

# INVITED POLICY PAPER



# How to Destroy a Country. The Economics and Politics of the Greek Crisis<sup>◇</sup>

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*The economic future of Europe, with its obvious implications for the world economy, depends on the combination of many processes, not only economic ones. The situation is becoming more complicated due to potential overlapping of Brexit and Grexit, what could be fatal for the European integration. Solving the Greek syndrome requires a radical change in the way the EU approaches this problem. Specific structural reforms and fiscal adjustments are necessary in Greece too, yet necessary is conditional reduction of the Greek debt. In the long run it will be critical that certain countries' surpluses are not financed with others' deficits.*

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<sup>◇</sup> An essay on the James K. Galbraith's book: *Welcome to the Poisoned Chalice: The Destruction of Greece and the Future of Europe*.

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## 1. - A Four-Hundredth Part of World Economy

Greece is a beautiful country that has contributed a lot to the history of our civilization, including the concepts of logic and democracy. Before our eyes a drama is unfolding there, whose essence is not easy to understand as there is no shortage of controversies. Greece is a small country. The population, out of which one-third lives in the capital city of Athens, is less than 11 million people; the same as London, or three-fourths of the nearby Istanbul. If the population in Greece is increasing, it is only due to the never-ending wave of refugees and migrants coming from Asia, Middle East, and Northern Africa as Greeks themselves are not growing in numbers from one year to another – the population growth is around zero. Few Greek children are born each year, and the population is aging. On average, people live to over 80 years old (women live about 83 years, and men about 78). We can attribute this to the Mediterranean climate rather than to the economy. Median age is about 44 years old, one of the highest in Europe and worldwide. People retire at the age of about 61.9 (in France 59.7). While the number of old age pensioners that the system needs to support is increasing, the funding available is dwindling.

The result is that 40% of pensioners receive benefits below the minimum poverty level. So the proud Greeks who live in their homeland – not to mention the large Diaspora scattered all over the world – represent a tiny fraction in this global city, just 0.15 percent of the nearly 7.3 billion-strong world population. I say “in the city”, as it is no longer a “village”, because for several years now most of us, Earth inhabitants, have been living in cities. It’s also the case in Greece, where urban population represents as much as 78 per cent of the total number.

Greece is a small economy. In the first half of the decade beginning in 2010 there was a sharp decrease in production, by about 25%. Meanwhile in Poland, production increased by about 11%. As a result, in 2015, Greece became the first western country which Poland was able to surpass in terms of GDP per capita. In Greece, per capita GDP (PPP) amounted to 25,600 USD, while in Poland it was already 26,400 USD. While this is not much to celebrate in Poland, it is a definite concern in Greece. Currently, Greek GDP (PPP) amounts to only 0.25% of total world production and less than 1.5% of the gross product of the European Union, of which Greece has been a member since 1981.

While the Greek drama continues, James K. Galbraith has got involved in it as an author and advisor by publishing a book that is sure to stir a lively debate (Galbraith, 2016*b*).

The initial K, which stands for Kenneth, James Galbraith's middle name, was passed down from his father, John Kenneth Galbraith (1908-2006), one of the greatest economists of the 20th century. But James Galbraith does not live in the shadow of his father, the author of the fundamental masterpiece *The Affluent Society* (Galbraith, 1958). With a certain distance, he considers himself an economic dissident, or with a sense of irony, a rebel, but he is a world-renowned economist, known and respected for his publications.<sup>1</sup>

In an earlier, provocatively titled book, *The End of Normal* (Galbraith, 2014), Galbraith disposes of the useless orthodox economic thought, and explains the global economic crisis. In this book, he demonstrates that what we have been dealing with lately, especially in the last several or even twenty years, is not just another accident, or another turbulence in the capitalist market economy, but a systemic crisis of modern capitalism, specifically of its Anglo-American neoliberal version. Galbraith's argument leads to the conclusion that there's no going back to the "good old days", or, if you will, to "normally" functioning capitalism, that is to an unrealistic textbook vision of it.

The world has changed considerably in the last quarter of a century. Today, and especially tomorrow, what used to be beneficial in the past, has no use today. It is not possible to stop the course of history, let alone reverse it.

Galbraith's book includes a powerful charge of first-hand information and high-end interpretations. His information is first hand because the author has participated in Greek events as a government adviser to the unorthodox Finance Minister Yanis Varoufakis<sup>2</sup>, with whom Galbraith had collaborated at the Lyndon B. Johnson School of Public Affairs at University of Texas in Austin. And I say high end because the author provides not only lots of proven facts, verified data, references to source documents, but also most often a correct theoretical interpretation of them. At the same time he formulates harsh, sometimes even extreme political assessments, when he tries to argue that a series of measures imposed on Greece from the outside was and still is harmful not only because of the ignorance of those who devise them, but also because of the desire to dominate and push to peripheral positions, if not downright neo-colonize the country.

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<sup>1</sup> See his last book on income and property inequalities (GALBRAITH J.K., 2016a).

<sup>2</sup> He is the author of several interesting books, also on the European and world economic crisis, VAROUFAKIS Y. (2015) and (2016). Is it not interesting that while an American professor is writing a book about the Greek crisis and its implications for the future of Europe, a Greek professor writes about the European crisis and its consequences for America?

Galbraith says: «This is economic policy as moral abomination. It is not designed to succeed as economics. It is failing because it is designed to fail. Europe's leaders know what they are doing. The policy is not intended to restore growth and prosperity; a policy whose clear effect over years and years is decline and destruction must have been actually intended to achieve that effect. (...) The only other possibility is that these leaders are incompetent beyond all reasonable imagining». (Galbraith, 2016*b*, p. 33).

This is strong and even accusatory language. However, reading Galbraith's book is an eye-opening experience, with readers able to see the truth for themselves and to realize who is to blame, who should take responsibility and, consequently, to see the poor standard of the media reports and the bias of some "well-known economists" or newspaper, TV and online "experts" who speak on the Greek saga. Let's hope that Galbraith's voice will make it harder to dupe those who take an interest: there's no shortage of them and there will be surely more as subsequent phases of the drama unfold and come to their climax. How it will end remains an open question.

## 2. - From Small Frictions to a Grand Crisis

It is amazing how a minor disturbance resulted in a crisis with global implications. In 2010, the Greek budget deficit was only 0.2%, one five-hundredth of GDP of the European Union. Now it's a challenge its policies cannot cope with, even though there is a way out. Why pay more when it is possible to pay less? Why give into chaos when it's possible to steer the process? Why suffer defeat, when the case can be won?

Greece can either escape the mounting difficulties or allow them to crush it. To escape, it is necessary to reduce Greek debt by about half. Of course, provided that Greeks will also do their part by changing the economic structure and properly setting its institutions. This is only possible with a social market economy, not a neo-liberal economy, because this would be a continuation of the past, of a moth's flight into the fire, and it is not possible to fly in that direction for too long.

Galbraith, sometimes strongly, maybe even too strongly, distances himself from free-market capitalism, which is devoid of institutions and policies promoting social cohesion, when he states: «The point of life and work in Greece should be stability and fairness, not competition and enrichment. Those who wish to get very rich will go elsewhere, in any event. You can build a good society with

the others». (Galbraith, 2016*b*, p. 90). The trick is to build an affluent society by properly associating concern for the economic efficiency with efforts to ensure social justice, and competition with stability. It is possible.

All it takes to get crushed is to insist on the current policy of further belt-tightening, cutting budget expenditures, raising taxes and, of course, privatizing, or selling national assets en masse to foreign entities (and selling them for cheap as whoever sells quickly, sells cheaply). What awaits at the end of this path is not stability, growth, and a transition to the phase of sustainable socio-economic development; what awaits us there is a crisis, even more serious than the one before, starting from Greece exiting the eurozone, the so-called Grexit, which would be (will be?) more expensive not only for Greeks, but also for their foreign partners, especially from the European Union.

Allow me to digress here. Careful observers could see certain analogies between the present harsh stance against Greece and the attempts to impose a similar policy on Poland in the mid-1990s. Some external centers, ranging from the then orthodox International Monetary Fund, and our local home grown neoliberals – as if not disgraced enough by the failure of their shock without therapy<sup>3</sup> – both called for similar moves. These would have by no means contributed to a more dynamic economy; instead, they would have certainly entailed even greater dependence on foreign capital. However, back then, it was possible to effectively resist such pressures by implementing a proper program of structural reforms and sustainable development – the “Strategy for Poland”.

Joseph E. Stiglitz referred to this when he wrote: «Poland’s former deputy premier and finance minister, Grzegorz W. Kolodko, has argued that the success of his nation was due to its explicit rejection of the doctrine of Washington Consensus. The country did not do what the IMF recommended – it did not engage in rapid privatization, and it did not put reducing inflation to lower and lower levels over all other macroeconomic concerns. But it did emphasize some things to which the IMF had paid insufficient attention – such as the importance of democratic support for the reforms, which entailed trying to keep unemployment and adjusting pensions for inflation, and creating the institutional infrastructure required to make a market economy function». (Stiglitz, 2002, p. 181).

Today I can add that surely the then Poland’s political position and overall geopolitical environment of those times did not favor imposing something like

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<sup>3</sup> We were writing about it, along with my co-author, as these processes were occurring. See: KOŁODKO G.W. and RUTKOWSKI M. (1991).

what Varoufakis now describes as economic water boarding. Poland took a dangerous turn, caused by the ideology and policy of the first phase of neoliberalism, but emerged unscathed. Will Greece?

Perhaps it is worth, in this context, highlighting one more similarity. The method often used when imposing absurd policies is to make irrational assumptions and to promote them publicly, of course making use of established “authorities” on economic matters and of “independent” media. And all this in order to give credibility to the incredible, bring the public around to the preposterous and gain approval for something that should be fundamentally rejected. Such absurd policy was shock without therapy in Poland in the early 1990s, needless cooling-off in late 1990s and the economy-stifling belt-tightening early in the second decade of the 21st century. Back in late 1989 in Poland, the GDP was expected to decline just for one year as a neoliberal economic policy based on wrong assumptions of the Washington Consensus<sup>4</sup> was pursued. However, Washington Consensus had been tailored to the Latin American realities and did not sufficiently account not only for cultural and social, but even for all economic circumstances of a deeply unbalanced real socialism economy. So GDP was supposed to go down by just 3.1%, causing an unemployment level of no more than 400 thousand (later on, it was supposed to steadily decrease) and a single digit inflation rate (on a monthly basis) within a quarter. The reality turned out to be dramatically worse. The recession that started in the second half of 1989 lasted for two and a half years more and the cumulated GDP drop reached, in real terms, as much as 18%. The unemployment level skyrocketed, eventually exceeding 3 million, and the single-digit inflation rate on a monthly basis became a fact only in late 1997 as a result of successful implementation of the “Strategy for Poland”.<sup>5</sup>

It’s similar in Greece. The so-called *troika* – the European Commission (EC), European Central Bank (ECB) and International Monetary Fund (IMF) – in fact blackmailed and forced Greece to officially accept the economically nonsensical program, which provided for a quick return to the path of economic growth, of course after a period of appropriate belt tightening, and a short-term shallow decline in national income. In particular, the IMF in its memorandum in the beginning of the current decade, assumed there would be recession caused by a

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<sup>4</sup> To understand what the author thinks of the term, see: WILLIAMSON J. (2005).

<sup>5</sup> More on the assumption called shock therapy and its failure, and the successful implementation of the “Strategy for Poland”, see: KOLODKO G.W. and NUTI M.D. (1997).

sharp fiscal adjustment, except that this was to last for a short time, amount to 5 percent and after two years, in 2013, the economy was supposed to be on a growth path. In reality, the recession lasted more than five years, and GDP fell by over 25 percent. There was no economic recovery and growth in production, which resulted in negative consequences for the employment and unemployment, for the budget, and in a drastic reduction in the scope and quality of public services, including education and health.

How could one propose, promote, enforce a “program” (while certainly not believing in it), which was supposed to lead, after years of sacrifices, to a situation where the public debt in 2020 would still be as high as 120 percent of GDP, or twice as high as the one permitted by the Maastricht fiscal criterion of monetary convergence? As a result of the awful policies imposed by the *troika*, the production was declining and the debt increasing. These occurred despite budget cuts and tax increases. As a result, the relative public debt, calculated in relation to decreasing production, is growing, though its size is no longer increasing in absolute terms.

Interestingly, a quarter of a century earlier, when neoliberals in Poland pushed for authentic shock with illusory therapy, the IMF was trying to temper their aspirations. I witnessed this, when heading the Institute of Finance and taking part in many discussions. The then minister of finance was more papal than the Pope of monetarism and neoliberalism, the IMF dominated by Americans, especially those coming from the so-called Chicago School of Economics. In the case of Greece, the Fund initially held onto the old but no longer useful orthodoxy, and only recently, as of 2015 clearly changed the tone and sought to moderate the radical aspirations of the “dvoika”, namely the EU and the ECB.

As for the dvoika, Galbraith approaches them with harsh and even sarcastic criticism when discussing meetings of finance ministers of 19 countries belonging to the eurozone, the so-called Eurogroup. He writes: *a dreary ritual known for wasting time and accomplishing little* (Galbraith, 2016b, p. 208) and in another place: «The end of Eurogroup meetings and hosting of the Institutions at the Hilton will be a modest plus on the budget». (Galbraith, 2016b, p. 86).

### 3. - Don't Play with Fire

When I published an article entitled “Africanization of Greece” (Kolodko, 2015*b*), Olivier Blanchard, the then Chief Economist of the IMF, wrote that he did not agree with my characterization of the IMF or its leadership as dogmatic. Now I can agree that it is currently far from dogmatism which, unfortunately, dominates the thinking of some European politicians, starting from Germans. Blanchard added: «There was probably a small space for an agreement before the referendum (as argued in my blog (Blanchard 2015), and we, the Fund, were working on it). With the economic deterioration, and the bad blood between Tsipras and the Europeans, I am not sure the space is still there».<sup>6</sup>

What next? Certainly we shouldn't play with fire, but we shouldn't sweep it under the carpet, either.<sup>7</sup> Greek authorities are correct when they're not getting tricked into socially harmful and economically irrational (in the long run) excessive budget cuts and further tax increases, representing a high burden on the population, in order for the state to have funds for the endless repayment of foreign debt it has been forced to incur. Of course, one can agree to some reduction in spending, and accept raising some taxes, especially those increasing the burden for the wealthier strata of society. In Greece, there is no shortage of the poor, but there are also wealthy people or even lavishly wealthy ones.

Is what Syriza's government is/was doing an amateur approach and populism or is it a pragmatic and professional approach<sup>8</sup>? On the one hand, James K. Galbraith, a strong supporter and advocate of Syriza, has no doubt about the responsible approach of the Greek leftist government. He points out that during negotiations with partners from the *troika* «(...) the government has been very careful, not to play games, not to present negotiating positions from which concessions are planned in advance, but simply to spell out in a transparent and honest way where the lines are that they will not cross». (Galbraith 2016*b*, p. 108). On the other hand, Olivier Blanchard, “number 2” in the International Monetary Fund, wrote to me that «(...) when it comes to the Syriza position, we never had a good sense of what it truly was».<sup>9</sup>

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<sup>6</sup> Private correspondence.

<sup>7</sup> My comment came out under this title on the pages of Nouriel Roubini's blog. Cf. KOLODKO G.W. (2015*a*).

<sup>8</sup> I make this distinction between two different tenses as, depending on when you read these words, Syriza is either still in power or has already moved to the opposition.

<sup>9</sup> Private correspondence.

Elsewhere Galbraith notes «(...) a crisis brought on by the neoliberal financial policies of the early part of the 2000s, and then aggravated and prolonged by the austerity ideology that succeeded the crisis, and by the profoundly counterproductive policies with which Europe has reacted to the crisis. The possibility that an anti-austerity government might lead the beginning of a recovery from the austerity regime is, I think, a present reality and it is, of course, a nightmare in certain quarters» (Galbraith, 2016*b*, p. 78). Sounds familiar? *Déjà vu?*

Yes, Poland was in a similar situation at the turn of 1993 and 1994, when following the “shock without therapy” fiasco, a left-centrist formation was democratically elected to power. There were the ominous forecasts of a “rolling destruction” (Leszek Balcerowicz, former finance minister in the “Wall Street Journal”), “300 percent inflation rate in half a year” (Jan Krzysztof Bielecki, former Prime Minister) and “national disaster” (Jan Winiecki, former Polish representative at the European Bank for Reconstruction and Development, EBRD. Much to their (and to some others’) disappointment, it turned out that the years 1994-1997 saw a period of economic success, with a record GDP growth rate in 30 years, and huge institutional progress, resulting in Poland joining the Organization for Economic Co-operation and Development (OECD) two decades ago. The unemployment level decreased dramatically, by over one million people, and inflation rate fell by about two-thirds. Yes, for some it was a real nightmare...

Back to Greece, it is already recording a primary budget surplus as in its budget it allocates less public money than it receives. In other words, if you leave out the costs of servicing public debt, the budget obtains more money than it is spending. We should acknowledge that nothing like that is happening in Italy or in France. But it is also necessary to note that the earlier demands of the *troika* for the surplus to reach 4.5% of GDP, were economically absurd and politically preposterous. The next proposal, this time by just the “dvoika” (the IMF did not make such radical demands), for the surplus to stand at 3.5% of GDP was also unacceptable. And even if the acceptance of it had been forced by political means, it would not have been possible economically.

It is also worth noting that the leftist government of Greece is a democratic one. People, who have been plunged into poverty for years, took to the streets, but still democracy has – so far – prevailed. And creditors have to reckon with it if they treat democracy seriously. What are the alternatives? A return to the “black colonels” dictatorship, in Europe, in the EU, in the second decade of the 21<sup>st</sup> century? One would have to be politically blind and economically ignorant to believe that a democratic majority in Greece will accept an extreme program of

excessive sacrifices spanning over a decade, if not more. This is not only contrary to logic, it's also unethical.

Thanks to subsequent "assistance" maneuvers, a majority of Greek obligations was successfully shifted from private banks, which were co-responsible for the Greek crisis, to public organizations including the EU and IMF. Currently, around 80% of debt is owed to a special EU institution, the *European Stability Mechanism*, to the ECB, and to the IMF. The next years saw an expensive game of moving the growing debt from the private to the public sector, which was similar to the principle of privatizing profits and nationalizing losses, well "tested" during the 2008-2009 financial crisis. Those "saving" Greece were lending to it subsequent installments of funds so that it could pay off its private creditors, which it did. This was the main point of the crisis that has already lasted 7 years, so lean for Greeks, but not for the overwhelming majority of their well-fed creditors...

#### 4. - 3 x 25

While the Greek debt rose from little over 100% of GDP in 2010 to 180% of GDP in 2016, Greece was pushed by outside forces as well as by the next series of "assistance", into the syndrome of triple 25:

- over 25% recession since 2010;
- over 25% unemployment rate;
- 25% of the population living below the poverty level.

This is something unheard of for a developed country during times of peace. At the same time, rich banks, mainly German, French, Swiss, Austrian, and from Cyprus, are shunning responsibility, passing on the costs of their earlier reckless lending, to European taxpayers. Admittedly, some of these banks had to write off the unrecovered debt, but this cost them a lot less than the profit they made from this practice.

Who should now pay the costs of lack of prudence and unwise policies? Greeks, who already work (if they have a job at all) the longest in Europe (2042 hours per year), about 6% more than Poles (1923 hours), and 49% more than Germans (only 1371 hours)? Out of the OECD countries, only South Koreans work more annually (2134 hours). Of course it's easy to tell Greeks to get down to work, but one needs to also answer the question of where to find this work? Hopefully not one that involves building barricades...

Incidentally, these striking differences show how much both Greeks and Polish people still have to do to substantially lift up their economy and living standards.

They cannot work longer hours, but perhaps, more efficiently. However, this does not necessarily require cuts in public spending, but rather a change in what the money is spent on. Expenditure could even go up, provided that at the same time corruption will decrease and additional expenses will go to improving the quality of human capital, especially to education, as well as to improving the infrastructure, without which private enterprise cannot develop faster. For those and other countries that are at a relatively lower level of development – which Poland (69.8 per cent of the European Union’s average of USD 37,800 at PPP) and Greece (67.7 per cent) still are – all this, coupled with better management, higher labor discipline, and improvement in the quality of institutions<sup>10</sup> is a necessary condition for productivity to grow at faster rates and for the development gap to diminish.

The *troika* – the European Commission, the European Central Bank and the International Monetary Fund – has a much greater share of responsibility for the crisis than Greece. Of course, the previous governments in Athens (and not the Syriza government that has only been in power since February 2015 – and part of the Greek society share the blame; the original sin was committed by the Greeks. Living beyond their means for too long, which contributed to a widespread entitlement mentality, highly unionized economy with strong anarcho-syndicalist tendencies, tax evasion, inadequate fiscal system, corruption, overly soft financial policy – these were the original causes of the crisis. Other factors that contributed to the crisis spreading include some structural deficiencies of the Greek economy, such as production base being relatively weaker and less diversified compared to other countries with a similar national income, underdeveloped export sector (except for tourism), a deficit economy that is not open enough and greatly dependent on imports and foreign capital, and excessive defense expenditures.

The author of the *Poisoned Chalice* points to some of those flaws, but he seems to have slightly less to say when it comes to the original causes of the Greek syndrome, focusing on the subsequent stages of its escalation. While he is right to do so, it would have benefited the narrative as a whole if he had been blunt about the recklessness of the Greek and their governments in the 1990s. and 2000s. They could have better prepared for joining the eurozone, which took place in 2001, but also they shouldn’t have been accepted then as it was well known, at

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<sup>10</sup> More about the importance of institutions, in behavioral rather than organizational terms, see: NORTH D. (2002).

least among experts from Brussels and Frankfurt, that the data provided by the government in Athens about meeting Maastricht fiscal criteria, including the real budget deficit amount, were quite misrepresented. Well, ill-conceived political considerations, once more, took a priority over the economic ones. The architects of erotization were committed to including as many countries as possible in the single currency area, so for Greece they turned a blind eye to the structural and institutional weaknesses and to some statistics being manipulated, and they only opened it wide when it was too late.

Of course Galbraith is aware of the Greek weaknesses. He emphasizes that: «It is true that the Greek government was always a weak borrower. It is true that the country has a large civil service, a patronage-based politics, aggressive unions, and dubious accounts». (p. 32). Nevertheless, he clearly takes the side of Greece, directing his criticism towards the rich countries having a structural surplus of trade balance, especially the large Germany, but also the small Austria or Holland. To be able to place part of their competitive and high quality production and surplus capital abroad, they needed countries that served as outlets and places for some long-term direct investments and short-term speculative investments. But we shouldn't forget that, as the saying goes, it takes two to tango. And both Germany and Greece were all for it. One country's surplus becomes another country's deficit; the richer one's receivables become the poorer one's debt; the propensity to lend to someone stronger corresponds to the willingness to borrow from somebody weaker.

According to Galbraith: «The flow of goods from Germany to its markets was matched by a flow of credit, either directly to state purchasers of arms and infrastructure, as in Greece, or indirectly via private financing of residential and commercial construction booms, as in Spain and Ireland. In all cases the unbalanced flow of goods matched the accumulation of debts; the Greek instance was merely the most extreme. The Greek story is properly a European story in which, as in all European stories, Germany takes the leading role» (p. 3). In a nutshell, Greece, as well as the other countries that got into similar trouble, though to a lesser extent, would not have found themselves in such a deplorable situation, if it wasn't for their richer partners having their eyes set on their individual interests.

Let me add that similar conclusions can be drawn with respect to some crises that occurred across the Atlantic, starring the United States on the one hand, and some Latin American countries, on the other, especially Argentina over a decade or so. However, in this case, after the decline of the fixed exchange rate of peso (so called currency board) in 2002, this country was able to resort to devaluing it against dollar. This mitigated, at best, the consequences of the collapse as it

didn't save Argentina, still grappling with its results to this date<sup>11</sup>. Meanwhile, Greece cannot do something like that as it is in the eurozone. It cannot devalue "its" euro against euro and so the only way to improve the economy's international competitiveness in this situation is the so called internal devaluation, which boils down to reducing the costs of manufacturing, mainly the costs of salary and social benefits. Hence the pressure from foreign countries, having their vested interest, for reduction of salaries and social transfers that add to the costs of salaries.

It's not the time to blackmail Greeks and to excessively corner them. And that's what is actually happening. This is what the *troika* is doing, with Germany playing a special role in this practice. If this country as well as other creditors, understandably, wants to get their money back, it needs to finally realize that only part of it can be recovered as Greece is insolvent. And Germany is greatly to blame as it would impose on it – both directly and indirectly through the *troika* where it has a lot of clout together with France – a bad and harmful policy of "tightening the belt" beyond reasonable measure. And now Greeks are supposed to cut their pensions and keep lowering their standard of living, by increasing prices and taxes, to pay off an exorbitant debt?

Politicians are often slaves to their own words. First the German-French duo referred to in the media as "Merkozy" – the German chancellor Angela Merkel and the president of France, Nicolas Sarkozy – unwisely maintained that the debt cannot be restructured at the expense of private creditors. Similar position was held, for some time, by Christine Lagarde, the head of IMF, former French minister of finance, which is of significance here. So who was supposed to pay for it? The working, and more and more often, non-working people of Greece? Or maybe taxpayers from the countries to which Greece owed larger and larger sums? Politicians – mostly those from Berlin, Paris, Brussels and Frankfurt – have put themselves in a very awkward situation as their earlier imprudent statements meant to prove how hard and steadfast they are, now are holding them back. We will not cave in! Let Greeks pay what they owe! The thing is they are so burdened with debt also through the fault of those politicians, that they simply have no funds to fully pay it off.

Now we need to admit, openly communicating to our own societies that we have a moral duty and an economic necessity to bear part of the costs of relieving the Greek tensions. And those who could not be bothered by the ethical dimension of the matter should know that coming to terms with irrecoverability of part

<sup>11</sup> For more about the origin, course and consequences of the Argentine crisis of the early 21<sup>st</sup> century see: EPSTEIN E. and PION-BERLIN D. (2008).

of the debt is cheaper than unrealistically insisting on its repayment, which leads to a yet more widespread crisis.

## 5. - How to Reduce Debt?

I have been advocating for reprofiling the Greek foreign debt for a long time now. My commentaries on this matter have been published by magazines that are opinion leaders in economic circles – “The Economist” (Kolodko, 2011*b*) and “Financial Times” (Kolodko, 2011*c*; 2012). Not only because of their merit, but also because they were written by Poland’s former deputy prime minister and minister of finance, with proven experience in reducing irrecoverable debt.

Adjusting the level of debt to the possibility of servicing it in a long term must be, understandably, based on continuing a tough financial program and appropriate changes in the functioning of the economy. We, Polish people, happen to know a thing or two about that. In September 1994, acting in the capacity of Poland’s deputy prime minister and minister of finance, I signed a memorandum of understanding on a conditional reduction of our debt by half, with creditors from private banks being members of the London Club. Earlier on, in 1991, similar agreements were reached with creditor-countries from the Paris Club. These were tough terms, and the progress in meeting them was implacably monitored by the IMF. If it weren’t for those decisions and the resulting adjustment processes, we would have been doing much worse as there would have been no chance for normal trade relations with foreign countries, favorable access to global financial markets or for rapid inflow of foreign direct investment, all of which had a major impact on our growth dynamic.

Reasonable and progressive financial commentators might have concluded that it’s worth using somebody else’s arguments, thus expressing their support for my proposals, though they did not do it outright. Since it made sense back then in Poland – and it did! – and it was successful, maybe it’d be worth trying it now as well, even though it’s different time and place? It would! I believe that writing off half of Greece’s public debt is fully warranted. Then the debt would be brought down from the current over eur 320 billion to 160 billion, or below 90 % of GDP. It would still be 50% more than authorized under the relevant Maastricht criterion, but the debt of this size – comparable to debt of France or Germany – would be possible to pay. In the present amount it is not and will not be.

Since I wrote already five years ago in the “Financial Times”, that “EBC must rescue Greece or pay more later”, now when the “later” has already come but it’s

still not too late – I will add that I fully stand by this view. But now the price of rescue measures is much higher. One must pay for the lack of common sense and economic imagination, for short-sightedness and ostensible political correctness. It's a shame the payment comes also at the expense of others who have nothing to do with all this mess.

In a nutshell: Greece will not pay all of its current debt. There's no point in deluding ourselves and muddling through unrealistic solutions, the way it is being attempted with perseverance worthy of a better cause. Postponing a pragmatic settlement only increases the costs of crisis. We are facing a sharp alternative: either Greece will pay off the agreed substantial part of its external obligations in an organized manner, as suggested by common sense and realism, or much less and in a chaotic manner. Pushing further on Greeks to bleed so that creditors, who have already made a small fortune "helping" them in the past, could keep lining their pockets is an economic, social and political nonsense, both from the perspective of Greek economy and from that of the European Union as a whole. Rational reprofiling of the Greek debt (I suggest talking of "reprofiling" as some won't even hear of "writing off" or "reducing" it...) by lowering it to the threshold of recoverability must be undertaken or else not only Greece will enter a nightmarish phase of its crisis, but the crisis will also spill over the entire area of Europe, also outside the single currency area.

The risk is immense, much greater than the one assumed in many different scenarios of Grexit, which would mean the end of euro as we know it. This would be a strong blow to the entire European integration process. This process is not Europe's private matter as it has a direct and indirect impact on economic relations with many non-EU countries and regions and is being watched in other parts of the world – from MERCOSUR<sup>12</sup> in South America and NAFTA<sup>13</sup> in North America to ECOWAS<sup>14</sup> and SADC<sup>15</sup> in Africa to ASEAN<sup>16</sup> and SAARC<sup>17</sup>

<sup>12</sup> MERCOSUR, *Mercado Común del Sur* or Common Market of the South, is a regional integration agreement, whose full members are Argentina, Brazil, Paraguay, Uruguay and Venezuela and associate countries are Bolivia, Chile, Peru, Ecuador and Colombia.

<sup>13</sup> NAFTA, *North American Free Trade Agreement*, whose members are the United States, Canada and Mexico.

<sup>14</sup> ECOWAS, *Economic Community of West African States*, has fifteen members: Benin, Burkina Faso, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Cape Verde, Senegal, Sierra Leone, Togo and Ivory Coast.

<sup>15</sup> SADC, *Southern African Development Community* is a loose integration grouping consisting of 15 countries: Angola, Botswana, Democratic Republic of the Congo, Lesotho, Madagascar, ./.

in Asia. And, naturally, by China. If the European integration process collapses, then integration processes in other parts of the world will hang in balance. And there is no better way to adapt to the challenges of irreversible globalization than through the processes of regional supranational integration, as then it will be easier to coordinate global policy on a worldwide level, which is necessary to keep a global balance, not only the economic one, in a longer term.

In economics and economic policy, one needs both knowledge and imagination to go beyond preconceived notions that are incompatible with the fast, sometimes quite dramatically, changing reality. In politics, which is defined as the ability to leverage opportunities that come our way, imagination is even more needed. What if someone plants some kind of a Trojan horse on us. Not only don't we know what the weather, prices, exchange rates, supply, demand will be like but, most of all, there's no knowing what "they" will do. They – meaning the coalition and the opposition, friends and foes, our country and world at large, the poor and the rich, and, of course, the notorious markets. Curiously enough, sometimes politicians themselves don't know what their next move will be, as politics is more like no-holds-barred wrestling than chess. There is no way to plan everything, but we can try to foresee, though it's not easy. At times, however, as it is the case of the Greek drama, this is extremely difficult.

## 6. - What a Beautiful Catastrophe!

Successive scenes of this saga parade before our eyes like pages of an economic and political thriller. No writer could invent what is going on these days. Neither Homer, nor Sophocles, well, maybe only Nikos Kazantzakis, the author of the immortal "Zorba the Greek". Interestingly enough, Zorba's first name was the same as that of Prime Minister of Greece in the years 2015-20..?, Alexis, and his adventure ends up in a big fat catastrophe. When all he has built with a newly met friend goes tumbling down, he asks him, laughing, if he's ever seen such a beautiful catastrophe?! He hasn't because there has never been one like that. Nor

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Malawi, Mauritius, Mozambique, Namibia, South Africa, Seychelles, Swaziland, Tanzania, Zambia and Zimbabwe.

<sup>16</sup> ASEAN is *Association of South-East Asian Nations*, whose members are Brunei, the Philippines, Indonesia, Cambodia, Laos, Malaysia, Myanmar (Burma), Singapore, Thailand and Vietnam.

<sup>17</sup> SAARC, *South Asian Association for Regional Cooperation*, is made up of Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

one like what *troika* is concocting these days for Greece during this one of a kind Troj(ik)an war, but this catastrophe, if it happens, will not be beautiful and there will be nothing to laugh about or dance around...

But there is also an episode in this story where an old French woman who ended up in Crete, is dying and her female neighbors won't even wait; they steal her furniture, carpets and sheets while she's still on her deathbed. A bit like rich creditors, who wanted Greece, pushed to the brink of death, to surrender to them its family silver in the form of attractive assets worth no less than eur 50 bn. Prime Minister Tsipras did not agree to this dictate of western creditors. Assets in more or less that amount are to be ring-fenced and, though subject to foreign control, three fourths of them are to be used in Greece: half to recapitalize the devastated Greek banks, and one fourth for investments. The last fourth would go to repay part of foreign liabilities.

The author of our thriller would have to be very imaginative to predict that at the next turning point of the negotiations/confrontation with *troika* (there have been more of those moments and there is more than one ahead of us), left-wing government prime minister will announce a national referendum. Its outcome was easy to foresee, even though Greeks were blackmailed that if they voted for "no", they would have to leave the eurozone or maybe even the EU. They voted for "no" and, for the time being, they are not leaving. The referendum question was worded in an extremely cunning way as there were many ways to interpret the negative response: I am against, nay, for. However, Greeks are not the only ones against (sacrifices) and for (euro). Also an overwhelming majority of Germans are in favor of Greece staying in the eurozone, but only half of them in favor of granting "financial assistance" to it, although the former is impossible without the latter.

After the referendum, which was meant to strengthen Prime Minister Tsipras's bargaining position in his efforts to reject the austerity package pushed on Greece, he presented to the *troika* their own package as his proposal, albeit slightly softened. This way he got his compatriots angry while getting his partners cornered: you must accept what you basically suggested yourselves. And so it happened. However, the *troika*, at the bidding of Germany and the Netherlands and some small states with conservative governments – Slovakia, Estonia, Finland, Latvia, Lithuania, Malta and Luxembourg – this time demanded that to lend credence to this offer, top level political guarantees are necessary. This was about immediate (which is very difficult, considering the legislative complexities) adoption of laws amending regulations on the fiscal system and tax rates (especially raising VAT

and CIT, job market deregulation, greater pension system discipline and extended retirement age) as suggested in the Brussels package.

Prime Minister Tsipras said the day after the Brussels summit – another one touted as a “breakthrough” – that he did not believe in the labored deal but he had accepted it. He referred to proposals contained there as “irrational”, but he was willing to implement them to “avoid a disaster for the country, the collapse of the banks”. But how do you implement an irrational agreement? Another paradox was that any implementation of those changes (and, mind you, apart from the parliament, there is also the constitutional tribunal that has already questioned decisions to trim certain social transfers and benefits awarded in the past) requires support from part of the opposition for the Syriza government as many of its deputies are also “for” and surely “against”. Zorba is scratching his head ...

Prime Minister Tsipras succeeded at what economists did not quite manage, though they used rational arguments based on correct economic theory. He is slowly convincing some of his largest creditors, especially France and Germany, to accept the indispensability of cutting not budget expenditure but foreign debt. Earlier on, French president François Hollande and Italian prime minister Matteo Renzi were open to talks on reducing the Greek debt, which is a sign of their economic pragmatism and class as politicians, considering that Greece owes them over eur 42 bn and over eur 37 bn respectively (ca. eur 57 bn to Germany). After all, it is more difficult to take this bitter pill when you have your own problems with lingering budget deficit and a major public debt, which stands at ca. 95% GDP in France and exceeds 120% GDP in Italy. There’s no need to point out that in both these cases it greatly exceeds the limit allowed under the Maastricht treaty.

Ostensibly it should be easier for everybody to follow this path, though still an uphill one, as the International Monetary Fund surprised all the other players in the summer of 2015 by fiercely criticizing the bailout deal offered to Greece by the eurozone. IMF believes that Greece’s public debt is currently “highly unsustainable” and urged a debt relief “well beyond what has been under consideration to date”.

How to get out of this dead end? Different proposals are being put forward. Well, I suggest making two shelves. The shorter one is already there. It’s the ring-fenced Greek assets worth eur 50 bn, aimed to restore the financial liquidity and capacity for output growth. What we need to put on the longer shelf is part of the debt, 150 billion euro, and these liabilities should be frozen for 25 years at their face value, that is with no interest charged, and then the whole amount written off. Of course, provided that Greece solves the part of the task that is allocated to it,

proving to itself and others that it is capable of strengthening its market economy institutions and of streamlining its fiscal and other policy. I believe it is capable.

Hence, we are in for next riddle: how will Germany and those marching alongside it justify their consent to reducing the Greek debt? Well, this is what they should do if they want to recover more money than they would in the alternative situation of a chaotic Grexit. The cue on how to get out of the pickle politically in this wandering world came from Barack Obama on the day the deal was struck on solving the conflict situation around Iran's nuclear program. US president said that the compromise reached – as this must be a compromise – is not built on trust but on verification. The same can be said, a year before the parliamentary election, by German chancellor and bureaucrats from Brussels to Greece, but for their own benefit. It's no longer about getting out of this mess without losing face but mostly without losing common sense.

How can one destroy such a country? Why insist on a policy that is harmful. To the society, to economy, to the state and to the European integration. For money? What money? Holding on to orthodoxy and dogmatism will no longer bring any financial benefits to the rich co-perpetrators of the Greek drama, and will only make them incur even greater costs. For prestige? What prestige? After all, they no longer stand a chance of going down in history as good guys. To get out of this with no extra losses, it's necessary to escape forward, or reach out for unconventional solutions.

It would be good to be clear about who is responsible for this whole economic and political mess but there won't be a consensus on that. Decisions are taken in such procedures and modes that it's easier to articulate mutually exclusive accusations than to determine who authored specific solutions. Sometimes reasoned objections, some other times tendentious allegations are directed towards huge structures such as *troika* or Greece, towards organizations such as the European Union or the International Monetary Fund, towards specific politicians such as the Greek Prime Minister or the German chancellor, minister of finance having his office in Athens or his partner (or opponent?) in Berlin.

## 7. - Divergent Points of View

In the book *Welcome to the Poisoned Chalice...* James K. Galbraith staunchly rejects the view that the Greek crisis is a clinical example of the irresponsibility of both the government and the governed, and tries to argue that the foreign en-

vironment of Greeks, the one involved for years in “overcoming the crisis”, is much more at fault for the current situation than Greeks themselves. Hardly anyone is as well versed as himself in its realities and multiple aspects. This can be clearly seen in his book, which also includes his technical memos and economic policy recommendations made on the spot. There are fragments that read like a live report, a riveting reportage from a unique journey to Athens, Brussels, Paris, Berlin, London. At times we can also see documents addressed to the Greek minister of finance, some other times to its American counterpart, which were drafted as strictly confidential. Now they are becoming public domain and they are available also to us to read and review.

Let’s be aware, however, that opinions are greatly divided even among luminaries of economics and political science. This is how Francis Fukuyama reacted to my opinion published in the summer 2015 (Kolodko, 2015*b*): «I broadly agree with your piece. There’s no conceivable scenario under which Greece can pay its debt, so I don’t understand why debt forgiveness isn’t on the table».<sup>18</sup> My line of thought is essentially shared also by the Chief Economist of the World Bank and its Senior Vice President for Development Economics, Kaushik Basu: «...the stereotyping of Greeks that has gone on for so long (as you point out) and with so little validity that a lot of damage has been done and it will take a lot of effort to undo this (if at all)».<sup>19</sup> One of the leading Chinese economists, Gang Fan, director of China’s National Economic Research Institute, NERI, commented on my statement in more radical terms: Yes, we are expecting you speak out. Some people in US mess up the “facts” and their “wishes”, and in their “analyses”, they pick up facts to fit their wishes. And no one makes apology for their wrong predictions.<sup>20</sup>

Different opinions are expressed by Nobel Prize winners in economics. Robert J. Aumann of the University of Jerusalem’s Federmann Center for the Study of Rationality reacted to my essay with those words: «I am not really familiar with the facts. Very superficially, it seems that they cannot pay their debts, *i.e.*, are bankrupt. Indeed, it appears from their electing Tsipras (...) that they don’t want to pay their debts, are in some sense repudiating them. There is not very much you can do about that, except being more careful about lending them money in the future».<sup>21</sup> Edmund S. Phelps, Director of the Center on Capitalism and So-

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<sup>18</sup> Personal correspondence.

<sup>19</sup> *Ditto*.

<sup>20</sup> *Ditto*.

<sup>21</sup> *Ditto*.

ciety at the Columbia University, wrote: «I must say I thought (...) that you were insufficiently critical of Greece's stance».<sup>22</sup> James K. Galbraith is much less skeptical about Greece and its faults than I, so he certainly risks criticism from more than one of his eminent American colleagues.

While the many controversies around the Greek syndrome are understandable, opinions on responsibility can be extreme both among experts and among public at large. Some, in Greece, behave reprehensibly by painting Hitler's moustache on posters of Angela Merkel visiting Athens, others, in Germany, yield to xenophobia and, demanding "Germany for Germans", hypocritically claim they only subsidize others, while refusing to remember they once earned much more on economic expansion, not always a responsible one, also in Greece. This can bring to mind the times of the Council for Mutual Economic Assistance, Comecon, which was dissolved a quarter century ago when the real socialism collapsed. While in Moscow you can still find economists that are deeply convinced Moscow was the one subsidizing Polish economy for years, in Warsaw an irrefutable belief is cherished that Poland subsidized the Soviet Union through various trade and investment channels. Similar views are held in Bratislava and Prague, in Budapest and Sofia. This is often the case of "mutual" assistance and "multilateral" benefits...

As for experts and "experts" on Greece, it's pretty baffling how easy it is to spread all kinds of negative stereotypes. Of course, as always in such situations, some media play their shameful role here. When they deserve it, Galbraith spares no bitter words and "good" wishes to them: «(...) the role of the "Guardian" and the "Financial Times" as the mouthpieces of the Brussels apparat, throughout the Greek drama, is one for which I cordially hope their editors fry in hell». (Galbraith, 2016*b*, p. 161). I am convinced that journalists and commentators of some Polish newspapers will also join them there...

Perhaps there's a proverbial light in the tunnel. Agencies report on a preliminary agreement on reducing part of the Greek debt in exchange for the extraordinary adjustment effort made by Greece. BBC informs: «The head of the Eurogroup of finance ministers, Jeroen Dijsselbloem, has said he hopes a deal with Greece on reforms and debt relief can be agreed later this month. (...) Greek MPs passed controversial new pension and tax reforms (...). The IMF believes Greece needs debt relief and says it will not sign off on a review of Greek reforms unless such relief is granted. (...) German Finance Minister Wolfgang Schäuble also said he was "confident" that a solution would be reached (...). (BBC, 2016)

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<sup>22</sup> *Ditto*.

On the one hand, it's amazing that this time IMF is on the offensive and demands debt reduction. It's as if the pope suddenly demanded sexual freedom... It was easier for the Fund to do this about-face as the costs of such unavoidable procedure are mostly incurred by the "dvoika", *i.e.* European structures. We need to help Germans reach this conclusion, too, as they have as much to say as to lose in this matter. After all, the losses have already been incurred, in major part. Now it only has to be politically admitted (which is not easy) and properly entered in the books (which is less difficult).

On the other hand, it's astonishing that the mighty of the world as well as analysts, economists and financial commentators rubbing elbows with them took so much time to reach a conclusion which was obvious already several years ago. Some might say "better late than never", but others will ask why it happens at such a great expense? Also at the expense of those who will now bear the burden of debt reduction. But now the debt is much higher. It is, to a significant extent, no longer an obligation to western banks and their shareholders (and the political beneficiaries of their sponsorship), but an obligation to public organizations represented by *troika* or, ultimately, to us, European Union's taxpayers. Still, there's no doubt: it's better to pay the costs of gradually getting out of the Greek syndrome this way as otherwise we'd have to pay the consequences of a much more costly chaos.

## 8. - Troj(ik)an War

At the same time, I am aware that giving help to Greece in the form of a conditional write-off of part of its debt involves a risk of demonstration effect. Others may demand similar solutions – countries that are structurally weak, struggling with deficit and excessive public debt, mostly Portugal and Spain. That's why when dragging Greece from the economic mire in which it has found itself, EU must have in place a tough and effective EU policy towards other countries, so that with reasonable support they can themselves handle the crisis processes that plague them. It should be, however, emphasized that the risk of demonstration effect is much greater in the event of Greece's bankruptcy and leaving the euro-zone. This cannot be done calmly, according to a plan, without the crisis spilling over to other weak countries. If Greece can't cope, soon Portugal and Spain, perhaps also Cyprus and Ireland and later even Italy can be in a similar situation.

I believe that not only economists will be fascinated to read the last part of Galbraith's book, "Appendix: A Summary of Plan X" (Galbraith 2016*b*, pp. 189-

198), discussing the potential turn of events and the various challenges that would (will?) have to be faced in the event of Grexit. It reads like expertly written economic *science fiction*, like a *counterfactual history*, or, colloquially speaking, *what if* novel? It is all the more intriguing that it may turn out that what is *what if?* now, a very professional one, may still become very useful advice for policy, not only the economic one.

Considering the subtitle of the book – “The Destruction of Greece and the Future of Europe” – according to Galbraith, the coming years look bleak for our continent. Especially that it has been swept by more crises than the still unsolved and even escalating Greek syndrome. Let me re-iterate: things happen the way they do because a lot happens at the same time. Refugee crisis, the confusion over Brexit (Kolodko, 2016), devolutionary tendencies within the European Union and conflicts near its borders, in Ukraine and Turkey, are just the most important ones among other crises which put the one in Greece in a more complex political context.

The situation is still as difficult as unpredictable, but it’s possible to find a way out as long as political common sense and true European solidarity prevail, and the economic policy follows the theoretical premises of the New Pragmatism (Kolodko, 2011 and Kolodko, 2014). The coming years will show if that will happen. It may, it should, it doesn’t have to...

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