Why Greece never got a fair chance

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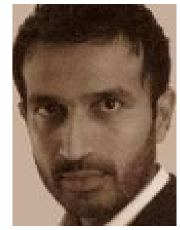

Following Greece's failure to make a scheduled debt repayment to the IMF on 30 June the country now stands on the brink of exiting the euro. **Sony Kapoor** *writes that while the Greek government could be accused of naivety in the manner it has conducted negotiations, the root cause of the crisis has been the unwillingness of Greece's creditors to rectify previous mistakes by providing further debt relief to the country. He argues that unless creditors alter their approach over the next few days, the consequences could be severe for both Greece and the Eurozone.*

Despite having experienced an angry German government almost push Greece out of the Eurozone in 2012 at first hand, I never thought we would be standing at this crossroads again. It took many of us – advisers, EU technocrats, American politicians and some academics – several weeks to convince the key-decision makers in Berlin not to pull the trigger, and it was far from obvious we would be successful. In the end Chancellor Merkel took a fateful decision to overrule the finance minister Wolfgang Schäuble, who remained unconvinced.

Living through this process was hell not least because economic arguments, financial calculations and political scenarios are not ideal for changing the minds of often-ideological lawyers that form the core of the German financial policymaking community. For them it was less about the economics and more about rules and morality.

To be fair to them, when Greece first announced in late 2009 that it had been understating its deficit figures for years, German policymakers were amongst the first to seriously countenance debt restructuring for Greece. However, word from Trichet at the ECB as well as active lobbying by large German and French banks convinced them otherwise. They were told that restructuring Greek debt would trigger a major financial crisis through losses that the banking system could not afford to bear and through potential contagion to other Eurozone sovereign bond markets.

Hence that fateful decision not to restructure Greek debt was taken, the best opportunity to offer Greece a fresh start was missed. To be fair to the rest of the Eurozone, the Greek government was also strongly against a restructuring of its own debt, seeing it as a humiliation. But the banks needed to be repaid, Greece needed money to survive and a bailout needed to be arranged in a hurry. This was the original sin. Conceived in a hurry, the bailout was deeply flawed at many different levels.

The initial financial terms offered to Greece were rather onerous, the conditions attached far too prescriptive and the pace of fiscal adjustment too much, as the IMF badly underestimated the impact of austerity on the economy. It has been estimated that of the money lent to Greece more than three-quarters went into paying off existing creditors and less than 10 per cent in supporting citizens through the shock adjustment. In effect, most of the Greek bailout funds were used to bail out Eurozone banks and other creditors.

The ECB, and Greece's central bank was part of a cumbersome 'Troika' arrangement that dictated policy to Greece, when central banks are typically at the receiving end of IMF conditionality. Decisions by the three institutions were taken on the basis of a "least common denominator" and thus many were ill conceived and no Greek government ever really bought into the onerous conditionality. Our suggestion that Greece needed a World Bank programme to facilitate state building was summarily dismissed both by Greeks and the Eurozone, which hubristically thought it humiliating.

By 2012, Greek GDP had predictably collapsed, domestic politics was upended, unemployment reached record levels and the IMF could no longer pretend to believe in its own models, thus a new deal was needed. Here again our recommendation for a deep face value haircut for external private creditors, easing the terms of the public bailout and leaving Greek banks and pension funds out of the restructuring were countered by proposals from BNP Paribas and other banks that argued face value haircuts were not necessary. In the end, after an inefficient two-step process, Greece did get a significant reduction in the face value of its debt but it was far too little and too late. Much of the private debt had already been replaced by public debt that could not be haircut.

With that second opportunity missed, Greece's descent into a great depression continued until more than 25 per cent of GDP was lost and youth unemployment reached 60 per cent: driven, in no small measure, by record levels of austerity. Greek citizens, fed-up after five years of public humiliation and economic suffering, rooted for the anti-establishment anti-austerity Syriza in the 2015 elections. As the only party that had not been part of Greece's clientelist state, Syriza offered to take on the oligarchs domestically and negotiate a new deal with the Eurozone internationally.

But Greece's answer to Obama's "Hope and Change" never stood a chance. With no previous experience of government and ill versed in what passes for diplomacy in the EU, Syriza overplayed what was essentially a very weak hand. The day after Syriza was voted in, senior German politicians said "Greeks had voted for a Grexit" and few Eurozone governments were ready to negotiate in good faith.

The good-will towards Greece resulting from the guilt staffers at the IMF and the European Commission felt about their own significant role in Greece's tragedy was also slowly eroded by the sharp elbows the Greeks brought to the table. Trust was eroded on all sides and it became impossible to triangulate between what the Greeks were willing to accept on the one hand and what the IMF and the Eurozone were planning to concede on the other. Disagreements between the Eurozone and the IMF were at least as big as those between Greece and its Eurozone partners.

On pure economics, Syriza got it mostly right both in terms of the diagnoses of the crisis and on what micro and macro level steps were needed to restore the Greek economy. But its big mistake was to assume that economic arguments could prevail over ideology and realpolitik. Another was its failure to convince its Eurozone counterparts that it would actually deliver on the promises it made. While Syriza could be excused for its naivety, its creditors get no such free pass. Their unwillingness to admit mistakes, keep promises for further debt relief and focus on petty parochial politics has once again trampled upon Greek democracy and sensible economic policy, and caused great harm to the European Project.

Unless they are willing to give Greece a fair chance over the next few days, the damage will be irreparable. And it is not just Greeks who will have to live with the consequences.

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Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

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