Greece – Deal or no deal? Parameters of a decision

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By Max Hänska

It appears to me that much of the ongoing discussion about the Greek debt talks misinterprets the parameters of the challenge, and the resulting (irreconcilable) disagreement. Some economists attribute the standoff to the unwillingness of creditors to accept economic facts (Greece needs debt forgiveness and economic support). Austerians argue that only radical reforms and cutbacks will salvage Greece, and attribute the standoff to Greece's unwillingness to reform. Though neither assessment is fundamentally wrong, both miss the political nature of the decision creditors faced.

The current crisis in Greece must be understood as the logical consequence of a flawed currency union. Without a political union, and attendant institutions that can both raise a budget (through taxation) and use that budget to establish permanent fiscal transfers within the currency union, crisese similar to the Greek one will repeat themselves. However, neither debtors nor creditors are willing to move beyond intergovernmentalism and give up (at least some) fiscal sovereignty (to the European parliament or some new institution), which would make the kind of permanent transfers necessary for stabilising the Eurozone possible.

Given the EMU's structural flaws, inevitable crises will need to be resolved intergovernmentally. Unfortunately, Greece's creditors have no confidence in Greece delivering on any of its commitments. The creditors view Greek promises as a fig leaf for an arrangement under which Eurozone citizens would indefinitely fund the Greek state —they don't believe that the Greek government is sincerely willing or capable of delivering reforms. I doubt creditors are uniformly committed to austerity as a panacea. Rather, their insistence on invasive and strict conditionality is better understood as a direct result of lacking confidence. Without invasive conditionality creditors have no leverage over, what they perceive as, unruly Greeks.

Greek governments, on their part, have been unable (irrespective of their willingness) to deliver meaningful reforms, as such reforms would require them to dismantle the very quid-pro-quo clientelism that carried them to power. Necessary reforms would require the Greek political system to self-administer a quasi-revolutionary rupture with its networks of patronage. Tsipras may genuinely want to deliver meaningful reforms. But his current gambit suggests that he considers it easier to endure seemingly impossible negotiations in an effort get creditors to fund his policies, than to tackle the herculean task of reforming the Greek state.

Given that neither creditors nor debtors are willing to give-up fiscal sovereignty, which solving the structural problems at the root of the crisis would require, and that it is near impossible for the Greek state to reform itself, the creditors must way-up the political and economic costs of the alternatives:

1. They can choose to keep Greece in the Euro by sanctioning *de facto* transfers and writing-off debt while accepting that promised reforms will probably not be implemented properly. For the Eurozone this entails the defenestration of its rules. Suspending the principles of the currency union may well damage confidence in the Euro and set a dangerous precedent. Sooner or later other EMU members will seek exception to the rules too. Eurozone governments will also have to sell a Greek deal to their parliaments, and legislators will have to explain to their voters why their taxes should fund the Greek state. A eurosceptic backlash may be the electoral consequence.
2. Creditors can also choose to enforce the rules of the currency union, and deny Greece exceptional treatment,

which would come to a *de facto* expulsion of Greece from the Euro. Here too the costs could be multiple. The EMU would be revealed as a glorified currency peg, without the political clout to solve fiscal problems in one of its smaller members—which would also damage confidence in the Euro (who's next?). The economic and geopolitical risks of Greece dropping out of the Euro are also hard to anticipate: could it trigger another Lehman-like financial event, and what would it mean for security on NATO's south-eastern flank?

Creditors will have to weigh the risks of their choices, each of which carries unknown political and economic costs. To turn this impossible choice into a favourable outcome will require much more political imagination and foresight than we have hitherto witnessed from Europe's political leadership.

Note: This article gives the views of the author, and not the position of the Euro Crisis in the Press blog, nor of the London School of Economics.

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