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Despite Pressure from Washington, Greek Bailout Increases Grexit Odds

It is now clear that the European authorities do not intend to let the Greek economy recover any time in the foreseeable future. The primary surpluses that the government has been forced to agree to – 2, 3 and 3.5 percent of GDP for the three years of the deal, 2016 through 2018 – will not allow Greece to escape its depression, which is now in its sixth year. Even if they miss these targets, which is likely, just trying to do what they have committed to will keep the economy from recovering.

The Foundation for Economic and Industrial Research in Athens has projected that the Greek economy will not recover in 2016. It is worth noting that since 2010 projections from official sources, e.g. the IMF, have almost always projected recovery for the following year – even though it never happened until the tiny, short-lived recovery of 2014.

One can only speculate on the motives for inflicting this harm on the people of Greece. Clearly it is not about the money – the Financial Times estimated that the primary surpluses will contribute about 4.5 billion euros out of what is now an 86 billion euro package. And the slower the recovery, the more Greece's creditors – including European governments, the IMF and the ECB, who together hold 86 percent of the debt -- will lose in the debt restructuring that almost everyone now realizes is inevitable. By shutting down the Greek banking system in order to put a gun to Greece's head before the July 5 referendum, the ECB was sacrificing tens of billions of euros owed to its creditors. And since the financial system is still not back to normal functioning, it means they will lose even more. Punishment is probably part of the motivation for these hateful conditions, as well as a fear on the part of the tormentors that "leniency" could encourage people in other vulnerable eurozone economies to vote for left parties or demand an earlier exit from mass unemployment.

The guaranteed extension of depression in Greece certainly changes the equation for Greeks with regard to the costs and benefits of remaining in the eurozone. Polls may still show a majority wanting to stay, but what if the question were put this way: "By remaining in the eurozone, the Greek economy is likely to experience two or more years of depression. Do you think it is worth this price to keep the euro?" A majority might very well say no.

Of course, leaving the euro could be worse than this, but that is very unlikely. A look at financial crises throughout the world over the past two decades shows that Greece has already suffered more damage than nearly any other country.[1] Although the Greek economy would get worse before it got better, given what Greeks are facing under the current program, the end result of leaving would very likely be a faster recovery.

Life after the euro is now being imagined by far more than just euroskeptics or economists such as Paul Krugman, who argues that the eurozone countries have never met the conditions for "an optimum currency area". Others, including François Hollande of France, are pushing for more fiscal and political integration in the eurozone in order to resolve the problem. But this is very unlikely to help, because it is the politics of the eurozone that are the more immediate and pressing problem. As noted above, this is not about money. The Greek debt problem could have been resolved back in 2010 for a small fraction of the money that creditors have already lost. They have increased their losses enormously by putting

1 M. Weisbrot: Failed: What the "Experts" Got Wrong About the Global Economy, Oxford University Press, forthcoming.

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Greece through its long depression, and now they are willing to sacrifice even more in order to achieve their political goals. What are those political goals?

Former Greek Finance Minister Yanis Varoufakis, after he left the government, wrote that German Finance Minister Wolfgang Schäuble wanted to "put the fear of God into the French and have them accept his model of a disciplinarian eurozone".[2] He could have included most of the eurozone along with France, and although Schäuble is the hard-liner, he is not alone in his vision for a new Europe. For direct evidence, we can look at the thousands of pages produced by the "Article IV consultations" that EU countries regularly have with the IMF. These present a clear story of what appears to be an elite consensus, or at least a majority: for the four years 2008 through 2011 (which include the world financial crisis and recession), there was a pronounced pattern of recommendations for fiscal tightening, cutting spending, reducing pensions and health care spending, increasing the labor supply and thus reducing the bargaining power of labor, and cutting public employment.

It is for this vision that the European Central Bank, up until September 2012, repeatedly pushed the eurozone to the brink of a financial meltdown, with markets convinced that the existence of the euro itself was at risk. This game of chicken contributed greatly to the additional two years of recession that the eurozone suffered after its initial recovery from the 2009 recession. It was only in July 2012 that Draghi uttered the three words that put an end to the financial crisis, declaring that the ECB would do "whatever it takes" to preserve the euro.

Of course, Draghi and the ECB could do the same for Greece as they did for Italy and Spain in 2012, the "too-big-to-fail" debtors whose bond yields were immediately stabilized by his statement and began a steady decline to very low levels, without the ECB even having to back up its statement with money. But it has chosen instead to do the opposite, to deliberately cause a severe crisis in the Greek financial system and push it deeper into recession. Apparently they think that Greece is not too big to fail, and that if it ends up out of the euro, the eurozone will persevere. We may well find out in the next year or so, because the Greek people are unlikely to accept the additional suffering that will occur if the current deal is implemented.

Meanwhile, there is another interest here that has been quietly lobbying the European authorities not to push Greece out of the eurozone: the U.S. government. At an IMF board meeting on July 1, the U.S. forced the release of an IMF analysis showing that Greece's debt was unsustainable. It may have helped Syriza win an overwhelming "no" vote in the July 5 referendum, as the Greek government cited it to prove that their demands for debt relief were reasonable. It was a breach of protocol at the IMF – normally Washington would defer to European wishes on a matter so important to Europe. It was also a shot across the bow, telling the hard-liners – especially among the Germans – that the U.S. government has its own interests in not breaking up the eurozone and will use its power where necessary and possible to prevent it. Washington does not care about the project for a new, more neoliberal Europe, but it does care deeply about the unity of its most important ally – Europe – and has a long (and admittedly not very proud) history of intervention in Greece in order to keep that country within its orbit.

But even Washington's heavy hand may not be enough to keep Greece within the eurozone, given the European authorities' impossible demands. Even debt relief, if the Germans were to concede to it, is almost certainly going to be too little and too late to allow for a Greek economic recovery in the foreseeable future. And without an economic recovery, this deal may very well collapse.

2 Y. Varoufakis: Germany won't spare Greek pain – it has an interest in breaking us, The Guardian, 10 July 2015.