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Greece and the Eurozone Crisis: Two Narratives

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1. The 'Greek story'

Events in Greece sparked off the Eurozone crisis in 2010 and continued to have a dominant influence on the course of the crisis ever since. Greece held prematurely and suddenly parliamentary elections in September 2009. The newly-elected government accused the previous one of concealing and grossly under-reporting the deficit it had run up to the elections but made no attempt itself to contain the deficit for the remainder of the year. In the event, the budget deficit reached about 15% of GDP with total indebtedness being 120% of GDP. In early 2010, the cost of borrowing for the Greek government began to rise at an accelerating pace and became forbidding by mid-spring. In May, Greece signed a memorandum with the European Commission, the European Central Bank and the IMF agreeing to a program of fiscal consolidation and structural reforms, in order to obtain the necessary financing and avoid immediate and disorderly bankruptcy.

It must be remembered that the Eurozone has two cardinal rules: *rule one*, governments of member states must not over-borrow; *rule two,* if they do over-borrow, they must not expect or seek help from the European Central Bank (ECB). The ECB is not allowed to lend directly to governments - a rule that clearly was intended to inhibit and restrain governments from ignoring *rule one.*

Greece's serious fiscal misdemeanors revealed in 2009 exposed a serious weakness in *rule two*: the strict application of the 'no bail-out' clause was effectively condemning member countries to default and exit from the single currency. Such harsh punishment could arguably be contemplated for serious offenders but only if the rest of the monetary union could be insulated from the effects of one member exiting the monetary union. Since the need for measures to prevent 'contagion' was not expected or foreseen, no such measures were put in place when the euro was created. This lacuna and the fear of contagion, probably played an important role

in how the Greek fiscal impasse was then handled by its Eurozone partners

Greece, instead of being pushed out of the Eurozone for its rule violations, was seemingly 'rewarded' with a massive 245 billion euro EU-IMF 'bail-out' and substantial debt restructuring. Whatever the real motives behind this decision - whether it represented a genuine desire to show European solidarity to Greece or simply self-interest - the result was unambiguous: Greece was given the opportunity for redemption. The country had to rebalance its economy through an economic adjustment program, designed and supervised by the so called 'troika', of fiscal consolidation and structural reforms. Similar assistance and adjustment programs (without debt restructuring) were extended to Ireland (2010) and Portugal (2011). During this period, Ireland (faithfully and stoically) and Portugal (more or less faithfully but less stoically) implemented, completed and exited the programs imposed by their creditors.

The Greek political system continued to be fractious throughout this period. The implementation of the 'troika' adjustment program concerning structural reforms, and especially reform of the state, was haphazard and half-hearted and anything but 'stoical'. Nevertheless, in 2014, despite the political turmoil and the insufficient implementation of structural reforms, Greece seemed to be preparing for exit from the 'troika'-imposed program. Both the large fiscal and current account deficits had not only been eliminated but turned into surpluses – a success story that required huge sacrifices in terms of living standards, with a 25% fall in GDP and a 26% unemployment rate. For the first time after six years of deep recession, Greece was expected to return to positive economic growth in 2014.

Yet, in December 2014, interest and concern about Greece dramatically shifted away from the possibility of a successful Greek exit from the 'troika' program to a possible disastrous Greek exit from the Eurozone (or Grexit). The future of Greece, and possibly the future of the Eurozone, were up in the air again because of the announcement of once again premature elections in Greece and the pledge by the Greek main opposition party, Syriza, to renegotiate the 'troika' program if it wins the elections. Syriza promised to put an end to austerity and demand debt forgiveness for Greece, along similar lines to that granted to Germany by the London debt conference in 1953.

The threat of repudiation of existing agreements has created exasperation in northern countries and particularly in Germany, which holds the Eurozone's purse strings. There is also, reportedly, considerable 'bail-out fatigue' among their electorate. From the standpoint of northern Europe, therefore, Greece appears to be 'irredeemable'. Is it time for the 'amputation' option or Grexit? What was deemed not to be an option in 2010 and 2012 because of the risk of contagion, appears to be feasible in 2015. But also in terms of morality, it seems unreasonable and unfair to expect that the taxpayers of Greece's prudent and responsible partners should shoulder the Greek debt. Is it reasonable to demand that they 'forgive' the debt or 'forget' the strict conditions attached to the bail-out that saved Greece from bankruptcy?

This familiar 'Greek story' and the related morality tale has become the dominant narrative of the Eurozone crisis, which divides Europe between the indebted and 'imprudent' southern periphery and the 'prudent' and solvent northern Europe. This narrative, despite its resonance and seeming credibility, is flawed both in terms of its diagnosis about the origins of the crisis and its ethical conclusions. The Eurozone crisis is a crisis of the euro's faulty architecture, resulting in public indebtedness and current account imbalances, but *not* (as is commonly portrayed) a fiscal crisis. The Eurozone crisis was a crisis 'waiting to happen' with or without Greece's rule violations. What is the alternative (and correct) narrative?

2. The alternative narrative

Since the 'Greek story' of political irresponsibility and fiscal imprudence is so central to the dominant narrative, the best way to approach the alternative narrative is to start by supposing that Greece had never been a member of the Eurozone. Would then a crisis not have happened? Counterfactual questions are, of course, notoriously difficult to answer but it is fairly safe to assume that events in Ireland in 2010 would have sparked off a crisis with rapidly rising deficits and high debt. Unlike in Greece, however, where the Greek sovereign miss-behaved, the Irish inordinate rise in sovereign debt was not the result of fiscal imprudence. It was the result of what has been described as a 'plain vanilla' banking crisis. Non-compliance with the rules of fiscal discipline would not have done, as an explanation for the crisis in Ireland. The Irish government's management of its public finances prior to the crisis was, in fact, exemplary. Moreover, many of the structural reform issues that had plagued the Greek economy - tax evasion, overblown public sector, inflexible labour markets etc. - were absent in Ireland. The necessary structural reforms were implemented in Ireland twenty years earlier, transforming one of the poorest economies in the EU into the 'Celtic Tiger' economy - the 'poster child' of the neoliberal economic growth model for peripheral economies. If the deadly sin of 'fiscal indiscipline and irresponsibility' was not the cause of the collapse of the Irish economy or, indeed, of the critical financial problems in Portugal and Spain (the next two euro-zone countries to be embroiled in the euro-zone debt crisis), what caused the crisis in Ireland that subsequently spread to Portugal and Spain?

Without a 'Greek story', the catastrophic public indebtedness in the Eurozone can only be explained not in terms of the mis-behaviour of the public sector but in terms of the gross mis-conduct of the private sector, in particular from the 'unholy alliance' of property developers and bankers, especially in Ireland and Spain. Why the private sector in Ireland and Spain was able to bankrupt the public sector of these economies? The answer is to be found in the so called 'design faults' of the Eurozone.

European leaders decided to create and share a single currency but without the necessary political foundations. They hoped and expected that a well-functioning monetary union would 'eventually' lead to greater political union in Europe. They anticipated that, in a monetary union without a fiscal union, the public sector could become a source of instability and, therefore, a strict set of rules for fiscal discipline was put in place. The architects of monetary union in Europe believed that the private sector was fundamentally stable and, therefore, no comparable measures were put in place to monitor potentially destabilizing activities in the private sector. With hindsight, they were wrong. The monetary union was malfunctioning from the start, failing not only to provide proper banking supervision and control but, most importantly, to correct wrong signals in the financial markets and increasing imbalances in current accounts.

The Eurozone masked several imbalances in both the real and the financial sectors of the economy. Current account imbalances and corresponding capital flow imbalances, which outside a monetary union are normally corrected by exchange rate movements, remained uncorrected and were allowed to grow causing distortions and increasing financial vulnerability. The elimination of currency risk, *inter alia,* fostered lower interest rates and easier credit conditions mainly in the Eurozone's southern periphery and Ireland. Artificially high availability and low cost of credit resulted in excessively high levels of borrowing by both private and public sectors. In Greece, imprudent politicians and, in Ireland, irresponsible bankers reacting to the same incentives created by a malfunctioning monetary union went on a borrowing binge. In Greece, excessive borrowing may have financed the creation of non-jobs and expensive early retirement schemes in an overblown public sector; in Ireland and Spain, it financed the building of empty flats in Dublin and in the Costa del Sol. These were different distortions in the economy but distortions nonetheless, resulting from the same 'design faults' of the

Eurozone – the lack of a surveillance mechanism for preventing crises and the institutional arrangements for managing a crisis, once it occurs.

The alternative narrative casts Greece in a different light. There is certainly no harm in castigating Greece for its fiscal indiscipline and manipulations of the official statistics. There is however a great deal of harm in 'stigmatizing' Greece because this distorts the correct understanding of the crisis. Fiscal discipline would probably have prevented a debt crisis in Greece but it would not have prevented the Eurozone crisis. The 'Greek story' simply diverts attention from the real task ahead, which is the correction of the serious 'design faults' of the monetary union in Europe.

According to the dominant narrative, Greece is not only the Eurozone's weakest link with the longest and deepest recession and highest debt to GDP ratio of all Eurozone countries but it is also the 'black sheep' of the monetary union. Syriza is adding insult to injury by demanding debt forgiveness and an end to austerity. Who is going to pay for all this? At this point, the dominant narrative raises the moral question again of whether it is fair that the (mainly) German tax-payers' hard-earned money be used to help the profligate Greeks.

There is, however, another aspect to this particular ethical dimension of the Eurozone crisis, which rarely gets a hearing in the dominant narrative. Greece may have broken the ***written*** rules of a monetary union but Germany has been violating the ***unwritten*** rules of a monetary union. Legally, the two cases are different but morally they are equivalent. Moreover, it can be argued that, in terms of actual economic impact, Greece's violation of the written rules is far less significant than Germany's violation of the unwritten rules. What is Germany's unfair, if not unethical, behaviour?

Suppressing wages below the agreed Eurozone inflation rate, in order to gain competitiveness and achieve export-led growth, is tantamount to cheating one's partners and is not only bad economics but also poor ethics. Amassing huge current account surpluses and refusing to eliminate them, is not playing by the rules of the game in a monetary union. Germany is largely responsible for the faulty architecture and has been benefiting from the consequent malfunctioning of the monetary union but is refusing to participate in the adjustment process by reflating its economy. It is also obstructing the ECB from taking measures to arrest deflation, which is making the debt dynamics in the indebted periphery more challenging. Moreover, it is dragging its feet in integrating the European banking system and objecting to the reforms needed, in order to level the field and equalize the cost of finance across Europe. What is worse, it benefits from protracting the crisis through the inflow of capital from the periphery, which further reduces its own cost of finance. Protracting the crisis also greatly benefits its aging economy, through the immigration of trained labor from the indebted countries suffering from high unemployment.

3. Implications for Europe

For Europe, it is not really Greece but Germany that is the problem. Europe's urgent need is to revive growth rather than reduce sovereign debt. The recognition of this priority and the consequent change in policy is obstructed primarily by Germany. In the normal course of events, Greece's influence on the future of the European economy is minimal. The only way it can affect Europe is by deciding to exit the Eurozone. Grexit will be catastrophic for Greece but, even if it may be initially only a minor shock for the European economy, it can have unpredictable consequences. It could be that its main effect may turn out to be that of facilitating Germany's imposition of austerity on the other southern countries by demonstrating the perils of exiting the euro. This will preserve Europe's faulty architecture and division between prospering creditor and stagnating debtor nations. But it might equally well be that it could serve as catalyst for the unraveling of the Eurozone,

given that the continuation of austerity offers no credible solution or hope to the less competitive and indebted countries. In either case, it cannot fail to deal a blow and set back the prospect of a federal Europe.

Turning now to the ethical plane, the situation is also ambiguous. The demand by the recently elected Greek government for partial debt forgiveness and reversal of the austerity strategy cuts both ways. The existence of a malfunctioning monetary union does not provide Greece with a moral justification for repudiating all of the country's debts. The Eurozone's faulty architecture does however provide a reasonably strong ethical basis for renegotiating at least part of Greece's huge mountain of debt. At the same time, it diminishes the moral justification for the tough, unbending and inflexible stance on debt forgiveness taken by Germany, which is the chief architect and beneficiary of the malfunctioning monetary union.

The alternative narrative does not seek to whitewash or condone corruption, tax evasion or inefficiency in Greece and the periphery. Greece has to fight corruption and must modernize its economy and indeed this is not negotiable. Exit from the failed strategy of austerity and the fixation with sovereign debt, however, is and should be negotiable. Insistence on debt reduction and debates on Grexit, as a response to Europe's failings, are a pernicious digression and a deleterious waste of time. The survival of the Eurozone is vital, if the original dream of a united Europe is to be fulfilled. Its rules, however, need to be re-written. What needs to be renegotiated urgently is a reformed Eurozone without its basic 'design faults' and with a clear vision of what unity in Europe means. It is to be hoped that the turmoil caused by the election of a new government in Greece, may lead to a resumption of this vital debate about how Europe can become truly united. Europe needs to take a bold step forward towards stronger integration rather than retrogress under the guidance of a false and dangerous narrative.

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