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Doing what it takes to stop a ‘Grexit’

Germany should take a flexible view of Greece’s debt, to contain the Left wing, anti-austerity uprising

The January 25 polls in Greece has resulted in a big victory to Syriza -- the left coalition opposed to the austerity programme imposed by the EU on Greece as a condition for financial assistance. The result symbolises a revolt of the Greek people against the so-called austerity programme that has so far not succeeded in bringing the economy back on its feet, and resulted in steep rise in unemployment.

It could have a fall out far beyond Greece, impacting on the future of the Eurozone, and future approaches to sovereign debt issues.

The election itself was triggered by the failure of Greek parliament to elect a President, even with a reduced majority in the later rounds of the election. The initial opinion polls showed Syriza leading by a small margin. The actual polling reflected a bigger swing in favour of Syriza, with a lead of 8.5 per cent beating the incumbent centre-right New Democracy (ND) party which got 27.8 per cent of the vote.

Under Greece’s system of reinforced proportional representation in the elections, the leading party gets a bonus of 50 seats in the Parliament, while the remaining 250 seats are shared among all the seven parties that get over a 3 per cent threshold of the popular vote. The incumbent ND now is in the opposition with 76 seats.

Entering an exit?

During the election campaign, the popular mood was marked with bitterness over the economic hardships of the people. Unemployment rates have soared from 10 to 26 per cent during 2010-14, while real GDP fell by 24 per cent. Consequently, the debt-to-GDP ratio rose from 146 per cent in 2010 to 176 per cent in 2014. This is despite the harsh austerity measures, with severe cuts in government spending and cuts in wages and social security benefits. In the last few months some green shoots of recovery were noticed, with GDP growth rates rising to 3 per cent, and a positive structural balance in the budget.

While the austerity programme has involved a write off of private debts (the “haircut”), official creditors represented by the Troika of Eurozone governments, the European Central Bank (ECB) and the IMF have maintained that all the official debts must be paid by Greece.

If this stand is maintained, it is difficult to see how Greece can meet its commitments. The result could be a default and a Greek exit from the Eurozone, which could have disruptive consequences for Europe and the global economy. Though measures have been taken since 2010 to strengthen and insulate the Eurozone from such eventualities, the disruption would be severe.

It could also trigger a loss of confidence and possible knock on effects in Spain, Portugal and Italy. A North-South cleavage would develop in the Eurozone. Europe is already facing a difficult situation due to the US-Russian conflict in Ukraine, and cannot afford a disaster in Greece.

With such high stakes involved, it is important that a balanced outcome results from the forthcoming negotiations with the new Greek government led by Syriza.

To avoid a default

Creditors such as Germany need to factor in the need for a programme that enables Greek GDP to grow and unemployment to fall. Relief must be provided from the crushing burden of Greece's official debt. If the Paris Club can write off a part of the official debts of developing countries, then some relief for Greece can and should be envisaged. It may be recalled that some years ago even the idea of a "haircut" for private debts was not acceptable to Eurozone creditors, but wisdom has prevailed since then. The last thing that anyone wants is an outright default, in which everyone loses.

Creditor countries have so far insisted on full payment of Greece's debts mainly due to fears that similar demands may arise from Spain, Portugal and Italy. However, the idea of sovereign debt restructuring has gained support, even to situations beyond Europe, and could provide a constructive solution to Greece's problems while resulting in agreed principles and guidelines for future situations.

The debt restructuring could be based on a combination of deferment of payments and debt reductions, so that Greece's burden of payments is reduced to a reasonable level for the next few years, while giving it a chance to resume growth. These ideas have been advocated by Syriza, which would prefer a solution within the Eurozone rather than a disruptive exit.

Germany, one of the leading creditors, has benefited considerably from the Eurozone (in terms of a surplus which would not have been possible with revaluation of a national currency), and must show more flexibility.

The Greek situation has been closely followed by people in Spain, Portugal, and Italy. The popular trend is against austerity packages that reduce GDP and drive up unemployment. Polls in these countries may well result in anti-austerity verdicts, strengthening left and extremist parties, and a general backlash against the perceived failure of economic policies of Eurozone institutions. This makes it all the more important for a balanced, constructive and creative solution to be found to Greece's problems.

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