European leaders have let their own hubris dominate their response to the Greek crisis. A total bailout of Greece would only cost the European Union 2 per cent of its GDP.

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The European leaders who established the Euro were guilty of political hubris, which blinded their vision of the common good. Jon Danielsson *argues that their successors are repeating the same mistake of 'hubrisk' in trying to resolve the sovereign debt crisis.*

What makes the European sovereign debt crisis so intractable is that it is not just another crisis. It is two crises in one. A sovereign debt crisis and a policy response crisis. Of the two the latter is doing the damage. The underlying direct causes are well known: the political desire for strong ties between European countries acting as the driving force of the European common market and the monetary union. History tells us that the success of such unions hinges critically on several factors, most importantly a common fiscal policy.

In the absence of these conditions, a monetary union is set to fail. The Maastricht criteria was devised by European leaders to avoid failure, but they then wasted no time in ignoring their own design. By ignoring the necessary conditions, the European leaders who created the euro were guilty of hubris. Their decisions were not rooted in a pragmatic determination for a common good but rather in their own personal political ability to implement a monetary union. This moment of weakness is now the biggest threat to European integration.

This problem was compounded by the prevailing view that sovereign risk had somehow been eliminated — a view encouraged by European banking regulations stipulating that sovereign debt is risk free. This both acts as a tax on other creditors and also sends a powerful signal. Interestingly, Greek debt is still considered risk free by the regulators.

The European policy makers have consistently misread the nature of the Greek crisis, letting hubris dominate their crisis response. Many countries have faced similar difficulties as Greece, and the EU leaders could have consulted those with first hand knowledge of sovereign crisis management. Instead they repeated mistakes made elsewhere. The leaders do recognise the common fiscal policy problem, and have contingency plans for a Greek exit from the euro. What they have not done is learning from other sovereign debt crises, and instead let politics get in the way of minimising the economic damage to Europe.

This continues. Now the European policy makers believe that Greece can manage with debt to GDP of 120 per cent, which is the level Italy manages with difficulty. Other crises would tell them this is wishful thinking. The Greek debt tolerance is closes to the Argentinian level of 40 per cent and the extreme austerity is not going to make that better.

The crisis resolution process shows the same familiar signs of further hubris risk. The direct financial cost of a Greek default is quite trivial in the European context. Total Greek debt is around €350 billion, but the EU GDP is €15 trillion, so a total bailout of Greece would only cost the EU around 2.3 per cent of its GDP. The cost of not solving the problem is an order of magnitude higher, estimated by myself and my colleague to be 22 per cent of European GDP.Greece will end up costing its creditors most of the €350 billion. Better to come to that realisation now, and let both the Greeks and the European economy get on with rebuilding. Extreme austerity and parcelling out bailouts will only make it worse.

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It is hard to see the objective of the European authorities. Perhaps they want to make sure that anybody receiving bailouts will have to suffer so much that nobody else will be tempted to get into the same situation. Or perhaps they want to use this as a means to create a proper European central government — a transfer union. Regardless of the motivation, the costs not only to Europe but also to the world are too high. By letting political desire triumph over economic reality, the EU authorities are yet again guilty of hubrisk, the risk of hubris.

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Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

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