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Three Theses on the Greek Crisis

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Greece is close to insolvency. If the country does not receive any more money from its creditors, it will soon not be able to meet its payment obligations. At the same time, the decision of the European Central Bank (ECB) not to increase the emergency liquidity assistance any further will lead to a situation where first insolvencies of Greek banks are only a matter of time, if no agreement with the creditors can be reached. However, Greece does not stand at the edge of a cliff from which it will shortly fall, as is often claimed. Rather, the country is on a steep slope that it moves further down with each day on which the agony is prolonged.

Three theses on how to deal with the crisis:

Thesis 1: "Hands off!" The Greeks have to design their reform agenda on their own

The medium-term prospects for Greece are gloomy. The actual problems of the country are not primarily the credits that have to be re-paid. The Greek economy and especially the legal and administrative conditions of the country are not in a state that would allow the country to balance its revenues and expenditures in the long run. The economic strength is very low and exports are focused on a few products, in particular tourism and transport services. A rapid change cannot be expected, because the most important ingredients are missing, namely a well-functioning and reliable legal and administrative framework. Among other things, this includes the right of ownership of land and property, the judiciary and the tax authority. Unsecured administrative structures also foster corruption and prevent that trust is put in competition as a selection mechanism. Without a reform of the administration, the judiciary and the economic constitution, the country will not be able to attract investors from abroad and to catch up with the overall European development.

This analysis is not new. For years, similar reforms have been demanded by the creditors – in return for additional emergency loans. But the experiences in dealing with the Greek negotiating partners during the last years have shown that it is not possible to achieve the implementation of the much needed institutional reforms in this way. In contrast to numerous wage cuts, which have been responsible for the fact that Greek people increasingly voted in favor of the left-wing political party

Syriza, fundamental state reforms have not been implemented. Greece has had enough time, thus there must have been a lack of political will for implementing these reforms.

The oligarchic system with its strong interest groups is often mentioned as a reason for the lack of will to implement proper reforms because it has a lot of power over the conventional political parties and prevented them from making hard cuts. But during the last months also the Syriza party, which seems to be independent in this regard, has not indicated any intention to implement fundamental reforms.

In light of these experiences, the reason for the lack of political will for implementing reforms is obvious: It is contrary to the democratic conception that an elected party has to follow a reform agenda set by an outside party. The current strategy of the euro zone countries for dealing with Greece has been viewed as a personal affront which has prevented and will continue to prevent all serious attempts to implement reforms. The opposite is the case: Greece is sticking to obsolete rules to maintain a rest of national pride.

Thus, a fundamental reorganization of the negotiation strategy with Greece is urgently required. The enforcement of specific measures (such as an increase in the average retirement age by x years or an increase in the rate of value added tax on holiday apartments by y percent) has been hopeless from the beginning. Even if the Greek government would agree to some of the demands, it is not clear whether it will actually implement the measures to the extent agreed upon and whether they will be supported by the Greek population which would be necessary for each reform to be successful.

Success is not possible as long as reforms are considered as hostile conditions to be opposed from within Greece. An effective reform agenda can only be designed by the elected government. Foreign experts might be able to support the government in designing the agenda – but only if they are explicitly asked and invited. In many areas of life, unwelcomed advice is not highly esteemed – why should this case be any different?

Thesis 2: "Solidarity!" During the restructuring phase a basic level of economic security is required

Despite the crisis, "Grexit" is unlikely. Greece will neither give up the euro, nor leave the European Union. Both is not in their interest and nobody will be able or want to force Greece into any exit. In the medium-term, an efficient reform of the structural conditions could help to make Greece an attractive location for production sites and research institutions within the European Union. However, fundamental reforms need time to take full effect. How will the Greek economy develop during this time? Below a few possible scenarios are described.

Haircut

The heavy Greek debt burden (currently around € 325 billion) will in some way have to be reduced to a sustainable level under a debt agreement. A haircut can be achieved with a debt waiver by the creditors or with debt restructuring – extension of the duration of the loans, reduction or temporary deferment of interest rate payments. The debt relief for the state budget would, however, only be modest. Because, in recent years, there have already been extensive extension of the duration of the repayments and reductions of interest rate payments. Also, considerable amounts of Greek government bonds are held by private investors which makes a debt restructuring more difficult because private investors (non-banks) usually insist on a full repayment of their bonds and they are also able to enforce these claims through international courts.[1]

Implications for Greek banks and their customers

The situation for the Greek banking system will be disastrous if its solvency is threatened by outflows of saving deposits abroad and by the decision of the central bank to provide no further emergency liquidity assistance. The behavior of Greek savers shows that they are aware of the fact that a European deposit insurance is still not in place. Currently, there is only an insurance for deposits of up to € 100.000 per bank account if the national deposit insurance fund is solvent. Apart from this, only if the state goes bankrupt, assistance from the European Stability Mechanism (ESM) can be expected. In the case of Greece, this could shortly be the case – however, this has not been officially declared and, thus, cannot be used yet, as the necessary instrument to avoid a bank run.

Substitute Currency

If Greece is not able to attract additional loans, the country will sooner or later not be able to meet its obligations, such as pension commitments. Then, the scope to take any measures is limited but an open bankruptcy will be unlikely. It is more likely that due to the limited inflows of euros governmental payment obligations will at least temporarily be paid with IOUs ("I owe you" – payment promises by the Greek government; documents that promise a later exchange into euros). Because Greece will earn euros with its tourism and, for example, also with its shipping companies and transportation industry, this exchange system would only gradually depreciate. Thus, in the medium-term, maybe for several months, the business cycle could be

[1] The amount of Greek government bonds held by private investors and non-banks is estimated to be around 50 billion US dollars (which is 20% of the GDP 2014). For these claims, a decision made at a debt conference would probably not be binding – thus, the full amount of these debts would remain. In the case of Argentina, private investors were able to enforce the full repayment of their claims by international courts.

maintained – provided that the IOUs will be accepted as a sort of substitute currency by the population.

Migration

During the restructuring phase, for many Greeks, especially for young and well-educated people, migration is an attractive opportunity for developing a career. Europe with its increasingly integrated labor market offers a lot of opportunities. The countries in the euro area have a special responsibility in this regard. The can help with appropriate programs to support job opportunities for qualified employees from Greece. These employees can return to their home country any time – however, they will probably only return when reforms with democratic legitimation will actually be implemented. In the meantime, emigrants will support their home country indirectly with transfer payments, which has been the case in the Balkans for a long time.

To summarize, there are several aspects that speak for a continued slow decrease of the Greek economic output without having an abrupt standstill of the economy with the respective incalculable reactions by the population. A number of factors would be necessary for such a slow decline: apart from a considerable debt restructuring, an explicit deposit guarantee for Greek (and other European) depositors as well as migration of qualified employees temporarily working abroad, and, especially, targeted humanitarian EU aid programs are needed, such as support with the operation of hospitals and supply of medicine.

All factors put together could act as a kind of basic security for Greek reform politics that will take effect with delay. Albeit, they will not prevent a creeping impoverishment of the population. It will be decisive whether and how fast the awareness for self-responsibility for the own destiny returns – and with it also the wish and the will for a conceptionally open reform agenda. Directly and indirectly the rest of Europe will then partly voluntarily (humanitarian measures) and partly involuntarily (deposit guarantee) deliver the financial basis.

Thesis 3: “Forward!” The euro area is also in need of an effective reform agenda

A national bankruptcy in Greece would certainly put the trust into the euro to a test. The monetary union could be questioned in its consistency. In how far this will have serious economic consequences will, in the end, depend on the behavior of the other European states.

Most economists agree that the crisis in Greece confirms the worst fears regarding the exploitability and the inner instability of an incomplete monetary union. It is “incomplete” in as much as the inner dynamics of debt, the excesses of which we are currently marveling at with the example of Greece, can only be resolved through imposed political decisions if there is no goodwill. This would, however, make a union-wide political legitimation in combination with a respective fiscal authortiy necessary. Both of the latter institutions – the political union and, embedded in it, the fiscal union – have been taboos so far.

They are taboos not only because a large-scale reform package with a splitting of European and national competencies involves extremely demanding planning, but especially because an extensive – albeit not necessarily complete – abandonment of national sovereignty would have to be at the beginning of such a reform process. Such decisions can, in general, only be achieved by national parliaments or through a national referendum.

For such a reform agenda the danger to fail is generally regarded as high. Still, taking a look at these challenges is worthwhile, especially in the context of the Greek crisis. The current situation shows that without a leap forward regarding the construction of the European Monetary Union, there will be no exit out of the dead end the euro area is currently heading towards.

"In the utmost emergency, the middle way brings death" is the literal translation of the 1974 movie titled „Blind Alley" by Alexander Kluge. This may serve as an admonisher also for the future development of the euro zone. Patient negotiations about restructuring obligations, as can currently be observed, do not lead out of the current situation. Quite the contrary, precious time is being wasted in a European "house" with an unfinished structure. Courageously taking the political chance that this deep crisis offers, could, instead, create the possibility for the European project to make the next crucial step towards a political union.

The recently published report by the President of the European Commission Jean-Claude Juncker, jointly with the President of the European Council, the Euro Group, the ECB and the European Parliament[2], formulates a sophisticated vision of a more integrated Europe. The outlined agenda points in the direction suggested here. Although there is a lack of detailed considerations, a chronological arrangement of individual measures is shown with the idea of a three-stage process. Several common insurance schemes within the euro zone are named, which would basically lead to a topic-related, dense form of the fiscal union. This involves a common guarantee for the Single Resolution Fund (SRF), the implementation of a "real" European deposit insurance scheme as well as an expansion of the role of the EMS in order to achieve bank recapitalization. Though the report is rather precise regarding the establishment of lasting facilities, specific information is missing concerning the central question on how to put together a package out of these individual measures and how the political legitimacy for this can be achieved. In other words, the authors diligently avoid addressing the „elephant in the room", i.e. the necessary modification of the EU treaty.

[2] European Commission: „Completing Europe's Economic and Monetary Union" (published 22 June, 2015)

All politicians involved are very much aware of the fact that this will be no walk in the park – so much aware that hardly anyone dares to even address, let alone debate in detail, the basic reforms plus the public referendums that would then become necessary in many countries. Since the hands of most political parties in Europe are tied in the face of the rise of parties critical of Europe, at this point – and this is to be seen as a demand to the policy makers and the professional public involved – a community of supranational and non-party researchers and intellectuals could take the initiative and in a structured process develop a trustworthy and realistic concept that drafts the next big step towards a political union of Europe. Within the framework of a broad and open discussion, different forms of a future model of Europe, respectively the euro zone, that are likely to gain majority support would have to be designed. Depending on the respective constitutions, decisions by public referenda or parliaments' decisions would eventually have to follow.

If there is a way forward, putting together a more or less comprehensive package, which combines elements of a partial international joint liability scheme with elements of a partial national abandonment of sovereignty, seems to be the biggest challenge for the necessary reforms. Here, the members of the euro area could prove that they are actually in the position to draw the necessary and courageous conclusions from the current difficult situation of the monetary union.