Greece and its euro-zone partners: why two sides that say they agree can't find their way to cooperate effectively

Ioanna Antonopoulou 2012-2-16

by Professor Kevin Featherstone

The European Union is built on structures of economic co-operation, yet the sovereign debt crisis is testing to the limit its ability to avert a financial disaster. In the current Greek imbroglio, both Athens and its euro-zone partners seem unable to achieve their aims and are finding it impossible to convince the markets they have found a way out. Given both sides proclaimed a Greek default (and possibly an exit from the euro-zone) is what they wished to avoid, how come they haven't been able to cooperate and secure their shared goal?

As in any strategic dilemma, the ability to set preferences, acquire the necessary information, and to trust the other side is crucial in resolving the Greek crisis. Greece's bailouts have been negotiated between the government in Athens and the so-called 'Troika' of the EU Commission, the European Central Bank and the IMF.

The EU was painfully slow in deciding if and how it wanted to intervene to help Greece in early 2010. Its delay undoubtedly increased the cost of the attempted rescue and what was offered in loans soon proved not enough. EU leaders were clearly divided: did Greece deserve help? If so, how much and how should it be given? These questions were not only sensitive with domestic publics across Europe facing a recession, they had been singularly left unanswered by the arrangements establishing the 'euro' currency – the articles of the Maastricht Treaty. In 1991, the negotiators at Maastricht had not planned for national rescues: fiscal stability was to be the prime responsibility of governments and those failing to provide it would be hung out to dry by the international markets. But, also, they did not foresee the kind of financial crisis bequeathed by the collapse of Lehrman Brothers.

So, the EU came to the Greek crisis not knowing what it wanted to do or how it could do it. Eventually, it agreed a bailout in May 2010 with a 'Memorandum' elaborating conditions and targets to be monitored by the Troika. A list of reforms was specified with the aim of making the domestic economy more competitive, flexible and open. But the Troika began with little knowledge of Greece and it became horrified at what it discovered over the course of its monitoring.

The Athens government made considerable efforts to achieve the reforms, but in reality, the reform efforts were diluted and blocked by domestic opposition frightened of the economic costs. The trust of Greek voters in their leaders ebbed away.

By summer 2011 it was clear that a further rescue was needed if Greece was to avoid a default. At this stage, European leaders were made well aware of the risks to their own banking systems if Greece went bankrupt and also of the risk of the market speculation spreading to other EU states. Self-interest led both Chancellor Merkel and President Sarkozy to stress that they wanted to avoid a default and to keep Greece inside the euro-zone. A shared commitment seemed to be strengthening.

But with the frustration of Greece not meeting its targets, the Troika lost faith and started to put its emphasis on Athens satisfying across-the-board cuts. The international financial institutions took steps to ring-fence the Greek problem as much as possible. In the latest package, the Troika has insisted that 15,000 civil service posts go each year for the next decade, that the minimum wage be cut again, and that salaries are reduced. The trust of EU leaders in Greece has evaporated: now simple, clear fiscal rules are to be applied.

The strategy – if it is still intended to rescue Greece – is very clumsy and indirect. The conditions are set by fiscal need, not by any coherent design of the kind of model that Greece should move towards. The Troika's actions are doing nothing to shift the Greek debate towards the critical choices, performance evaluations, and selective allocations of resources that are needed for long-term planning. To make matters worse, EU leaders seem intent on humiliating their Greek counterparts –requiring personal testimonies to be signed of commitment to implement the measures, snubbing them in direct meetings, making derisory comments to their own domestic audiences.

For its part, the government in Athens is weak after recent failures and social pain.   It may attempt to talk of long-term shifts, but all attention is on the short-term. It is in no position to speak of new policy models.   Thus, the domestic debate is essentially one distinguishing those who feel more misery is necessary and those who believe a default brings relief from it. Little wonder, then, that tensions run high with the stakes set so sharply.

The insistence of the Troika on a clumsy method and on such huge deflation may, of course, be the course Greece's partners have set in order to expel her from the euro-zone. No legal right of expulsion exists, so playing the market is the only option. The comments of German Finance Minister, Wolfgang Schauble, hint in this direction and every syllable is sensitive for the markets.

It takes two to Tango and it's clear that Greece and its euro-zone partners are no longer able to connect effectively. Unless they do so very urgently, the music will stop and it'll end in tears.