It has to come from France, Germany and Brussels. The International Monetary Fund (IMF) already admitted three years ago that the austerity policies had been taken too far. The fact that the affected countries were forced to reduce their deficit in much too short a time had a terrible impact on growth. We Europeans, poorly organized as we are, have used our impenetrable political instruments to turn the financial crisis, which began in the United States, into a debt crisis. This has tragically turned into a crisis of confidence across Europe.

With banks temporarily limiting withdrawals and global markets slipping, Greeks went to the polls to choose between endorsing the higher taxes and pension cuts their creditors have sought, or demanding a better deal that may never materialize. The first option threatens to drag down a Greek economy that is already suffering from shrinking demand and an unemployment rate more than twice as high as the rest of Europe's (and four times as high as United States of America). But the second, favored by the ruling leftist Syriza party, could force Greece to abandon the euro, which economists say would cause even more pain in the near term by driving the country into a deeper recession.

The Greek conundrum came to a head on 5th July, 2015, when 61 percent of Greeks voted on the referendum against the country's austerity-heavy bailout program proposed by its creditors.

Prime Minister Alexis Tsipras had the opportunity after his election in January and last weekend's referendum to inspire Greeks to embrace the reforms their struggling economy so badly needs. Sadly, even the humble task of strengthening the tax administration has not yet begun. If you were a pro-European, you would most probably think that Greek ideology, political grandstanding and patriot games took precedence over the practical need to govern, and to compromise with European partners and the International Monetary Fund. Anyway, much trust has been lost. Now, however, the only thing that matters is what comes next.

From another point of view, Joseph Stiglitz, the international economist who is an adviser to the Greek government, sees the investor demands as lacking in merit. Indeed, he points to the inherent contradiction in allowing the richer countries in Europe to borrow heavily to pull themselves out of recession while the poorer countries are forced to take a knife to the very programs intended to soften the

intellectual reasons” for not wanting to teach in the United States and sees himself as part of the tradition of French social scientists.


2 Ibidem

3 Ibidem


6 Which, for example, in Slovakia brought 3% of gross domestic product in additional revenues within three year. Peter Kazimir, Amicable split with Greece is not the worst fate for eurozone, "Financial Times", 10.07.2015, at http://www.ft.com/intl/cms/s/0/1b7053f8-26f2-11e5-bd83-71cb60e8f08c.html#axzz3dRbayuQ (11.07.2015).
blow of an economic downturn. Mr. Stiglitz proposes that Europe’s richer countries like Germany and France take the lead in aiding Greece — for the sake of the European whole, however shaken it might be.

It could be that the time has come for Europe to acknowledge that it has neither the technical expertise to monitor government behavior, nor the ability to quickly raise rescue funds. That would probably mean that I.M.F. is the only financial entity capable of truly doing that job. Who really knows?

What can be clearly observed without much digging is that we need a fiscal union and a harmonization of budgets. We need a common debt repayment fund for the euro zone, like the one proposed by the German Council of Economic Experts, for example. Each country would remain responsible for repaying its portion of the total debt. In other words, the Germans would not have to pay off the Italians’ old debts, and vice-versa. But there would be a common interest rate for euro bonds, which would be used to refinance the debt.

Whether Europe can hold out much longer, though, remains in doubt. Nevertheless, a simple, coldhearted truth says that the rising borrowing costs for countries like Greece and Portugal are a sign that the economic problems in Europe’s south are deep and will not disappear without a long and painful readjustment.

We, the Europeans have always loved to talk, often for years on end. It was always considered a better way to deliberate over difficult dilemmas, soften the edges of intractable conflicts. That luxury is not any more. This present moment, in the common interest of all eurozone member states, European leaders need to act decisively one way or the other. Whatever the outcome of talks over the future of Greece, we have to work hard to deepen the European currency union in the aftermath.

European leaders have drawn a line in the sand: Greece has to come up with a proposal they consider workable in the next few days, and everyone needs to be on board with it, or the EU and the euro zone will have to start looking at the (still unspoken) Plan B. Also, Germany’s Angela Merkel said she will not accept haircuts on Greek debt, but the officials said a short-term deal would be possible.

A more and more larger group of economists, mostly Americans or teaching at American universities, sees Angela Merkel as Nana’s successful 1996 hit single "Darkman". To many of them, Germany is using its size and wealth to compel its euro-zone partners to take a hard line toward Greece, but in the end, Germany would also have much to lose by forcing the Aegean nation to choose between more austerity and dumping the euro.

Even if austerity and structural reform are eventually producing growth, in subsidiary it also creates dislocation and inequality. The catch is that even in the “best” case scenario, the inequality would be unevenly distributed among countries. Meaning, Germany and a few other North

---

2 “If you tighten the way the markets seem to want you will get a political response that is non-viable. These are democracies — not dictatorships”. Ibidem

---

4 Peter Kazimir, Amicable split with Greece is not the worst fate for eurozone, "Financial Times", 10.07.2015, at http://www.ft.com/intl/cms/s/0/b7053f8-26f2-11e5-bd83-71cb60e8f08c.html#axzz3idRbayuQ (11.07.2015). Peter Kazimir is the Slovakian minister of finance.
European nations would go on taking most of the gain; others, the pain.\(^1\)

Mainstream German politicians and economists fiercely dispute this analysis. Austerity and structural reform are the one true way to salvation, they insist. As German Chancellor Merkel put it in 2013: “What we have done, everyone else can do”\(^2\). There are at least three problems with this. First, even the right medicine can be disastrous if administered in too strong of a dose to a weakened patient. Second, Greeks, Italians and French are not Germans. Their economies need structural reforms, but their societies and companies simply do not respond in the same way as Germany’s. Third, even if the whole Eurozone becomes one giant German-style Exporter, who will be the consumer? Some of the demand must come from richer countries like Germany. If everyone else is to behave more like Germany, then Germany must behave a bit less like Germany. But Germany is not yet prepared to do that.

In the long term, Germany will suffer from the consequences but not in the short term. Germany has had to bail out countries such as Greece, but much of that money went straight back to imprudent lenders, including German banks.

Meanwhile, the German export business has benefited greatly from the Eurozone\(^3\).

Everyone admits in private that Greece cannot repay its mountain of debt, so let Berlin parlay explicit debt forgiveness into continued meaningful reform by the new Greek government. Or agree on fiscal transfers from richer states to poorer ones as in a proper federal union such as the United States, where nobody expects Alabama to perform like Silicon Valley any time soon. But in creating a monetary union without a fiscal or political one, Europeans put the cart before the horse. National democracy therefore stands in a growing tension with European integration\(^4\).

And so the monetary union that was meant to unite Europe pulls it apart\(^5\). But the torture is slow. In the countries that are suffering most from this “machine from hell,” as one senior German official has described the Eurozone, there is still a passionate determination to stay in Europe. Even Greece has shown a remarkable readiness to compromise. Domestically, these countries still have the safety net provided by even a much reduced welfare state\(^6\).

The labor mobility guaranteed by the EU also provides a safety valve, as young Spaniards with two university degrees come to work as waiters in London or Berlin. However, that migration in turn

---


\(^2\) Ibidem


\(^4\) Ibidem

\(^5\) “The whole history of the euro has been a Greek tragedy. It started with hubris – arrogant pride and over-confidence. It is now in nemesis – the pit of despair and fear. If we are lucky, it can end with catharsis – cleansing redemption and purification. Catharsis would be a split into a hard EuroNord (Germany, the Netherlands, Austria, Finland) and a soft EuroSud (all the rest, led by France). This two-tier Europe would more accurately reflect the unevenness of the European economy. It would delight those in Germany who are spearheading a nationalist campaign to disengage the continent’s largest economy. It could also allow the periphery countries to devalue their currency and become competitive in world markets”. Gwyn Prins, *This doomed currency was meant to hold Europe together - but it's ripping it apart*, ”The Daily mail”, 05.11.2011, at http://www.dailymail.co.uk/debate/article-2057997/This-doomed-currency-meant-hold-Europe-ripping-apart.html#ixzz3fe0PZDws (05.07.2015)

\(^6\) Gwyn Prins, *This doomed currency was meant to hold Europe together - but it's ripping it apart*, ”The Daily mail”, 05.11.2011, at http://www.dailymail.co.uk/debate/article-2057997/This-doomed-currency-meant-hold-Europe-ripping-apart.html#ixzz3fe0PZDws (05.07.2015)
fuels anti-EU political parties that hitch their Euro-skepticism to genuine popular fears about immigration\textsuperscript{1}. And gradually these material and cultural reserves will be exhausted.

The German chancellor has been seen, by many, as responsible for cultivating the notions that the Greek government is run by reprobates unwilling to reform Athens' finances, austerity is the golden path to prosperity, and establishing a new Greek currency is either impossible or guarantees disaster\textsuperscript{2}.

As structured now, the euro is undervalued for Germany and overvalued for southern European economies, guaranteeing German export success, trade surpluses and prosperity. Without those weak sisters, Germany's real competitiveness would be exposed and its industrial might — with a fairly valued currency\textsuperscript{3} — might not prove so mighty after all\textsuperscript{4}.

Five years of austerity has reduced the Greek economy to a state of dysfunction. GDP is down 25 percent and unemployment exceeds 25 percent. Private-sector wages are down by a similar amount, but Greece has failed to attract investment sorely needed to expand exports and eventually pay its debts\textsuperscript{4}.

More austerity — without debt relief — would further pummel the Greek economy and take its debt-to-GDP ratio — now an astonishing 177 percent of GDP — to even more absurd heights\textsuperscript{5}. And when Greece ultimately defaults, German losses on holdings of Greek debt — both public and private — will be much greater than if Germany and other creditors wrote down Greek debt now\textsuperscript{6}.

As things stands now, there are fairly two possible scenarios that could be considered as viable actions in order to address the present taught situation. Firstly, cutting Greek sovereign debt by as much as half and empowering the European Central Bank to provide Greek banks with massive creditor-of-last-resort financing, much as the Federal Reserve and Treasury did for U.S. banks during the financial crisis. This is a scenario very unlikely to happen and as it results, either Greek Prime Minister Alex Tsipras signs up for more bloodletting and inevitable economic collapse or, - and here comes the second possible scenario - persuades Greeks to quit the euro. The latter possibility it should not be as frightful as it appears to be. Set loose from the euro, Greece at least would have a chance at prosperity\textsuperscript{7}, but the rub for Germany is that the other Mediterranean nations could follow Greece's example, if it proved successful. Then, a downsized euro — with an underlying value that was dominated more by German

\textsuperscript{3} Ibidem
\textsuperscript{5} Ibidem
\textsuperscript{6} Ibidem
\textsuperscript{7} A new, cheaper currency could create some important opportunities. It would suddenly make Greek exports a lot cheaper. For example, the country could resurrect the textiles industry that disappeared a few years ago. The country could also make gains with cheap vacation deals. Currently, many holiday destinations in Greece suffer because prices are cheaper in neighboring Turkey, where the skies and seas are just as blue. Some truly believe that the Greek tourism industry, in particular, would strongly profit from a Grexit. The question here is the degree of stimulus this would provide to the exports and tourism sectors. More important yet is the question of when the boom would begin. SPIEGEL Staff, The Grexit Dilemma: What Would Happen if Greece Leaves the Euro Zone?, "Spiegel Online - International", 20.02.2015, at http://www.spiegel.de/international/europe/what-a-grexit-would-mean-for-greece-and-for-europe-a-1019542.html (03.07.2015)
competitiveness — would rise substantially in value against the dollar and other key currencies.\(^1\)

To be very clear about it. Changing currencies could provide one key advantage for the Greek government: It could print as much money as it needed to finance the promises it made during the election campaign.

Up until now we have been talking more about the economic and financial consequences of a much undesired Grexit, but how about the political consequences? The political damage, of course, would be much greater. A Grexit would represent a significant political defeat for European leaders. For the last five years, they have tried to keep Greece in the euro zone at almost any price. Were the country to leave the euro, there is a danger that it could begin to orient itself more toward Russia or China.

In the final analysis, leaving the euro zone would be an almost incalculable economic risk for Greece, but one which could pay political dividends. The reverse is true for the euro zone. The best option for all involved remains that of finding a compromise. After the difficult structural reforms it has introduced in recent years, it would be extremely difficult for Greece to confront the additional pains of a currency reform. The euro zone, in contrast, has no interest in allowing Athens special rights that no other country could claim. A deal remains possible, but the longer the negotiations last, the more doubtful it becomes if both sides are willing to make the sacrifices necessary.

In the end we could come up with a couple of short conclusions which might be used also as a forecast: first, Greece's election served as a reminder that democracies, now and then, have trouble sustaining reforms when they're imposed from outside and secondly, any concession made to Greece, no matter how desperate the situation becomes, would probably be demanded by every other bailed-out country in the Eurozone.\(^2\) Here are two prospect situations that have to be given a second thought by every European policymaker breath.

As for the Greeks, a painful process of national rebuilding lies ahead, regardless. So they would do well to examine what the real costs of exiting the euro zone andreviving the drachma will be for their economy. At the very least, that will give them monetary leverage, just as the East Asian economies enjoyed during the 1998 crisis, and which played an important part in restoring the region's growth.

The truth is that Europe's self-styled technocrats are like medieval doctors who insisted on bleeding their patients — and when their treatment made the patients sicker, demanded even more bleeding. A “yes” vote in Greece would have condemned the country to years more of suffering under policies that haven't worked and in fact, given the arithmetic,\(^3\), can’t work: austerity probably shrinks the economy faster than it reduces debt, so that all the suffering serves no purpose. The landslide victory of the “no” side offers at least a chance for an escape from this trap.

And let's be clear: if Greece ends up leaving the euro, it won’t mean that the Greeks are bad Europeans. Greece’s debt problem reflected irresponsible lending as

---

\(^1\) Ibidem

\(^2\) Now, European leaders have to be careful not to give other struggling countries an incentive to follow Greece's lead into default, potentially costing creditors more than if Greece exited the euro. That's why the focus is on Greece, not Germany or France, to come up with a plan to restructure its $271-billion debt that can appeal to both sides' needs. Such a plan would have to do more to promote economic growth while still paying as much as possible of the debt Greece ran up through its profligacy. Yet if that were an easy path to chart, the two sides would have done it already. The Times Editorial Board, *Now it's up to Greece to deliver a better bailout plan*, "Los Angeles Times", 07.07.2015, at http://www.latimes.com/opinion/editorials/la-ed-greece-referendum-debt-20150707-story.html#navtype=outfit (08.07.2015)

well as irresponsible borrowing, and in any case the Greeks have paid for their government’s sins many times over. If they can’t make a go of Europe’s common currency, it’s because that common currency offers no respite for countries in trouble. The important thing now is to do whatever it takes to end the bleeding. It’s everybody’s guess, that at least for the near future, the larger question about the Greek economy’s ability to recover remains unanswered.

Bibliography:

5. Ellyatt, Holly, Deal or no deal, Greece still faces bankruptcy, "CNBC.com - Europe News”, 04.05.2015, at http://www.cnbc.com/2015/05/04/deal-or-no-deal-greece-still-faces-bankruptcy.html.
10. Kazimir, Peter, Amicable split with Greece is not the worst fate for eurozone, "Financial Times”, 10.07.2015, at http://www.ft.com/intl/cms/s/0/1b7053f8-26f2-11e5-bd83-71cb60e8f08c.html#axzz3fdRbayuQ.
14. Thomas Piketty on the Euro Zone: We Have Created a Monster, interviewed by

---

15. Prins, Gwyn, *This doomed currency was meant to hold Europe together - but it's ripping it apart*, "The Daily Mail", 05.11.2011, at http://www.dailymail.co.uk/debate/article-2057997/This-doomed-currency-meant-hold-Europe--ripping-apart.html#ixzz3fe0PZDws


