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Up-to-the-Minute Analysis from
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How the Greek Situation Could Still Be Saved: A Three-Point Programme

Much has been written on the Greek case, and there is a good degree of "noise" and discordant views. Still, many analysts now seem to be converging toward a 45-10-45 probability assessment.[1] Under this scenario, observers are assigning relatively low odds (around 10%) to the possibility of securing a comprehensive agreement between Greece and the international institutions that have bailed out its economy twice (a "policy breakthrough"). Vastly more likely seems one of two eminently less desirable outcomes: a last-minute "muddling-through" compromise (rated at around 45%); and a disorderly falling apart, a Grexit, or more precisely, a "Graccident," where control is unintentionally lost by both Greece and its creditors (a scenario whose likelihood is also, disarmingly, now put at around 45%).

These are woefully bad odds for an outcome which all say must be avoided, spawning serial meetings in search of an agreement.[2] The precise consequences of a Greek exit from the eurozone are incalculable but undoubtedly considerable – both for Greece, where the social cost would be exorbitant, and for the eurozone as a whole, where even the inevitable short-term economic impact would be overshadowed by one impossible-to-miss development – the demonstrable reversal of the euro, which would have a corrosive effect on the very core of the European project. Indeed, the fallout could well be broader, with Greece even

[1] A probability range of this order has been given by such long-term experts in international crises as Anne Krueger, former first deputy managing director of the International Monetary Fund (who spoke at a 17 April 2015 American Enterprise Institute event in Washington, DC http://goo.gl/fJkp5M) and Mohamed El-Erian, chief economic adviser at Allianz and former CEO of Pimco. See Mohamed El-Erian, "Eleven Acts Toward a Greek Tragedy," *Bloomberg View*, 20 April 2015. http://goo.gl/T7tgTK
[2] Eurozone ministers will meet in Riga, Latvia this very weekend (24-26 April) in search of just such an agreement.

presenting a global risk and a potential "trigger for a future tipping point," as one *Financial Times* columnist has argued.[3]

We broadly share the 45-10-45 probability assessment. But we think that it is hardly too late. Far from seeking a "Greek exit," we think it is time to focus on a "way out" – not of the euro, but of the policy impasse which is pushing two difficult partners towards a conclusion each of them would like to avoid.[4] This will clearly require compromise and action from both sides. Specifically, it would involve dropping some of the more difficult short-term requirements both sides have proposed (on the Greek side, for comprehensive debt relief; on the creditors' side, for maintaining all memorandum of understanding objectives). But, if this can be done, it would create a framework for progress – falling somewhat short of the durable agreement that would be desirable, but at least providing breathing space and re-injecting a degree of confidence. We propose a three-point programme – a "way out" instead of an "exit" – which is summarized in the table on page 5.

At the 17-19 April 2015 International Monetary Fund meetings in Washington, DC, the declarations of the main players in the Greek saga often seemed like ships passing in the night. Most notable were the directly contrasting presentations at a Brookings Institution event of German Finance Minister Wolfgang Schäuble and Greek Finance Minister Yanis Varoufakis.[5] However, if carefully examined, even these opposing presentations delineate possible common ground. This Economic Intelligence Briefing seeks to cut through the "noise" and posturing, and concretely describe a way out. In the absence of such an agreement, as noted, an accidental "stumbling out" of the euro acquires about equal probability of occurring, with likely ruinous consequences.[6]

The Unprecedented Nature of the Greek Negotiations

In searching for a way out of the impasse, one has to be cognizant of why the negotiations on the Greek programme have been so difficult. Much of the commentary has tended to focus on personalities or national typecasts (Germany v. Greece, for example) and, according to the analyst's priors, attribute blame accordingly. This, however, misses the real stumbling blocks, which reside essentially in the unique nature of the Greek programme negotiations:

- **Never before has a country found itself negotiating a programme with the bulk of its creditors as its direct counterpart.** The eurozone governments, the European Central Bank and the International Monetary Fund together account for close to 80% of Greece's outstanding debt, with most of it (62%) held by Greece's

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[3] Ralph Atkins, "Greek Contagion Still on Global Risk List," *Financial Times*, 23 April 2015. http://goo.gl/cBoU62

[4] In Washington, DC for the 17-19 April IMF meetings, the two main players, Germany and Greece, both expressed their firm desire to see Greece remain in the euro zone. See German Finance Minister Wolfgang Schäuble http://goo.gl/STTMMh and Greek Finance Minister Yanis Varoufakis http://goo.gl/QnnjtI, both speaking at a Brookings Institution session on 16 April 2015.

[5] Ibid.

[6] The turmoil would be comparable, in the view of University of California economist Barry Eichengreen, to "Lehman squared." See Greg Robb, "Greek Euro Exit Would be 'Lehman Brothers Squared," *Market Watch*, 05 January 2015. http://goo.gl/pKAwD4

eurozone partner countries. This is unprecedented, even in the cases of Ireland and Portugal – and is notoriously due to the delay in restructuring debt held by the private sector, allowing these creditors to rush for the exits and unload onto the public purse.[7] Today's legacy is that, in the ongoing negotiations with Greece, participants in the Brussels Group hold appreciable stakes in the game, complicating mediation and compromise. In this lop-sided setting, there is no one to play the "honest broker" role traditionally exercised by the IMF. Even governments that have been critical of the eurozone's crisis management see themselves first and foremost as creditors (the case, for example, of Matteo Renzi's Italy, with an exposure of €40 billion to Greece). Nor are there any mechanisms in place to promote the Brussels Group's operational independence – on the contrary, its accountability is ultimately to the eurogroup, i.e., the main group of creditors.

- **Never before has a debtor country in need of a programme and financial support been so hostile to established negotiating procedures.** On the debtor's side, matters are scarcely more conducive to agreement. Greece's opposition to established negotiating setups is not limited to its well-known rejection of the "troika." This has not only entailed costly delays, as cosmetic changes were made to the troika's moniker, but – more importantly – it has severely impacted the technical work. As anybody involved in programme negotiations can attest, gathering information on the ground, clearing up the facts directly *in situ*, is indispensable to informed programme design. Agreement at a technical level on the facts is in turn critical to final political endorsement. Putting obstacles to this work is inimical to agreement, while at the same time sending a noxious signal of non-collaboration to career civil servants.[8] Such lack of collaboration is particularly egregious in a country whose official data has proved so unreliable.

- **Never (or almost never) has a government seeking a programme been so internally divided on its need and rationale.** The internal divisions of Syriza lie beyond the scope of this Economic Intelligence briefing, but there is little doubt that they account for the half-hearted, ill-defined and at times contradictory proposals put forward to date. While proclaiming the need for agreement, the reform lists presented have been long on rhetoric but short on the required detail and specificity.[9] At the same time, back in Athens, a number of unilateral and adversarial initiatives were pushed forward.

These are formidable obstacles. It is indeed plausible that Syriza's core ideology will ultimately prove to be irreconcilable with the structural changes needed for the Greek economy, or that creditors' exposure to Greece will harden positions to a point that impedes

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[7] For a critique of this experience, see Alessandro Leipold, *Thinking the Unthinkable: Lessons of Past Sovereign Debt Restructurings* (Brussels: Lisbon Council, 2011). http://www.lisboncouncil.net//index.php?option=com_downloads&id=487

[8] See Mark Paul, "EU Mandarin Declan Costello Faces Greek Wrath Over 'Ultimatums' Letter," *The Irish Times*, 20 March 2015.

[9] For the latest publically available list, see "Greek Reforms in the Context of the 20/02/2015 Eurogroup Agreement," March 2015. http://goo.gl/RGZyW0

compromise. Hence the increasing probability being assigned to Grexit. Not, however, by EU or Greek officials, at least not in public.[10] It is thus incumbent on these officials to find a way out. A possible route is delineated below.

Moving Beyond Jean-Paul Sartre's 'No Exit'

The starting point in the search for a workable solution is to ask what a programme for Greece should aim to achieve and by what means. In essence, three elements stand out:

1. **Fiscal adjustment (largely achieved) should be de-emphasized in favour of reforms that fundamentally change the structural workings of the Greek economy (largely absent).** As the other euro area programme countries at the onset of the crisis, Greece needed both balance-sheet adjustment (to restore sustainability) and structural reforms (to remove long-standing growth impediments). In fact, it needed both to a significantly greater degree than the rest of the periphery. Balance-sheet adjustment, defined primarily in Greece's case in terms of fiscal correction, has since then been largely achieved. Thus, between 2009 and 2014, Greece's primary fiscal balance improved by 12 percentage points of GDP (to a surplus of 1.5% of GDP, the third highest in the eurozone); the structural fiscal balance by 20 percentage points of GDP (also to a surplus of 1.5% of GDP, the highest in the eurozone); and the current account balance by 12 percentage points of GDP.[11] Thus, this side of the adjustment ledger can and should be de-emphasized; on the other hand, supply-side reforms remain sorely needed and should be assigned priority, in a focused manner.

2. **Greece's immediate debt problem is one of liquidity, requiring short-term refinancing and/or replacement of its more onerous obligations with lower-cost, longer-dated ones.** On the debt front, Greece is facing a short-term liquidity crisis, due to the pronounced bunching of debt service payments in 2015, while savers' jitters are squeezing liquidity out of the system. Such near-term humps are typically overcome via short-term refinancing, which also helps alleviate immediate market anxieties. But provision of such financing, while a tiny economic cost for creditors, should be contingent on prior actions – notably, in the case at hand, tabled legislation on agreed structural reforms. An alternative approach would be to replace the current (expensive) IMF loans and ECB-held bonds (which account for the bulk of upcoming debt service obligations) with cheaper and longer-dated loans by the ESM (European Stability Mechanism).[12]

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[10] Categorically not, for example by Commission President Jean-Claude Juncker, who told *Politico*, "I am excluding at 100 percent this Grexit, or Greek exit." See Florian Eder and Carrie Budoff Brown, "Juncker: 'There will be no default,'" *Politico*, 20 April 2015. http://goo.gl/Wma9Xs

[11] For a rejection of what he calls "six Greek myths," including the "Greece has done nothing" myth, see Martin Wolf, "Mythology that Blocks Progress in Greece," *Financial Times*, 21 April 2015. http://goo.gl/tdMXAY

[12] As proposed by Jacob Kirkegaard, *Can Greece Make a Deal with Europe? Part 2: What Kind of Deal Can Greece Hope For?* (Washington DC: Peterson Institute for International Economics, 07 February 2015) http://blogs.piie.com/realtime/?p=4811, and by Ajai Chopra, *Greece: Incremental Solutions Will Not Work* (Washington DC: Peterson Institute for International Economics, 10 February 2015).

Greece: A Three-Point Programme

Objective	Instrument	Implementation
1. Relieve growth impediments	Supply-side reforms	Focus on 3-4 macro-critical structural reforms. Key is improved business climate. Preclude reform reversals.
2. Secure short-term debt servicing	Refinancing	Bridge financing to full programme agreement, conditional on prior actions. Alternatively, replacement of IMF-ECB funds with longer-term ESM loans.
3. Ensure fiscal and debt sustainability	Primary surplus	Easing of Memorandum of Understanding objectives in light of adjustment to date and exceptional economic weakness. Target a manageable primary surplus, of ~ 1.5% of GDP.
	Medium-term debt restructuring	Start, upon programme approval, of negotiations to implement the February and November 2012 eurozone agreements.

http://blogs.piie.com/realtime/?p=4818. As noted by Kirkegaard, similar steps were undertaken for Ireland and Portugal in 2014.

3. **The sustainability of Greece's debt and the country's ultimate solvency is a longer-term problem, not a pressing one today, and insistence on immediate, long-term debt relief is misplaced.** Loans from euro-area members to Greece carry exceptionally low interest rates and have extremely long maturities. The average maturity of EFSF loans, for example, is over 30 years with the last loan expiring in 2054. Moreover, interest payments on EFSF loans have been deferred by 10 years, implying zero cash-flow interest cost on these loans for the next decade. Greece's insistence on an early debt restructuring is thus a distraction, harmful to its own best interests. Still, the large debt overhang and related uncertainty weigh on confidence, affecting expectations, investment and entrepreneurial initiative. Such economic millstones need to be lightened by prospects of a resolution, as would be offered by the initiation of good faith negotiations upon programme approval. Indeed, the eurogroup pledged such relief in February and November 2012, upon achievement of a primary surplus by Greece (which occurred in 2013 and 2014).[13]

Focusing on Essence

While clearly rudimentary (the details must be left to the technical experts on the ground), the three-part programme on page 5 serves to highlight the need to a) remove the Damocles sword of default and exit, whose lifting would in itself be a likely confidence- and growth-booster, and b) shift the focus from fiscal adjustment (or "austerity" in the common parlance) to a few key supply-side reforms.

1. To this end, **creditors will need to rethink their definition of a "comprehensive agreement."** Creditors have coined a new mantra for what they are seeking: while conceding that there is a new government with a different mandate, they insist that any agreement needs to be "comprehensive." While "comprehensiveness" as such remains undefined, it is generally interpreted as referring to a traditional, full-fledged IMF-type programme, derived from the Fund's established "financial programming" approach, and covering the full range of the previous programme(s).[14] But this is not what is primarily needed for Greece at the current juncture.

2. **"What Greece needs isn't an IMF bailout programme but a World Bank-style state-building programme" – ECB official (2012)**.[15] Hence the need to focus on a few, key structural reforms. Long laundry lists are unhelpful, indeed even harmful: they strain implementation capacity (already institutionally weak in Greece); they lack focus and thus prioritisation; and their perceived intrusiveness weakens programme ownership (also scant in

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[13] Eurogroup Statement on Greece, 27 November 2012. http://goo.gl/P2PKXp. For 2015, furthermore, the State primary balance is reported to considerably exceed expectations. See Silvia Merler, *Big Improvement in the Greek Primary Budget* (Brussels: Bruegel, 2015). http://goo.gl/tBRNaM

[14] The IMF now offers a Massive Open Online Course (MOOC) on Financial Programming and Policies; see http://goo.gl/i5xiaj.

[15] As quoted in Simon Nixon, "Beyond the Strains of Austerity, Greece Faces Deeper Troubles," *The Wall Street Journal*, 02 February 2015. http://www.wsj.com/articles/SB20828474211274784520404580435760786618620

Greece).[16] In this regard, the Brussels Group and Greece should work to slim down and refocus the programme.[17]

3. Finally, **determine the key structural reforms to be given priority.** Again, this is best left to negotiations on the ground (provided they effectively are "on the ground"), where the parties can fully assess where requirements, implementation capacity and ownership converge sufficiently to foster success. Ideally, the principal negotiator with Greece on these issues should be the OECD. It has the expertise in the area, it does not have direct stakes in the game, and it is viewed benignly in Athens, facilitating collaboration.[18] This negotiating setup would however require a degree of international statesmanship that does not appear readily forthcoming. Still, the Brussels Group could usefully draw on OECD recommendations, as set out in *Going for Growth 2015*, seeking overlaps with the European Commission staff's assessment of Greece's 2014 national reform programme.[19]

The Need for Political Will

This three-part programme may appear a tall order, especially in today's Europe of diminished expectations, and given the stumbling blocks described. While these hurdles should not be downplayed, the stakes are high enough that all players should strive to converge on the elements of a package outlined above. Once again, we find ourselves confiding in Jean Monnet's dictum: "Europe will be built in crises, and will be the sum of the solutions brought to these crises."[20] So far, despite the many flaws of eurozone crisis management, the progress recorded since 2010 has largely proven him right. May it continue to be the case at this critical juncture.

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16 For a fuller criticism of conditionality overload in the structural area, see Alessandro Leipold, *Lessons from Three Years of Euro-Area Crisis Fighting: Getting it Right Next Time* (Brussels: Lisbon Council 2013). http://www.lisboncouncil.net//index.php?option=com_downloads&id=857

17 As recently suggested by Poul Thomsen, head of the IMF's European Department: "We need to simplify these programmes… We'll need to have fewer moving parts and focus on a few critical areas… I would like to refocus [the Greek programme] even further on a few critical measures" – Press Conference 17 April 2015. http://www.imf.org/external/np/tr/2015/tr041715a.htm

18 A proposal in this sense was made by Michael Burda and Holger Schmieding, "A New Deal for Greece," *The Wall Street Journal*, 9 March 2015. http://goo.gl/2XrM1o

19 See, respectively, Greece country note in OECD, *Going for Growth 2015* (Paris: OECD, 2015) http://goo.gl/HDGLDL , and European Commission, "Assessment of the 2014 National Reform Programme for Greece," Commission Staff Working Document SWD(2014) 409 (Brussels: Commission of the European Communities, 2014). http://ec.europa.eu/europe2020/pdf/csr2014/swd2014_greece_en.pdf

20 *"L'Europe se fera dans les crises et elle sera la somme des solutions apportées à ces crises."* Jean Monnet, *Mémoires* (Paris: LGF, 2007).

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