

Greek Crisis: Resolved or Postponed?

Last Monday, after a marathon 17 hour negotiating session, agreement was reached between Greece and its creditors (EU, the European Central Bank and the International Monetary Fund) on a package of fiscal targets, privatisation, tax changes and spending cuts: fresh funding of about € 80 bn has been promised, but the process will have to be negotiated. Greece had until yesterday to enact the agreement in parliament. Only if this is done will Greece get funding which will enable it to meet its liability to the ECB which falls due on 20th July.

The negotiations, while tough, were surely more polite than what happened in Indonesia in 1998. Eswar Prasad, in his *The Dollar Trap* describes as “*iconic*” the photograph showing “*a stern-looking Michel Camdessus, then the head of the IMF, ...glaring in schoolmarm fashion at President Suharto of Indonesia signing*” the agreement; Dr. Raghuram Rajan, in his *Fault Lines* described the publication of the photograph as “*unfortunate*”, as “*it conveyed an impression of a new form of financial colonisation*”. Has Greece now become a financial colony of its creditors?

In a way, Greece has been in the intensive care unit (ICU) of fiscal austerity and structural reforms for five years now. The end result has been a 25% drop in GDP, 25% unemployment, sharp cuts in pensions for the aged, etc. In the process, Greece’s sovereign debt as a proportion of GDP has gone up to something like 180% of GDP, from 140% in 2010. One reason underlying this is that most of the bailout funding received in 2010 and 2012 has gone to reduce the exposure of French and German banks to Greek debt: to be sure, they also bore a part of the losses.

Mark Blyth, in his *Austerity: The History of a Dangerous Idea* defines “Austerity” as “*a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices and public spending to restore competitiveness, which is (supposedly) best achieved by cutting the state’s budget, debts and deficits*”. And, “structural reforms” often mean relaxation in laws prescribing minimum wages, job security, etc., most of which the leftist government now in power in Greece would hate to undertake. (The UK also has been following fiscal austerity under the ruling

Conservatives for the last 5 years but with a different result: unemployment down and growth resuming, **thanks to a sharp fall in real wages.**)

Earlier this month, the IMF released a report publicly acknowledging that Greece sovereign debt is unsustainable; this suggests that write offs are essential if Greek finances are to be put on some kind of sustainable basis: the package seems to be silent on this. A payment due on 30th June to the IMF is in arrears (though this is not technically a “default”). With Greece running out of money, and the ECB refusing funding, Greek banks have been closed for the last couple of weeks; ATMs have no cash to disburse, even when withdrawals have been limited to a very nominal amount. Before the imposition of capital controls recently, there has been a flight of capital by wealthy residents; the result is that the dues of the Greek central bank to the European Central Bank under the so-called “TARGET 2” clearing system for interbank payments within the euro zone, have gone up from € 40 bn to € 100 bn in the last one year. With euros in short supply, shops and restaurants are accepting even Turkish and Bulgarian currencies from tourists. The Greek 2017 bond is quoting at 47, and giving a yield of around 50% p.a.! As ordinary people suffer, hedge funds and other “vulture” investors are buying Greek assets at dirt cheap prices.

At the time writing, it is difficult to forecast the outcome. Broadly speaking, there are three different scenarios in the short term:

- i. Greece signs on the dotted line accepting all the conditionalities. This may solve the immediate problem but is unlikely to provide a lasting solution. **Debt write-off will, in any case, be necessary at some stage;**
- ii. If Parliament rejects the package, Greece defaults on its debts, introduces a “new drachma” which would be legal tender only within Greece, but does not exit the single currency.
- iii. Greece defaults, exits the euro zone but remains a member of the European Union (EU).

Robert Mundell, the economist, believed that a single currency for multiple sovereign nations can work if there is free movement of factors of production, namely capital and labour. One wonders whether similarity of the cultural values, of “behavioural

economics”, is not equally important: contrast the protestant work ethic and thrift of the northern countries in the EU with the easy going, more “catholic” lifestyle of the south; contrast the Teutonic meticulousness so hilariously portrayed a century back in Jerome K. Jerome’s *Three Men on the Bummel*, with the boisterous exuberance of Nikos Kazantzakis’ *Zorba the Greek*.

In a historical perspective, after two major and hugely costly wars in the 20th century, the European project was aimed at peace and prosperity. It has achieved the first objective but the second remains a dream at least for some countries. Also, though it lost both the wars, Germany has by now become Europe’s hegemon, not through military power but through economic power – and, it has obviously not forgotten the lessons of the hyperinflation it experienced in the 1920s, which also helped the rise of the Nazis.

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