Solving the Greek crisis with Syriza

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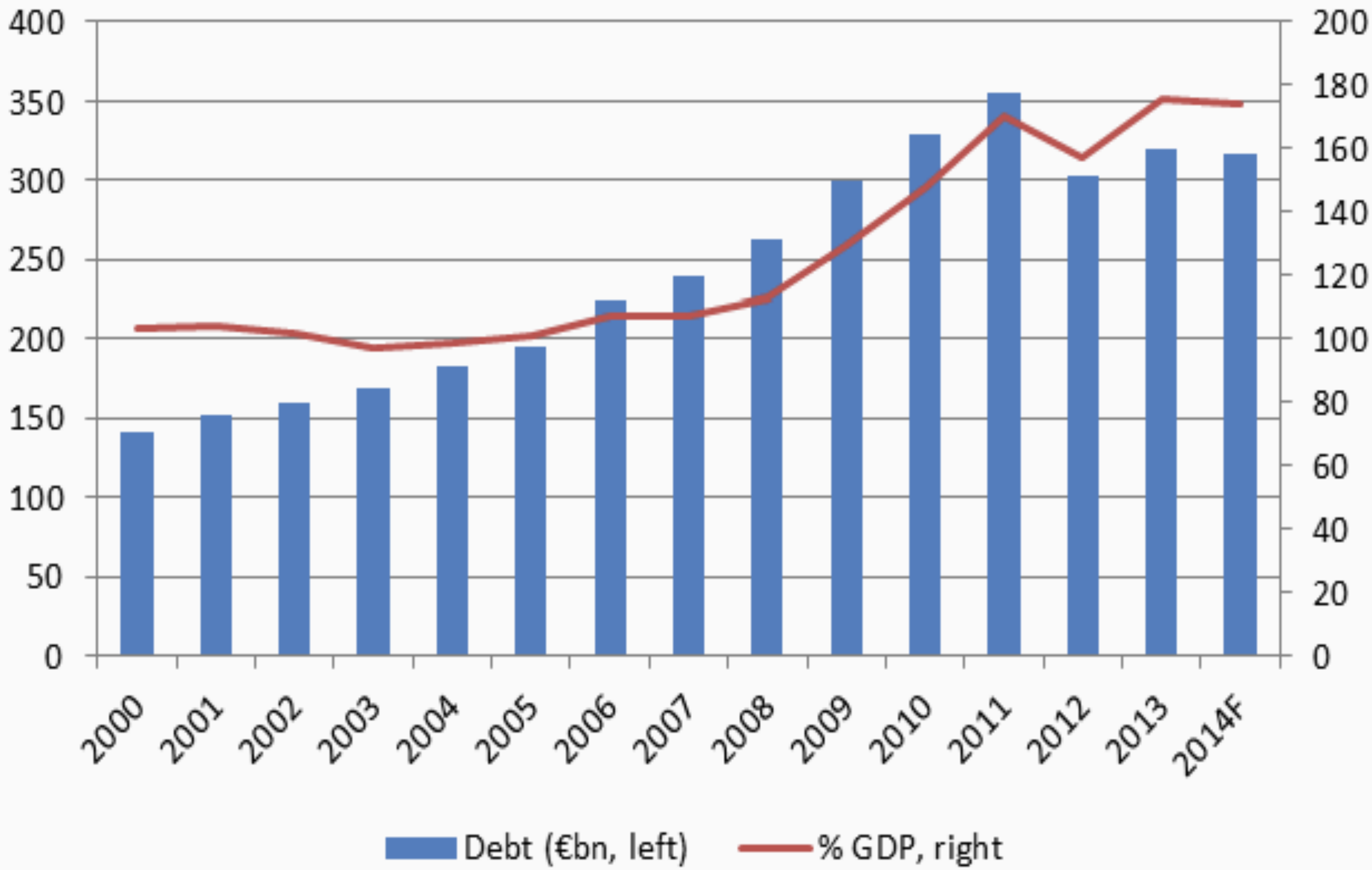
- Greek landslide elections for Syriza show extent of social disaster, anger and destabilization.
- German-inspired austerity-driven debt restructuring policy has not worked.
- Greek citizens have endured great suffering, akin to 1929 crisis.

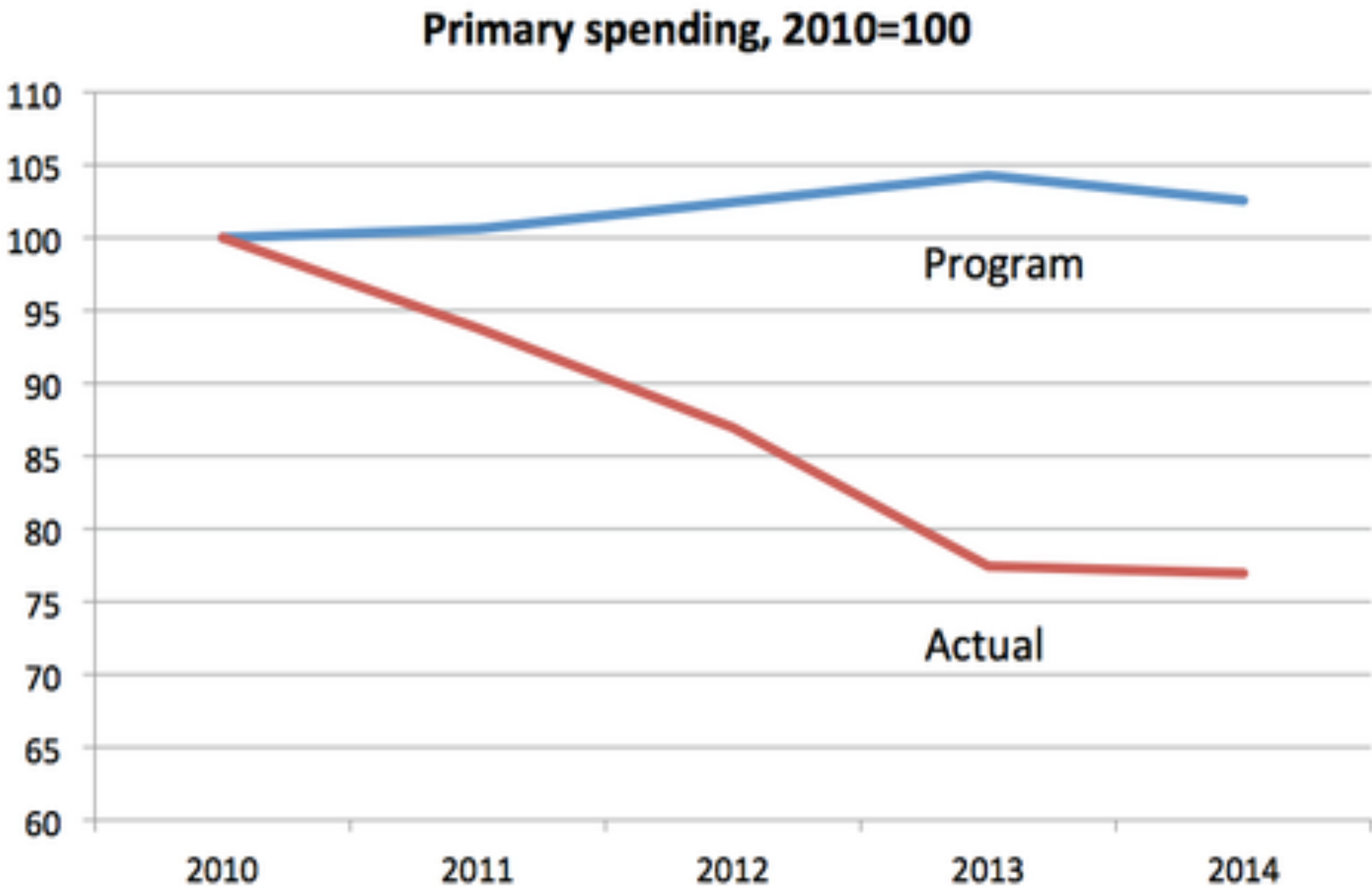
Figure 1. Greece: General government debt



Source: IMF Fiscal Monitor, April 2014.

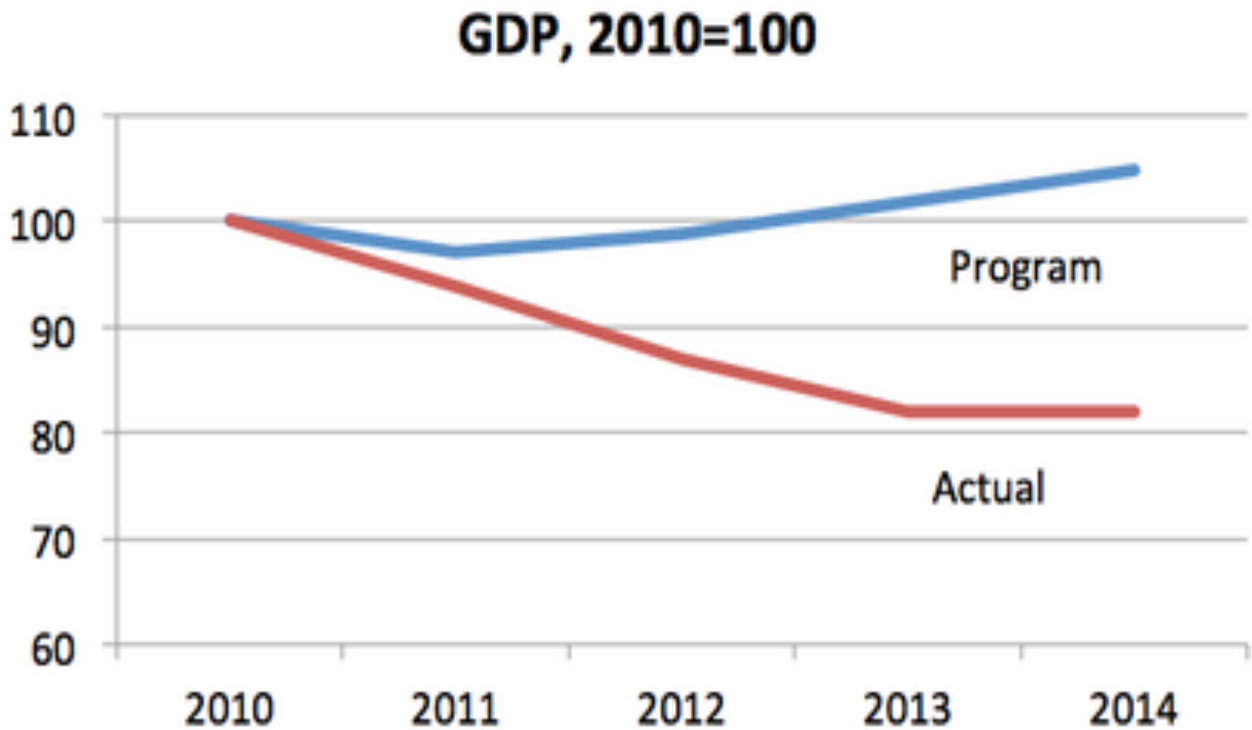
- The reason the debt restructuring has not worked is that it is based on a deflationary spiral. Expenditures are cut to reduce the deficit and create a primary surplus to service the debt.
- Expenditure cuts lead to lower GDP and lower tax revenues, countering the initial cuts. More cuts are needed, leading to more cuts…

The troika has persisted in this logic.

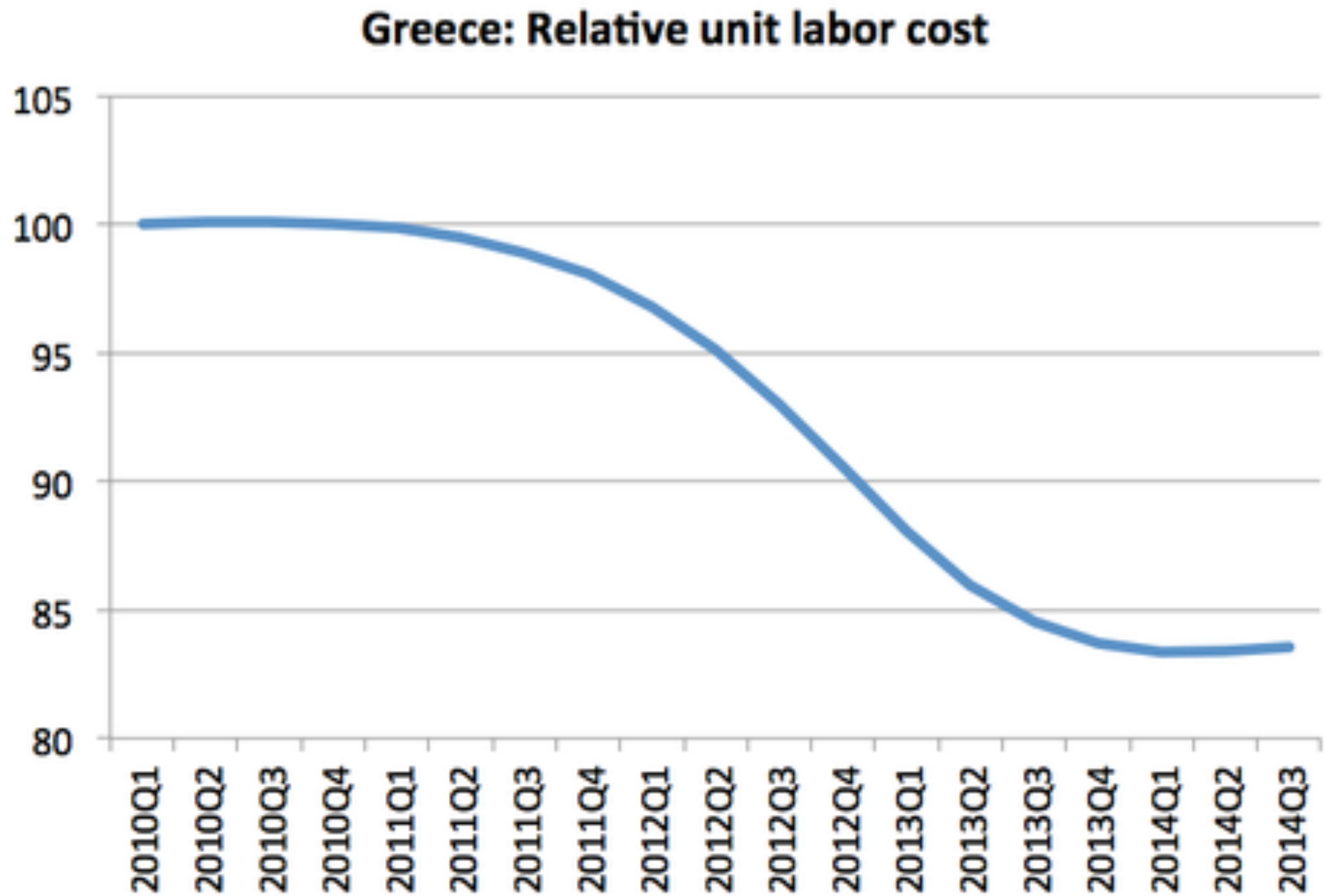


International Monetary Fund

With catastrophic effects on GDP and the economy.



International Monetary Fund


Greece: Relative unit labor cost
105
100
95
90
85
80
2010Q1
2010Q2
2010Q3
2010Q4
2011Q1
2011Q2
2011Q3
2011Q4
2012Q1
2012Q2
2012Q3
2012Q4
2013Q1
2013Q2
2013Q3
2013Q4
2014Q1
2014Q2
2014Q3

Eurostat

- Unemployment is at 28%, 50% for youth.
- Debt is not and cannot be repaid. Previous debt restructuring was mostly designed to bail out private banks holding Greek debt.
- Greek citizens voted to overturn austerity policies.

What are the options?

- Greece needs mostly breathing space to undo austerity policies, enact serious reforms on corruption, taxation and organization of government.
- Current primary surplus at 4.5%. Bring down to 1.5% to help the poor and restore growth.
- Many proposals on the table, but most aim at creating this breathing space.

Syriza proposal

- Debt swaps. In part against perpetual maturity bonds, in part GDP indexed bonds, or growth-indexed bonds.
- Other options: grace period, contingent repayments.
- Experience of UK debt after WWII, German debt in the 1950s.

What if Greece is forced to default?

- Lack of agreement will force Greece to default. This will most likely force Grexit even though they do not want it.
- Greece has a primary surplus so does not need new loans, but there will be liquidity problems.
- If Greek banks cannot get liquidity from Bank of Greece via ECB, Greek banks will have to close immediately before bank run. Argentinian scenario.

What if Greece is forced to default?

- Grexit would not help Greece too much as it would likely be stuck in spiral of depreciation and inflation.
- Grexit could trigger run on Italian and Spanish financial system worse than in 2012. This would trigger either collapse of the Eurozone or massive bailout from eurozone countries, much larger than Greek debt.

What if Greece is forced to default?

- Grexit would leave Greece odd partner in EU. Would be able to block any new initiatives.
- Russia would be too happy to forge alliance with Greece.
- Putin is already doing his best to destroy the EU.
- Grexit would be last nail on coffin of European Union, probably best period ever in European history.

Compromise preferable

- Compromise is much more preferable and likely.
- Concessions on Greece would create temptations to renegotiate debt in Spain and Italy?
- Yes, but this is desirable! Economists have been calling for many years for strong reduction in debt of European countries to roughly 60% of GDP.
- Even if compromise is reached, Greek government needs to dispel skepticism on its ability to reform tax collection, corruption, government administration.

Speed is important

- Speedy resolution of crisis is important to avoid financial panic in view of the uncertainty created by the Greek election.
- Varoufakis has insisted Greece is facing a solvency crisis.
- ECB is speeding the process by cutting off use of Greek bonds as collateral.
- Dangerous territory but moves are in the right direction. Other countries need to help Germany swallow the bitter pill.

Conclusion

- If Tsipras fails, Golden Dawn may take over in Greece.
- Failure to solve the crisis would help Russia on the continent.
- European wide economic and political consequences of Grexit potentially catastrophic.
- Syriza election is a wake up call to end economically disastrous austerity policies in Europe.
- European left in France and Italy should take unilateral initiatives in forgoing the bilateral loans to Greece. France has 15bn and Italy 10bn.