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Greece And The Eurozone Crisis: An Evaluation

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GREECE AND THE EUROZONE CRISIS: AN EVALUATION[1]

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Abstract

This paper examines two questions regarding the controversial relationship between Greece and the Eurozone during the current crisis. First, why was Greece bailed-out in 2010? Second, why did the Greek economy collapse despite the largest 'bail-out' in global financial history? There are conflicting answers to these questions and the paper compares the answers of the so called 'dominant narrative' to those provided by the 'counter-narrative' of the Eurozone crisis. The paper reaches the following conclusions. First, the primary motivation for the bail-out of Greece was the maintenance of European and global financial stability. Second, although programme implementation was less successful in Greece than in other programme countries the catastrophic collapse of the Greek economy had more to do with the programme itself than its implementation. Third, political unity will not only improve efficiency but also democracy and accountability in the Eurozone.

Key-words: Bail-out, expansionary austerity, fiscal consolidation, internal devaluation, structural reforms, programme implementation, democratic dialogue

JEL Classification: B20, B25, E44, E52, F15, H30, H60

1. Introduction

The Eurozone crisis erupted in 2009 when the newly elected Greek Prime Minister George Papandreou revealed that his country's public finances were a lot worse than what was stated in the official statistics. In fact both the budget deficit and total indebtedness as a proportion of GDP were well in excess of what was allowed by the rules of the monetary union. Greece had not only broken the rules but also lied about it. There were also rumors that Greece had gained entry to the Eurozone in 2001 by allegedly 'cooking the books'. Moreover additional stories begun to circulate in the media about the Greek economy and society that painted a very sorry picture of a country that expected to be treated as an equal and respected member of a monetary union. There were stories about endemic tax evasion, an overblown public sector, political corruption and cronyism, and unsustainable pensions including over-generous early retirement schemes. Any fair-minded person would have been astounded if told in 2009 that this saga would remain unresolved several years later. In fact, a fair-minded person would have expected Greece to have been ejected from the monetary union in 2009.

Why have events in a country that accounts for less than 2% of Eurozone GDP, which had violated the rules of the monetary union and lied about it sparked off a crisis in the Eurozone and continued to cause it problems? This is one of the main issues to be explored in this paper.

We proceed as follows: Section 2 examines the first question, which is why the problem was not resolved in 2009. Section 3 considers the paradox of how the 'rescue' of a country can result in its virtual destruction and section 4 summarizes and concludes[3].

2. The 'rescue' of Greece

Having repeatedly flouted the Maastricht rules and lied about it, Greece was 'bailed-out' in May 2010 in a clear breach of the same rules. Why?

The fiscal rules of the Economic and Monetary Union (EMU) were put in place for a purpose: to prevent fiscal irresponsibility. Excessive deficit spending by a member

[3]For an expanded version of this paper see Kitromilides (2016). For the importance of the story-telling paradigm in economics see, Ackerloff and Shiller (2009), Kitromilides (2013), McCloskey (1990), Shiller (2012).

country could eventually create ‘unsustainable’ levels of national indebtedness, which in turn could undermine the unity and cohesiveness of the monetary union. The Eurozone was initially constructed as a monetary union but always aiming ultimately at a political union, which would also involve a fiscal union. In the meantime, sovereign member states agreed to use their fiscal autonomy responsibly, which meant adhering to the so-called Maastricht rules of fiscal discipline: budget deficits should be kept below 3% of GDP and total sovereign indebtedness below 60% of GDP. To deal with the ‘moral hazard’ element of this arrangement there was a second major rule, which was expected to re-enforce and cement the first rule on fiscal discipline. This second rule has come to be known as the ‘no bail-out’ rule. The European Central Bank (ECB) was not allowed to act as lender-of-last-resort to governments.

All member countries, therefore, were aware of the twin requirement of (a) not to over-borrow and (b) not to ask for help from the ECB when they do over-borrow. Given this crucial ‘no bail-out’ clause in the Maastricht treaty why was Greece bailed-out in 2010? Greece was bailed-out in 2010 in the sense that, although Greece was unable to meet its financial obligations through market borrowing at sustainable rates, a default was prevented because of the loan provided by the troika. The way this question is answered has a pivotal influence in determining the tone and nature of the narrative of the crisis. Was the ‘bail-out’ of Greece an act of altruism and an expression of genuine community solidarity or a decision based on naked self-interest and the desire for self-preservation by the Eurozone policymakers? Given the lack of transparency during the relevant Eurogroup meetings there is no way of knowing with certainty the real motives for the actual decisions taken by the Eurogroup between May 2010 and July 2015.

Without a bail-out in 2010 Greece would have been in very serious trouble. Its immediate financial needs, which were estimated in 2010 to be □53 billion (Treanor, 2010), could not have been accommodated either by the ECB or the markets. Financial markets had finally woken up to the fact that lending to the Greek sovereign was not ‘like lending to the German government’. There was indeed for the first time in the short life of the euro, a real and present danger of a sovereign default in the Eurozone. The bail-out decision in May 2010 was an ad hoc institutional reform in the monetary union, agreed after several acrimonious meetings of the Eurogroup between April and May 2010, which prevented a Greek default and probable exit from the Eurozone. According to one, often repeated, interpretation of this decision, the Greek bail-out

was in fact an act of generosity and altruism and a demonstration of European solidarity towards Greece and the Greek people. Despite the rule violations and deceptions, Greece was given in 2010 a reprieve, saved from bankruptcy and default and given another chance to sort out its many social and economic problems.
An alternative and more plausible interpretation sees the Greek bail-out as a policy decision by the Eurogroup based not so much on altruism and generosity but fundamentally on self-interest and pragmatism. There is no doubt that without a 'bail-out' the economic consequences for Greece would have been dire. Whether these consequences would have been more disastrous than the current situation in Greece, is a counterfactual question for which we can only speculate. What is not in dispute, however, is that in 2010 a Greek default would have had grave adverse repercussions for the rest of the Eurozone. A contagion - the inability to confine the effects of Greek default only to Greece - was highly probable.

The architects of the EMU had failed to put in place an adequate crisis management mechanism. This was one of several so called 'design faults' of the monetary union, which meant that in 2010 the Eurozone had no adequate means of preventing the spread of the crisis to other Eurozone member countries. The fear of 'contagion' from a Greek default was of two interconnected types: a 'contagion' to the European banking system and a 'contagion' to the bond markets. Regarding the effects on the European banking system it was estimated that most of the Greek government debt was held by non-domestic banks, notably French and German (based on data from the Bank of International Settlements, BIS; see Treanor, 2010). This would have meant that the taxpayers of these countries would have had to foot the bill for the bail-out of their systemic banks in the event of a Greek default. This in itself would probably not have caused a serious 'contagion' problem for the banking systems of these countries' and the rest of the Eurozone if the exposure of European banks was confined simply to the Greek sovereign.

The very real fear of 'contagion', however, was based on estimates, again using BIS data, of a huge exposure of $2.9 trillion of the European banking system to the PIIGS (Portugal, Ireland, Italy, Spain, and Greece), an exposure which was particularly concentrated among French and German banks (Treanor, 2010). If there was a 'contagion' of this magnitude it is difficult to envisage how the effects of a Greek default could have been contained under the arrangements prevailing at the time in the Eurozone. Moreover, if there was 'contagion' in the banking system following a Greek default there would almost certainly have been a 'contagion' in the bond

markets as investors would have feared that if one sovereign in the Eurozone could default why not others? This was not a risk worth taking. Thus, the Greek bail-out, by preventing Greek default, in effect prevented a possible collapse of the Eurozone in 2010 with all its global repercussions.

Glover and Richards-Shubik (2014) simulated the effects of a hypothetical Greek default on other sovereigns and found minimal risk of contagion in 2010. Similar empirical simulations were carried out by Bonaldi et al. (2015) with similar conclusions with regard to contagion risks in the banking system in Europe. This of course was not the perception of policymakers in 2010. So soon after the Lehman Brothers meltdown in September 2008, the fear of possible 'contagion' was very real. Although Davies (2015) dismisses the claim that the sole motivation for the Greek 'bail-out' was to protect France and Germany from having to bail out their domestic banks, he nevertheless concludes that the primary motivation for the 2010 bail out was, indeed, preserving European financial stability. If that is the case it is fair to ask who should bear the burden for preventing contagion. The IMF (2014a) suggested that under these circumstances some form of burden sharing was warranted. Greece should have been compensated for having to hold on to its unsustainable debt burden in the interest of preventing contagion, through some form of what the IMF (op. cit.) calls 'concessional assistance' or grant instead of a loan. The Greek bail-out in 2010 contained no such 'concessional assistance' and it was to act shortly afterwards, and fundamentally for the same reasons, as a template for the 'bail-out' of Ireland, Portugal, and the banking system of Spain and, eventually in 2013, the partial bail-out of Cyprus. The stated aim was the 'rescue' of these economies individually; the unstated aim was the rescue of the whole of the Eurozone. In 2010 the 'no bail-out' rule had to give way.

The bail-out plan for Greece was proposed by Jean-Claude Trichet, the then president of the ECB and vigorously advocated by President Sarkozy of France who managed to convince the German government, allegedly by threatening to leave the euro (as Spain's former prime minister, José Luis Rodriguez Zapatero, later revealed to the newspaper El País); namely that this was an operation not simply to save Greece but to rescue the whole of the Eurozone. It had the desired effect of preventing default and 'contagion' in the Eurozone. It had also the effect of transforming the nature of indebtedness in the Eurozone and the relationship between borrower and lender. As Sinn (2015) points out, a private dispute between creditors and debtors was transformed into a dispute between sovereign states with disastrous consequences for

the cohesion and unity of the Eurozone. Before the bail-outs of 2010 and 2011 Greece was a borrower and owed money to European banks who were the original lenders. After the bail-outs Greece was still a borrower but owed money to new lenders, the taxpayers of the Eurozone and, via the IMF, to taxpayers in the rest of the world.

This development introduced a new ethical dimension to the relationship between borrower and lender. The following question is often asked by politicians and commentators in the media: is it fair that the (mainly) German taxpayers' hard-earned money be used to 'bail-out' the irresponsible and profligate Greeks? This type of question, however, does not consider the dual ethical dimension of the relationship between debtors and creditors.

Irresponsible borrowers are usually only able to obtain credit from irresponsible lenders. There is of course 'asymmetric information' between borrowers and lenders but this is typically dealt with by the lenders charging a higher interest rate for those borrowers that they suspect of being a 'bad risk'. In modern economies, the punishment for irresponsible borrowing is bankruptcy; the punishment for irresponsible lending is that the lenders lose their money. In 2010 irresponsible Greek borrowing would have resulted in default and 'Grexit,' which would undoubtedly have been disastrous for Greece and certainly would have been sufficient punishment to satisfy the angry European (mainly German) taxpayers' sense of fairness and justice. It would also have resulted in the just and fair punishment for the irresponsible or foolish (or both) lenders (predominantly German, French, Greek and other European banks) who would have lost their money had Greece defaulted.

If the high moral standards of those who believe that irresponsibility must be punished are to be consistently applied, then not only the irresponsible Greeks but also the bankers who foolishly lent to Greece (and to the other peripheral countries) should have been punished. The strict application of this ethical code, however, would have produced perverse outcomes: the punishment of irresponsible borrowers in Greece would have resulted in the punishment of irresponsible bankers which could have threatened financial stability in Europe and the global economy. Eventually pragmatism prevailed over considerations of strict morality. This was indeed the case with most countries (except for Iceland) that experienced a banking crisis in 2007-8: banks were bailed-out by the taxpayers of each country. In the Eurozone this was done in an indirect way.

Greece was 'rescued' by lending the Greek government billions of euros to pay back the money they owed to the 'irresponsible' bankers- an arrangement that undoubtedly prevented Greek default but more significantly preserved the stability of the European and global financial system. The Greek, Irish, Spanish, Portuguese, and Cypriot tax- payers now owe money to each other and to the tax-payers of all other member countries such as Malta, Slovenia, Slovakia, Finland and, of course, Germany. Naturally these taxpayers have no sympathy for the plight of Greece. If they were asked in a referendum whether they approve of debt relief for Greece they would, almost certainly, vote 'no'. This question, however, as we argued in this section is only part of the story. It is equally legitimate and equally likely that a referendum would produce a 'no' vote if the question was: do you approve of your money being spent on bailing-out irresponsible bankers, which is in effect what happened with a significant proportion of the Greek bail-out funds?

There are, therefore, two answers to the question posed at the beginning of this section. First, the 'no bail-out' rule was breached in order to save Greece from default and bankruptcy. Second, the 'no bail-out' rule was breached in order to save the euro. There is some truth, of course, in both answers but the more plausible answer is the second one. Yet the first answer is the one most commonly provided by the dominant narrative of the crisis, i.e. that Greece was 'saved' by the Eurogroup decision to bend the rules of the monetary union in 2010 and this was a generous altruistic act of community solidarity.

3. The collapse of the Greek economy.

Although, according to the dominant narrative, Greece was 'saved' from bankruptcy and economic catastrophe in 2010, the Greek economy experienced a 1930s style economic collapse following the bail-out. What is the explanation for this apparent paradox? Despite receiving €240 billion in 2010 and 2011 and a Private Sector Involvement (PSI) partial debt restructuring in 2012, by the beginning of 2015 the Greek economy had shrank by 25% from its pre-crisis level in 2010, its debt to GDP ratio shot up to 175%, unemployment, especially youth unemployment, sky rocketed and the country faced a serious humanitarian crisis. As with the previous question discussed in section 2, there are two conflicting answers. The dominant narrative sees the collapse of the Greek economy as the inevitable consequence of the failure of successive Greek governments to implement appropriately the agreed troika economic adjustment programme; the alternative narrative claims that the opposite is

the case: the collapse of the Greek economy was primarily due to the implementation of the troika programme. Is it the case that Greece did not take the prescribed medicine or was Greece prescribed the wrong medicine? As with the previous question, there are elements of truth in both assertions. Unlike the previous question, however, the truth concerning this paradox is not so easy to disentangle. The main difficulty lies in finding an acceptable definition of what a successful implementation process consists of in all its quantitative and qualitative aspects. Clearly the implementation process in Greece was far slower and effective than in other peripheral economies under the troika economic adjustment programmes (Pisani-Ferry et al., 2013: Sapir et al., 2014). Equally, however, it would be wrong to claim that Greece did not implement fully a great deal of the troika imposed programme, in particular fiscal consolidation (OECD, 2013 and IMF, 2014).

The economic adjustment programme was a condition for the bail-out of Greece but also of the other programme countries of Ireland, Portugal and Cyprus. It was designed by the troika and is generally known as the 'austerity' strategy. It had three components: fiscal consolidation, internal devaluation and structural reforms. All three elements were expected to promote growth and ultimately result in a reduction in indebtedness although elements of the programme differ in each country, depending on what the troika perceived as country specific problems.

Fiscal consolidation - the process of reducing the budget deficit by cutting government spending and raising taxes - is, of course, contractionary because it reduces total demand in the economy. At the same time, however, it can be expansionary because of the effect that the achievement of sound public finances can have on confidence in the economy. In the first place, rational consumers, seeing that the government is serious about reducing the deficit, will become more confident and increase their spending, in anticipation of lower taxes. The relevance of this factor in an economy that allegedly suffers from endemic tax evasion is not clear. Also business confidence will improve and investment will increase as a result of anticipated and actual lower interest rates resulting from lower government borrowing. Overall the theory predicts that the net effect of fiscal consolidation will be expansionary and growth inducing because improved confidence can stimulate business investment and growth. This is known as the theory of 'expansionary fiscal contraction' or 'expansionary austerity' (Alesina and Ardanga, 2009, 2010, Briotti, M.G, 2004, Heylen, F. and Everaert, G, 2000).

Internal devaluation, which is necessary in the absence of exchange rate adjustments, can also promote growth by improving competitiveness. The effect of internal devaluation would also initially be contractionary but again it can be arrested and reversed by an increase in demand due to an increase in exports. The proponents of the austerity strategy insist that fiscal consolidation and internal devaluation although necessary conditions for the success of the strategy are by no means sufficient. They must be accompanied by structural reforms which, by modernizing the economy, can create the conditions necessary for a sustained private sector-led growth.

In Greece and other countries of the southern Eurozone periphery, the implementation of a wide range of measures of structural reforms were considered by the troika to be as important, if not more important, than fiscal consolidation and internal devaluation in promoting growth. The reform agenda therefore has become an integral part of the troika growth strategy. Structural reforms are vital in promoting private sector-led growth because by lowering the cost of doing business they encourage more investment, growth and job creation as well as improving competitiveness and encourage exports. In fact countries should vigorously pursue and implement these reforms irrespective of the requirements and dictates of the troika programme. Acquiring 'ownership' of the adjustment programme, and in particular the reform agenda is, according to the troika, an essential prerequisite for its successful implementation (Rogoff, 2015).

In December 2013, Ireland, which had faithfully and 'stoically' implemented the austerity strategy, exited the 'troika' programme. Portugal also faithfully but less 'stoically' did the same in May 2014. Greece was also preparing for exit from the programme in 2014. In fact in June 2014, the IMF chief in Greece declared that he was 'cautiously optimistic' about the progress the country was making in that direction (IMF, 2014b). Earlier in April 2014, the Greek Finance Minister went a step further and claimed that after four years of fiscal consolidation, internal devaluation and structural reforms the Greek economy had been 'turned around'; both fiscal and current account deficits had not only been eliminated but turned into surpluses - an economic adjustment success story unparalleled in global financial history (Stournaras, 2014). For the first time after six years of deep recession (more accurately of a 1930s style depression) Greece was expected, according to the IMF (2014b) to return to positive economic growth in 2014. By July 2014, only □7.2 billion of the □240 billion of the Greek bail-out funds had not been disbursed. The rest of the funds have

been disbursed following successful programme reviews. The final disbursement would have been effected on successful completion of the final programme review, which had been fixed for 28 February 2015, by which date Greece was expected to meet all its outstanding programme targets and, like Ireland and Portugal, exit the programme.

The claim, therefore, that the collapse of the Greek economy was due to the inadequate and insufficient implementation of the troika programme by successive Greek governments since 2010 must be evaluated against this background. Both the OECD (2013) and the IMF (2014b) were impressed with the progress of programme implementation in Greece. In terms of fiscal consolidation, the first element of the austerity strategy, Greece was by the end of 2013 above target and ahead of schedule. According to the IMF chief in Greece (IMF, 2014b) "the fiscal adjustment in Greece has been extraordinary by any international comparison. Having entered the crisis with a deficit in double digits, Greece has not only achieved a primary surplus in just four years and ahead of schedule, but also now has the highest 'cyclically-adjusted primary balance' in the euro area, that is, the highest underlying primary balance after accounting for the effect of the business cycle on revenues" (p. 1).

With regard to the second element of the austerity strategy, internal devaluation, private sector nominal wages have fallen by 16% during the period 2009 – 2014, which put downward pressure on prices (IMF, 201b). This resulted in an improvement in competitiveness although due to price rigidities the price declines were not commensurate with those of wages. This indicated the need for further structural adjustment measures to deal with the problem of price rigidities. However, the structure and export specialization of the Greek economy was such as to cast serious doubts on the potential effects of internal devaluation as a means of promoting exports and growth. The kind of Greek exports that internal devaluation was expected to boost were simply absent. In this case, an active industrial policy in Greece would have been desirable in order to incentivize a change in the Greek productive structure and develop the kind of export industries with higher added value that could benefit from internal devaluation.

In terms of the third element of the austerity strategy, the implementation of a wide ranging programme of 'structural reforms', the verdict was that a great deal had been achieved but more needed to be done before exit from the troika programme. According to Angel Gurria of the OECD , "Greece, which has been under an

internationally coordinated adjustment programme since 2010, has made impressive headway in cutting its fiscal and external imbalances and implementing structural reforms to raise labour market flexibility and improve labour competitiveness" (OECD, 2013, p.1). In the words of the IMF chief in Greece: "Greece implemented path-breaking labor market reforms in 2012, which have helped wages to adjust in line with productivity" (IMF, 2014b, p. 1). However 'impressive' or 'path-breaking' the various structural reforms implemented in Greece had been, the general consensus was that more needed to be done. The critical question, therefore, is whether these 'residual' structural reforms in 2014, on the eve of the final programme review and the disbursement of the final tranche of the bail-out funds were so crucial that they were primarily responsible for the economic catastrophe that befell Greece after 2010.

The aim of the strategy of simultaneously implementing rapid fiscal consolidation, internal devaluation and structural reforms was to promote economic growth that could in turn enable a heavily indebted economy to achieve debt sustainability. That failed spectacularly in Greece. Austerity in Greece proved counter-productive and the Greek economy experienced a 1930s style economic depression. It has been argued in this section that the 'non- implementation of the economic adjustment programme' explanation for the economic catastrophe in Greece is only partially correct because Greece did in fact implement the bulk of the economic adjustment programme demanded by the troika. It is also undoubtedly true that the implementation process with regard to many structural reforms was slow, half-hearted and lacking in 'political ownership'. Moreover, several 'residual' reforms which had they been implemented would have enabled Greece to exit the troika programme, remained unresolved and outstanding in 2014. How significant and crucial these remaining reforms were is not easy to ascertain. It is, however, highly unlikely that they were such key reforms that they were the sole reason why the Greek economy experienced such a catastrophic collapse after 2010. The economy seems to have collapsed despite implementing the bulk of the 'troika' economic adjustment programme.

It is fair to point out that this conclusion ignores some important qualitative aspects of the issue. The cornerstone of the austerity strategy as a growth-inducing strategy is the re-establishment of both consumer and business confidence in the economy. Improved confidence, which comes about not only by restoring sound public finances but also through the credible implementation of 'growth-inducing' structural reforms, can lead to increased domestic and foreign business investment which could

in turn counter the severe deflationary effects of fiscal consolidation and internal devaluation. Restoring sound public finances, which Greece achieved remarkably well, was, according to the conventional narrative, a necessary but by no means a sufficient condition for preventing the economic collapse of the Greek economy. Although the bulk of the troika targets were met and nearly all but a small fraction of the bail-out funds have been disbursed, it may be argued that due to the manner in which the structural reform programme was implemented in Greece, which was half-hearted, slow and totally unconvincing, it had adverse effects on confidence and growth. According to this point of view, therefore, Greece failed to implement credible structural reforms and without credible reforms Greece was doomed. This might be termed the 'holistic' approach to the problem of achieving growth in a heavily indebted economy: this is the 'troika' philosophy that fiscal consolidation, internal devaluation and structural reforms must be implemented simultaneously, attaching paramount importance on the 'credibility' of structural reforms. The 'holistic' approach, of course, is not without its criticism.

The principal objection is that there is a very real possibility of creating a 'vicious circle' of economic decline. Fiscal contraction is only expansionary if it is reasonably quickly accompanied by a return of confidence in the economy. Growth-enhancing structural reforms can contribute to this process by further boosting confidence and growth. The contractionary effects of fiscal consolidation, however, are immediate whereas the growth-enhancing effects of structural reforms take time to have an effect. Under these circumstances, a deflationary spiral can be set in motion, which according to Fisher (1933) makes the fall in output self-feeding and the attempt to reduce indebtedness self-defeating. Significantly according to Terzi (2015) it can also make the task of implementing growth enhancing structural reforms even harder. To make matters worse in the case of Greece, the initial under-estimation of the fiscal multipliers (Blanchard and Leigh, 2013, IMF, 2013) further aggravated the severity of the deflationary spiral and consequently the swift and credible implementation of much needed reforms.

Sen (2015) has used a medical analogy to illustrate the ineffectiveness and futility of the 'holistic' approach. The insistence that an indebted economy must implement structural reforms at the same time as savage austerity is like a patient who has fever being forced to take a pill that contains both antibiotic and rat poisoning. He writes: "We were in effect being told that if you want economic reform then you must also have, along with it, economic austerity, although there is absolutely no reason

whatsoever why the two must be put together as a chemical compound…The compounding of the two – not least in the demands made on Greece – has made it much harder to pursue institutional reforms. And the shrinking of the Greek economy under the influence mainly of austerity has created the most unfavourable circumstances possible for bold institutional reforms" (p. 4). Mody (2015) uses another medical analogy, namely, in conditions of debt-deflation imposing fiscal austerity is like asking a trauma patient whose blood flow does not stop on its own "to run around the block to demonstrate good faith" (p. 3).

The linking at the policy level of the problem of structural reforms with that of indebtedness is a mistake. This is not to deny that there is a very clear link between the two problems in the case of Greece. Endemic tax evasion, an overblown public sector and an unsustainable pension system are but a few of the structural problems that need to be addressed urgently and have a direct bearing on national indebtedness. These and a whole host of other problems commonly associated with the Greek 'malaise' must be addressed. The problem with the 'holistic' approach, however, is that it assumes that the confidence-boosting and growth-enhancing effects of combining severe and rapid fiscal consolidation with a swift implementation of structural reforms will eventually bring about growth and ultimately resolve the indebtedness problem. As noted above, the negative effects of fiscal consolidation on growth are immediate while the growth-enhancing effects of reforms take more time to have an effect. Furthermore, as Terzi (2015) points out the sequencing of reforms in the Greek adjustment programme was wrong. The reforms that could have produced quick positive effects on output were delayed until 2012. This combined with unnecessarily harsh fiscal consolidation imposed in 2010 set in motion a classic debt-deflation spiral that made the task of implementing further structural reforms more difficult. It is far easier to implement institutional reforms in an environment of growth than in an environment of stagnation and economic depression (Rodrik, 2009; Sen, 2015). Terzi (2015) goes a step further and extrapolates, based on the empirical findings of Acemoglu et al., (2001), that if the aim is a swift return to growth and debt sustainability, institutional reforms are neither a necessary nor sufficient condition for success. He concludes: "Once growth momentum is restored, however, improving the institutions will help to solidify and sustain it" (p. 14). This, of course, is easier said than done. How can the growth momentum be initiated and restored in a heavily indebted member of an imperfect monetary union?

According to Mody (2015) there is greater certainty about what is not needed in the

midst of a debt–deflation cycle. A depressed economy burdened with an unsustainable debt mountain does not need austerity. Fisher (1933) reached the same conclusion with regard to the US economy during the Great Depression of the 1930s. What the economy needed was not austerity but 'reflation'- a policy lesson that President Roosevelt had quickly learned. He abandoned his pre-election promise of balancing the budget, engaged in deficit-spending and ultimately ended the Great Depression. Such a policy option is precluded by the rules of the monetary union in Europe. 'Rules are rules' but should not rules be changed when they clearly do not make sense?

Is the major claim of the dominant narrative that the successful exit from the troika programme of Ireland and Portugal, the return of growth in Spain and the prospect of a return to growth in Greece in 2014, a vindication of the austerity strategy in the Eurozone periphery? A satisfactory answer to this question would require a separate paper. Suffice it to note at this point that each economy in the periphery, faced with specific challenges, none had to deal with the severity and inconsistencies of the Greek programme (see, Mody 2015, Terzi 2015, Sen 2015). Moreover as the Independent Evaluation Office (IEO) report (2016) on the IMF's involvement in the Eurozone crises points out, in the case of Greece "the decision not to seek preemptive debt restructuring fundamentally left debt sustainability concerns unaddressed, magnified the required fiscal adjustment, and thereby, -at least in part- contributed to a large contraction of output and a subsequent loss of Greek public support for the program".

4. Summary and Conclusions

In this paper we focused on three important questions concerning the troubled relationship between Greece and the Eurozone: first, why instead of 'Grexit' was Greece bailed-out in 2010; second, why despite the biggest bail-out in global financial history, did the Greek economy collapse; and third, what is the meaning of democratic choice in a monetary union?
There is a dominant narrative of the crises, which provides the following answers to the above questions:

Greece having broken the rules of the Eurozone and lied about it was nevertheless shown leniency and solidarity through a generous multi-billion euro 'rescue' package. In 2010 the 'no-bailout' rule of the EMU was circumvented on condition that

an economic adjustment programme would be implemented with the expressed aim of promoting growth and reducing indebtedness, thus lifting the country out of the crisis.

Greece, unlike Ireland, Portugal and Cyprus, failed to implement the agreed strategy and as a direct consequence of this failure its economy experienced a catastrophic collapse.

Adding insult to injury Greece elected in January 2015 a radical-left government of inexperienced amateurs who believed they had a democratic mandate to unilaterally reverse the austerity strategy and demand debt-forgiveness. If Greece wants to stay in the Eurozone it must be prepared to accept the democratic decision of the other 18 member states to reject the Greek plea for a reversal of the austerity strategy and debt restructuring.

The following are the main elements of the 'counter-narrative'.

It is undoubtedly true that in 2010 the multi-billion euro bail-out saved Greece from a disastrous bankruptcy. Whether Greek default and exit from the euro in 2010 would have been considerably worse than the current economic catastrophe in Greece is debatable. It is, however, disingenuous not to acknowledge the following two factors. First, the Greek bail-out had significant beneficial effects on the whole of the Eurozone and the global economy by limiting theelevated risk of contagion, as perceived at the time. European taxpayers' money was not simply used to bail-out irresponsible borrowers but also irresponsible lenders. As Mody (2015) points out: "The argument is that contagion is a global problem and the global community should share the cost of preventing contagion. Absent such burden-sharing, it is an arithmetical matter that the austerity required on Greece was much greater than it would otherwise have been. And before the terms of the official loans were finally eased, the wind was knocked out of the Greek economy" (p. 1). Second, bailing-out an illiquid but solvent economy makes sense. Bailing-out a bankrupt country makes no sense, as the IMF rules that have been ignored clearly stipulate.

Presenting the 1930s style collapse of the Greek economy as solely the result of failure to implement reforms is also disingenuous and misleading. First, the economic adjustment programme had serious flaws. It was based, as noted above, on the assumption that the country was solvent when it was (and still is) insolvent. Fiscal multipliers were seriously under-estimated (Blanchard and Leigh, 2013) and the

sequencing of structural reforms was inappropriate (Terzi, 2015). Second, it is simply not true that Greece failed to implement important parts of the troika programme, parts of which, like fiscal consolidation, were above target and ahead of schedule (IMF, 2014b).

It is true that Greece massively violated the fiscal rules of the monetary union and lied about it. Greece, however, was not the first country to violate these rules. The first was Germany, followed by France and Italy. Furthermore, although Greece violated the rules of monetary union, Germany also has been violating rules: these are the 'unwritten' rules of the monetary union. The 'neo-mercantilist' German policy of fiscal austerity, while maintaining massive current account surpluses, makes no sense outside a monetary union and even less within a monetary union: and it is a great deal more harmful for its partners in the monetary union.

According to the alternative narrative of the Eurozone crisis, Greece not only got a raw deal in terms of the policies imposed on the country by the troika but also in terms of its efforts to win hearts and minds among the northern European electorate. As Rodrik (2015) points out: "One might argue that Europeans are not well informed about the plight of the Greeks and the damage that austerity has done to the country. And, indeed, it is possible that with better information, many among them would change their position" (p. 1). Most of them, however, have been told a substantially different 'morality tale' which, as we argued in this paper, is at best only partially correct and at worst a serious distortion of the nature of the Eurozone crisis. The bail-out of Greece was not the bail-out of the Greeks but as the IEO report (op.cit) claims "the most dramatic credit migration from private into official hands in the history of sovereign debt"

It seems that the only real 'contradiction' that remains in the Eurozone is the utopian expectation that a monetary union, which has been imperfectly designed, will work under German hegemony without political union. The European Project is based on the shared aspiration of an 'ever closer union'. A dysfunctional and malfunctioning monetary union is a barrier to an ever closer union and, therefore, as the recent post-2008 experience in the USA shows, a barrier to the establishment of a rational crisis management mechanism in Europe. 'Muddling-through' is no substitute for rational policymaking, in the second largest economic grouping in the world. A politically united federal Europe, despite the centrifugal forces unleashed by the UK referendum result of 23 June 2016, seems the only way forward.

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