Greece, Its International Creditors and the Euro

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Can the Syriza government in Greece maintain an impossible triangle: (1) stay in power, (2) reverse austerity, and (3) stay in the euro? It will all depend on whether the European Union sees itself as a progressive ethical project of civilisation based on liberal market principles or as an anti-democratic imperialist project of international finance capital.

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On 25 January, Syriza won the Greek elections but fell two seats short of the 151 seats it needed to form the government on its own. Subsequently, it formed a coalition government with the 13-seat Anel party the next morning. Syriza (an acronym of Synaspismós Rizospastikís Aristerás) is a coalition of the radical left as its Greek name indicates. Anel (Independent Greeks) is a conservative nationalist party which opposes austerity. Alexis Tsipras is now the Prime Minister of Greece whereas the economist Yanis Varoufakis is the current finance minister.

Since the formation of the new government in Greece, Europe is in flames and the world is watching. Consequently, Tsipras, Varoufakis, the European Union (EU), the Eurogroup and the Troika have become household names. (The "Troika" consists of the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF).) The EC is the executive body of the EU. The Eurogroup is a conference of finance ministers of the 19 euro area (eurozone) member-states for the discussion of matters related to the euro.

Macroeconomic Adjustment Programmes

The Eurogroup provided the bilateral eurozone member-states loans pooled by the EC into the so-called Greek Loan Facility (GFL). The €77.3 billion GFL was part of a 2010 joint "financial assistance (bailout loan)" package, with the IMF committing an additional €30 billion. Provided on 2 May 2010, these bailout loans were made to "support" the first Macroeconomic Adjustment Programme (MAP) for Greece. The loans were to be disbursed from May 2010 to June 2013 in a certain number of tranches.

In addition, the Eurogroup controls the European Financial Stability Facility (EFSF) and, its successor, the European Stability Mechanism (ESM). Established in June 2010, the EFSF was a private company — a special purpose vehicle — created as a temporary crisis resolution mechanism. Established in September 2012, the ESM is an international organisation created as a permanent rescue mechanism with the same mission as the EFSF: to "safeguard" financial stability in Europe by providing bailout loans to the eurozone countries. The ESM and EFSF now share the same staff and offices.

Unlike the GFL and like the EFSF, the ESM funds its operations by issuing money market instruments as well as medium- and long-term debt. Currently, the ESM is the only rescue mechanism. The EFSF will not provide bailout loans to any more countries. However, it will continue its operations to make payments on the EFSF debt, roll over the EFSF debt since the loans it made are of longer maturities than its own debt and collect payments from the debtors until loans are redeemed.

Bailout Package of 2012

On 14 March 2012, the Eurogroup approved a second bailout package, this time, to "support" the second MAP for Greece. The eurozone member-states and the IMF committed the undisbursed amounts of the GLF with an additional €130 billion to be disbursed in tranches between March 2012 and the end of 2014. In this second package, the loans the eurozone member-states committed were to be made through the EFSF. The total commitment of the package was €164.5 billion. The EFSF was to contribute €144.7 billion, while the IMF was to contribute €19.8 billion.

The MAPs were imposed and overseen by the Troika. The programmes consist of (1) fiscal reforms to "generate savings," that is, "austerity," (2) structural reforms to "enhance competitiveness and growth", such as privatisation of public assets and deregulation of the markets including the labour market, that is, "labour market flexibility," and

(3) financial reforms to "enhance financial stability", such as banking regulations, and bank recapitalisation and resolution mechanisms.

It is claimed that the ECB is in the Troika to provide technical expertise, it is not a bailout creditor. But, it is still a creditor to Greece through its Securities Market Programme (SMP), which ran from May 2010 to September 2012. Indeed, the SMP was created in response to the Greek debt crisis, which triggered the ongoing European sovereign debt crisis. The stated purpose of the SMP was to purchase government bonds in secondary markets, to provide liquidity and thereby alleviate pressures from sovereign debt risk on the balance sheet of monetary finance institutions. In February 2012, shortly before the Greek debt restructuring, the ECB holdings of the Greek government bonds through the SMP amounted to €42.7 billion.

Liquidity Provider

In addition, the ECB is the liquidity provider to the banks in Greece in two ways. The first is through its monetary policy operations. The second is through its control of Bank of Greece (or any national central bank in the eurozone) which extends emergency liquidity assistance (ELA) to solvent domestic lenders facing temporary liquidity problems. In both these operations, lenders pledge acceptable quality debt securities as collateral for central bank loans. The ECB determines the acceptability criteria.

Prior to the second programme, it became evident that without debt reduction Greece would default. Since the debt held by the official holders could not be restructured, it was agreed that Greece would make an exchange offer to the private holders. The total face value of the then privately held public bonds was €205.6 billion: €184 billion of Greek Law whereas €21.6 billion was of Foreign Law. Two common components of the sovereign bond contracts are the "pari passu" and "collective-action" clauses. The former ensures that the issuer treated identical bondholders identically, with the understanding that some senior creditors such as the IMF would be treated differently. The latter is a clause that applies the terms of an exchange to all creditors once a specified majority has agreed to it. The Greek bonds did not have these clauses.

Since most of these bonds were Greek Law bonds, Greece could modify their terms as it liked. In its exchange offer in March 2012, Greece passed a law to add collective-action clauses (CACs) — where a majority meant 50% — to the Greek Law bonds retroactively. When more than 60% of the Greek Law bondholders signed on, Greece invoked the CACs and, as a result, a significant portion of the Foreign Law bondholders decided to participate as well. After a second exchange in April 2012, Greece was able to restructure 96.9% — €199.2 billion — of the offered €205.6 billion, leaving holders of the remaining €6.4 billion as holdouts. That the bonds did not have the pari passu clause turned out to be a blessing, since Greece could pay the holdouts in full without facing litigation. So, the bonds the holdouts owned remained on its balance sheet.

Based on the face value of the debt, this was the largest sovereign debt restructuring in history. It is this restructuring the German Chancellor Angela Merkel refers to when she denies a second debt relief to Greece. On paper, the reduction was 53.5%, indicating a debt relief of €106.6 billion. However, the actual amount of debt relief was much less. The new debt swapped for the old debt was a portfolio of four instruments, two of which were the EFSF notes. They totalled €34.7 billion which Greece had to pay back to the EFSF. Further, since the Greek banks were among the private holders, they lost €25 billion in the exchange and had to be recapitalised. For this, Greece had to use €25 billion of the loans it borrowed from the EFSF for bank recapitalisation. Therefore, the actual debt relief was €46.9 billion, a measly 23.4% of the €199.2 billion.

But, how did Greece end up in this mess? To answer this, let us go back to 2001.

Origins of Greece's Problems

For an EU country to enter the eurozone, the country must meet the 1992 Maastricht Treaty (the treaty that established the eurozone) limits on debt levels and deficit spending. Despite meeting the Maastricht criteria with difficulty, Greece entered the eurozone in January 2001. From 2001 to 2007, the gross domestic product (GDP) of Greece grew at an impressive average annual rate of 4.3%, compared with the eurozone average of 3.1%. Incidentally, this period intersected with the 2002–07 monetary expansion in the advanced capitalist countries (the United States, the United Kingdom, Germany, France and the like) of the centre. In search of high yields, private capital started to flow from the centre to the periphery which includes Greece, creating excessively easy credit conditions.

Easy Credit

Indeed, the primary drivers of these impressive growth rates were the easy credit which fuelled private consumption and government spending, although the EU contributed also by financing some public investments. Unfortunately, a significant portion of the credit-fuelled government spending was on non-productive purposes such as the 2004 Athens Olympics. Another unfortunate key component was military spending, notably on German ships and tanks — about 3% of the GDP in the period, the highest in Europe.

Then came the Great Recession in the US, which lasted from January 2007 to June 2009. Further, in June 2007, the Global Financial Crisis (GFC) hit the US. When Lehman Brothers collapsed in September 2008, both the GFC and Great Recession became global. Under these conditions, the private capital flow surge that started in 2002 from the centre to the periphery suddenly reversed in 2008. Both of these adversely affected not only the Greek economy, but also its ability to roll over its debts. Unlike non-eurozone peripheral countries with their own domestic currencies, Greece was unable to devalue its currency and raise the interest rates to weather the storm. Greece was in trouble.

With hindsight, we now know that from the beginning until 2009 the Greek governments had been masking their sovereign debt and budget deficit through "creative" accounting and Wall Street (Goldman Sachs, in particular) assisted

financial engineering, involving off-balance sheet transactions as well as complex currency and credit derivatives. Although Greece had managed to get away with massaging its balance sheet for years, the balance sheet cosmetics became evident in early 2009. When the Papandreou government which was elected in October 2009 stopped the massaging and released the true numbers, it became evident that Greece was not suffering from illiquidity. It was insolvent.

Then the hell broke loose and Greece ended up in the mess that started in May 2010.

Fast forward to today, despite two bailouts and adjustment programmes Greece has been in depression since the beginning of 2009. The Greece's GDP is down about 25% from its peak in 2008, unemployment is at about 25%, youth unemployment is above 50%, Greece's public debt to GDP ratio is at about a mind-boggling 175% and many Greeks are lining up for soup in front of soup kitchens reminiscent of the soup kitchens of the Great Depression of 1929.

And they call this a bailout.

Beneficiaries of Bailouts

However, no one can debate that Greece's private lenders in general, and German and French banks in particular, benefited from these bailouts. According to the Jubilee Debt Campaign, 92% of €240 billion Greece has received since the May 2010 bailout went to Greek and European financial institutions. Furthermore, the restructuring of 2012 led to a holder transformation of the Greek public debt. While more than 60% of €356 billion Greek public debt was held by the private lenders at the end of 2011 this percentage was less than 25% at the end of 2012. This percentage fell way below 20% of €315 billion Greek public debt at the end of 2014, with the Troika holding 78% of this debt.

Varoufakis appears right when he claimed that it was the banks that got bailed out, not Greece and that Greece got deformed, not reformed!

When the Syriza government started its journey on 26 January 2015, its main objectives were to (1) write off 50% of its sovereign debt, (2) reverse austerity, (3) reverse structural reforms, and (4) remain a eurozone member. Since then, Tsipras and Varoufakis have been negotiating with their creditors to no avail. Varoufakis even went on a road show to gather support from several other European finance ministers, again to no avail.

From day one, Merkel, the chancellor of Greece's largest eurozone creditor, Germany, and Mario Draghi, the Governor of the ECB, made it clear that debt write-off was a no go. So instead of debt write-off, Varoufakis proposed a "menu of debt swaps" consisting of two types of new bonds: one, a floating coupon bond whose coupon indexed to nominal GDP growth to replace eurozone bailout loans and the other, perpetual bonds, which defer the principal payments for eternity, to replace ECB-owned Greek bonds. This did not fly either, signalling the creditors of Greece have no intention to negotiate and expect Syriza to cave in.

Rebuffing Syriza's Attempts

On 4 February 2015, the ECB dealt the final blow to Syriza's attempts to rewrite the terms of its €240 billion bailout. It lifted the current waiver of minimum credit rating requirements for Greek government debt as collateral in its monetary policy operations. Since the Greek bonds are junk rated and hence below the acceptable minimum, this means that Greek banks will no longer have access to regular ECB loans which are cheap. Greek banks will continue to have access to central bank funds to meet their liquidity needs through the ELA of Bank of Greece. But the ELA loans carry a higher interest rate. Given the liquidity needs of the Greek banks because of increased withdrawals after the elections, there are now fears that the Greek banking system might collapse and Greeks are back in the streets, this time, protesting not against their government, but against the ECB.

After these developments, the question remains whether Syriza can maintain what some have called the impossible triangle: that is, (1) stay in power, (2) reverse austerity, and (3) stay in the euro. Whether Greece will exit or be forced to exit the eurozone, and, if Greece exits in one way or another, whether this will lead to the end of the eurozone and the euro is difficult to predict objectively. Indeed, as Antonio Gramsci claimed in *The Modern Prince*:

> But it is absurd to think of a purely 'objective' prediction. Anybody who makes a prediction has in fact a 'programme' for whose victory he is working, and his prediction is precisely an element contributing to that victory.

What Is the EU?

Some used to claim that the EU was a progressive ethical project of civilisation based on liberal market principles, standards of democratic governance and the rule of law. Others used to claim that the EU was an anti-democratic imperialist project of international finance capital under the hegemony of Germany.

Given what has been going on in Greece, I wonder which one?

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