TIGER

TRANSFORMATION, INTEGRATION and GLOBALIZATION ECONOMIC RESEARCH

CENTRUM BADAWCZE TRANSFORMACJI, INTEGRACJI I GLOBALIZACJI

TIGER **Working Paper Series**

No. 133

Causes, Mechanism and Implications of Grexit: Its Politics and Economics

Grzegorz W. Kolodko

Warsaw, September 2016

Greek Crisis

(May 6, 2011)

I'm afraid that while considering the Greek public finance crisis "The Economist" (*A question of maturity*, April 20th) is right while suggesting that "the economics point to a harsher solution: a steep write-down as part of a broader package of reforms." I'm afraid that such an obvious argument will hardly be understood nor supported for some time. And the elapsing time makes the whole unavoidable adjustment only more costly for both, the Greek taxpayers and the domestic and international creditors.

Yet I'm not sure why some bring to the fore a seeming analogy with the sample of Uruguay from 2003? I would rather learn from the case of restructuring of Poland's nonperforming foreign debt. It was not easy to strike the deal, yet – as then the deputy premier and finance minister – I signed in 1994 a pragmatic accord with the London Club. And it did work. Half of the outstanding debt was written off and is what paved the road for smooth service of the remaining obligations. Yet such a significant reduction was based on very tough conditionality and enforced far-going structural reforms which enabled us not to enter again the debt trap of living beyond our means. The difference is that in the case of Greece it's not only the matter of outstanding foreign debt, but the forthcoming domestic insolvency too, but – hopefully – our Greek friends have learned by now that the inescapable invoice has already arrived.

The Greek Drama: Act No. X…

(June 2, 2011)

The Economist (May 18th 2011) continues the presentation of subsequent acts of lasting Greek financial drama… Accordingly, there are supposed to be five options, although only the last one – "serious haircut on the value of the Greek debt" – seems to be a way out of the deep fiscal crisis. This is what I've suggested in my comment published in The Economist a month ago

(http://www.economist.com/node/18679417?story_id=18679417). Now, The Economist calls it "hard" restructuring. Indeed, it must be hard, deep, and well managed. The sooner it's acknowledged the better.

Moody's rating agency cut its rating for Greece again. And, to be sure, not for the last time. It's been downgraded significantly, by as many as three notches, to Caa1 from B1. There are only five more notches left to default. Following the Moody's methodology, Caa1 implies that there is 50/50 chance to restructure or default on Greek debts in the next five years. According to my calculations, there is 100 percent chance, and it will be in months rather than years…

While Moody's stance is on the safe side (there is 100 percent chance that one is right if one says that there is a 50/50 chance for something; how smart! isn't it?), The Economist is developing the Greek drama a step further. It writes: "A year after Greece was bailed out by its euro-area partners and the IMF, even more help is being considered, given the impossibility of the Greek government raising money from the bond markets in 2012 as originally envisaged. Despite objections from the European Central Bank to any form of debt writedown, German politicians have been airing this idea as they face opposition from taxpayers at home to opening their wallets again. The terms used—"restructuring" or "reprofiling"—are fancy words for saying the money will not be paid back in full or on time." ("The Greek debt crisis. Fingers on the trigger. How the credit-default market will judge a deal on Greece", Jun 2nd 2011)

Let's be clear: soft "reprofiling" or, better, hard "restructuring" would be superior for the taxpayers, for gains of which the German politicians seem to be very much concerned, than the 'stay the course' option. I bet 80/20 that they will come to such conclusion in a matter of the next five months.

The Greek Crisis: Time Is More Precious Than Money

(June 18, 2011)

And we've got yet more news… "The leaders of Germany and France have said that they want a new rescue package for debt-laden Greece to be agreed as soon as possible…. But Angela Merkel and Nicolas Sarkozy said any private sector involvement should be "voluntary" not compulsory. It was unclear under what terms private investors might voluntarily take part in a Greek bail-out." (http://www.bbc.co.uk/news/business-13809433, June 17th). Of course, it is unclear, how it could be otherwise? The private sector must – must, it's imperative – bear a part of the burden of Greek debt restructuring. And by all means restructuring implies downsizing, or cutting it down, because the Greek problem is not just a lack of liquidity. It's already the challenge of insolvency, even with the execution of tough austerity measures.

It is a waste of time to claim that the private sector – banks and other investors speculating on this drama – can escape their part of responsibility for the crisis. In the theatre of international finance and debt trading there is always a risk. And, as it happens, sometimes one must pay for playing it unwisely. The sooner it's accepted, the better for everyone including the French and German banks and taxpayers, and for their political leaders which have contributed to the current malaise and deterioration of the situation by their indecisiveness over the last year.

'…the comments by Mrs. Merkel and Mr. Sarkozy were seen as a signal to banks and bondholders that they will not be made to incur losses on Greek debt.' Again, wrong comment, wrong conclusion. They will. There is no way through policy maneuvering, made in France and in Germany (you bet; these two countries are holding almost 60 percent of Greece's outstanding debt), that the private sector won't be forced to accept the truth. And the truth is that in the medium term it must lose certain money due to earlier reckless borrowing.

Hence, chancellor Merkel and president Sarkozy are wrong when saying that 'any private sector involvement should be "voluntary" not compulsory.' Well, by the nature of the case at the end of the day it must be negotiated and agreed. You can call it 'voluntary', not 'compulsory'. I call it indispensable. Instead of wasting more time with unrealistic scenarios, better to start

restructuring the Greek debt right away. It must imply writing a slice of it, and how big a slice? That's a good question.

While I was Poland's finance minister I had signed in 1994 an accord with the London Club of private creditors. Until the agreement, as much as half of nonperforming debt had been reduced. However, it was done under very demanding conditionality, calling for far going structural reforms and progress in liberal institutional building. After hard work, we succeeded. And what about the foreign creditors? Have they lost a lot of money? I don't think so. They were the winners too, since it happened to be sound long-term investment. Such agreement pays until today for both sides of the transaction.

So it can be in the case of Greece and its creditors. Yes, it is already a 'credit event'. The alternative is not 'voluntary' or 'compulsory'. The choice is between restructuring 'by design' or 'by chaos'. It goes without saying that the latter will be much dearer.

The Greek Syndrome: A Prelude to Revolution?

(October 6, 2011)

Time to go to Greece! I should have already been there, but due to the general strike I have been forced to reschedule my flight for this morning. Hopefully, I will be there soon.

It shouldn't come as a surprise that the Greek people are on general strike again – not the first time and, to be sure, not the last. Would you not go on strike if you were in their shoes?

The mishandling of the debt crisis by the international agencies is obvious. How can the so-called troika, that is the European Union, the European Central Bank, and the International Monetary Fund, expect the Greeks to accept such harsh austerity measures, which is not only cutting sharply their current consumption, but has also been driving their country's economy into an even deeper recession? No doubt, the Greeks must learn how to live within their means and not beyond them, and they must learn how to pay taxes instead of avoiding them, but there is a limit of enforced austerity and there is a case for sharing the burden of necessary adjustment.

I have suggested to keep the IMF out of this case, and to deal with it through European institutions. Unfortunately, they've committed a series of mistakes, including the one the other day. Not only the Brussels bureaucrats, but especially Chancellor Merkel and President Sarkozy and their advisors are responsible for this mismanagement. The delay of the release of the next earlier agreed upon bail-out tranche is a severe mistake.

The contraction of GDP in 2011 could be as much as 6 percent. Hence, the fiscal basis is still shrinking further. It is no wonder that the government can't meet the target of bringing this year's deficit down to 7.5 percent.

At the same time the false claim is repeated over and over again that there won't be a default of Greek foreign debt. There will be. It is unavoidable and the sooner it is admitted, the better, since the overall costs of dealing with such a messy situation will be less dear. It is high time to accept the reduction of Greek debt by a half, what I've been suggesting for the last half a year here and elsewhere, including my comments published several months ago in The Economist, Financial Times, and on RGE's EconoMonitor.

Of course, the reduction must be based on tough, yet sensible conditionality, calling for a proper fiscal adjustment. It must be carried forward by the Greek government in a way that is understandable and acceptable to the Greek people. Otherwise, there won't be a calm solution to the challenge, but rather a revolution, if it has not started already. And not only in Greece…

Europe: Falling off the Volatile Bull?

(October 26, 2011)

For quite a long time I've been arguing in favor of writing off a proper amount of the Greek debt, since Greece is insolvent, and not just having problems with liquidity, like some other European countries. And now – it's quite late, but still not too late – it looks that the European Union at the October 26th, 2011 summit* at last will acknowledge that the Greek debt must be cut and cut it will be.

It's happening this late for several reasons – one of them, and maybe the most important, which won't be officially admitted, is the time needed for transferring as much as possible the outstanding obligations from private banks to public institutions, that is the European Union, European Central Bank, and the International Monetary Fund. Now, when the so-called troika is in possession of a substantial share of the debt, it can be written down because now it makes such operation less painful for commercial banks. Of course, it's going to happen at the cost of – who else – the taxpayers' money. Yet, there are still three major challenges.

First, how to sell this costly action (although much more reasonable than alternative chaotic default) to the people, so often called "the electorate". It is especially difficult politically in France and Germany – two countries with the banks most exposed for losing money lent to Greece, and countries where next year there are elections for president and parliament.

Second, since just a conviction by logical arguments is not going to work, how to enforce particular banks to accept a loss of certain money they've lent so recklessly to a country living beyond its own means. They must pay the price for such mismanagement, since it's been the banks' management and supervising boards' own doing. The clients of the banks, first of all the depositors with their savings, and not the shareholders and managers should be protected. The President of the EU, Manuel Barosso, is absolutely right for calling for not paying any dividends and bonuses in cases of bailed-out banks. Will it happen? This will be another test for economic common sense, political honesty and tough commitment to the right cause.

Third, a part of the loss of the commercial banks must be compensated by the EU and the governments, mainly the French and the German. And again, it's going to occur at the costs of taxpayer money. What part; by what techniques; under what conditionality? These are as much political as technical questions, which must be answered as soon as possible, better in a matter of days or weeks, and not again in months or quarters.

And – which should go without saying – the Greek people ought to accept unavoidable austerity measures bringing their standard of living in line with their economic abilities. That means that they must accept a certain fall of income and welfare. I'm sure it will be easier for them to understand and agree if the outside world, mainly the rest of Europe, will come to its rescue with partial forgiveness of nonperforming and non-payable debt.

So, what's a proper portion of the debt to be reduced? If the advice to cut it down was followed earlier in the year – as I've argued here (see my posts: http://www.economonitor.com/blog/2011/10/the-greek-syndrome-a-prelude-to-revolution/, http://www.economonitor.com/blog/2011/06/time-is-more-precious-than-money/, http://www.economonitor.com/blog/2011/06/the-greek-drama-act-no-x/, and http://www.economonitor.com/blog/2011/05/greek-crisis/) and elsewhere, including my comments published by "The Economist" and "Financial Times" – a reduction by half could work. Now I think it should be more, about two thirds. The trimming of the obligations must bring the debt over GDP ratio down to a manageable 50 percent. Otherwise, it doesn't make much sense.

Let's do it now, at the long-waited so-called decisive meeting of the EU leaders. Otherwise, Europe may be not be able to ride the capricious bull much longer, which is ever more volatile due to the enfolding crisis…

An Unorthodox Crisis Calls for Unorthodox Action

(December 13, 2011)

Let's face the truth: it is not possible to overcome sensibly – and socially peacefully – the more and more dangerous debt crisis. Indulging in idle chatter by shifting the debt from the private to the public sector, from the member-countries to the European Union, is not a way to reduce debt, but only a change of its structure and maturity. Anti-economy spending cuts and timid raising of taxes are not able to balance budgets, and may bring a perverse effect of weakening economic growth even more. The temptation to use inflation is illusory, since its acceleration could cause more harm than good. If attempted, not only would part of the debt be inflated and reduced in real terms, but so too people's savings. It is unacceptable. The belief that this is an ordinary situation, but just a little more difficult, is naïve and treacherous. Hence there is not some orthodox way out, which actually seems to be the point of the recent European Union summit. More EU-wide policy coordination is badly needed and ought to be welcomed as well as further

fiscal consolidation by cutting expenses and raising taxation, but it won't be enough to overcome the crisis. An unorthodox crisis calls for unorthodox action.

Unorthodox Actions

It is vital to take unorthodox actions, which – strangely – is not debated at all. Possibly, because for many traditionally thinking and acting policymakers and lobbyists this would be a revolutionary solution. Yet the most important, after all, is to come up with a rational solution, capable of helping to solve the problem. There is not only mountainous public debt, but also giant – in many cases excessive – government financial reserves, mainly in the form of foreign exchange reserves. After all, these are provisions made for hard times. And if these times are not considered hard, what else would need to happen?!

Let's have a look at my country, Poland. If it were to spend half of its reserves – which amounts to the equivalent of over $US 100 billion (the equivalent, because they are kept in several currencies, and somewhat in gold) – to repay part of the foreign debt (its share in public debt already exceeds 27 percent), then the ratio of public debt to GDP would fall dramatically, from the current 55 to 45 percent of GDP. The owner of the reserves is the Polish nation, while the Polish National Bank, NBP, only administers them on its behalf. So the society not only owes the public debt, which is the responsibility and headache of the government, but also financial reserves, which the NBP enjoys and manages. Two sides of the coin, two sides of the street Świętokrzyska in Warsaw. Similarly – by, of course, different values and relations – it is in many other indebted countries, including those, which currently are not able to cope with handling the mounting liabilities in the classical way: from Greece to the UK, from Italy to Portugal, from Spain to Hungary.

What's the problem?

Well, the problem is that foreign exchange reserves are located primarily in the specific debt securities (mainly bonds of USA and Western European countries, especially those still with the credit rating note AAA) and placed on short-term deposits in Western banks. Nobody keeps

reserves in North Korea or Zimbabwe, not even Bangladesh or Nigeria, not (yet) in China or Brazil. In the case of Poland, the central bank obtains on this account the average interest rate of less than 3 points. At the same time – by financing part of the budget deficit and rolling old debts – Poland borrows the same (that is, its own!) money, issuing and selling bonds abroad, of which it pays interest that is about twice as high (recently 10-years bonds bear 5.87 percent). The difference – in nominal terms about $US 3 billion, i.e. about 10 billion zlotys (an annual income equivalent to 1.5 percentage points of VAT) – is Poland's expense and net profit abroad.

After reducing the reserves by half, to an amount of about $US 50 billion, that would be sufficient to maintain financial security of the country and handle smoothly the currency exchange flow. At the same time, there would not only be a reduction of public debt by as much as 10 percent of GDP (and dramatically cut down foreign debt, which would increase the country's financial security), but also the burden for the budget (and therefore taxpayers), since the costs of handling public debt would fall by about $US 3 billion per year. This is an example of Poland, which – so far – copes quite smoothly with handling its internal and external commitments. But other countries also have reserves – some cases just enough, other cases even excessive – and they are sinking under an avalanche of debt. While in certain countries there is just friction to preserve liquidity, in some others the debt is already non-repayable, and the policy of kicking the can down the road is in due time a recipe for even grander default. And such "due time" will come sooner rather than later.

Particular interests or the common good?

The problem, therefore, is that resorting to such symmetrical reduction of state reserves and public debt, as well as a great redistribution of financial stocks and flows, is clearly detrimental to the interests of the financial lobby. When such a plan arises at the official political arena, the political group of particular financial interests, its political spokesmen and media propaganda, raise unprecedented repudiation immediately saying that it is populism, robbery, an assault on the "sacred" independence of central banks and other kinds of folly!

A legitimate postulate for the introduction of a turnover tax on financial transactions (in order to reduce the temperature and the extent of speculation) is challenged at the dawn. Recently it was raised again in the joint letter of German chancellor and French president to the European Union President. The British response that London agrees only on condition that this solution will be global, comes down to the fact that the City financial lobby knows that agreeing to the use of such an instrument on a global scale is nearly impossible. A "no" from British Prime Minister repeated after the G-20 meeting in Cannes at the EU summit in Brussels means, at least for now, blocking the idea of financial transactions taxation. Incidentally, its introduction on a world-wide scale would be a much better solution than just a regional application, in the EU-26 or only EU-17 which, however, does not mean that alternatives are on the table: it is everywhere or nowhere.

Economy and policy of overcoming the crisis

Returning to the possible use of a portion of financial reserves for partial discharge of excessive debt syndrome, the decision in this case is basically in the hands of the concerned countries. There are no necessary difficult and laborious trans-national negotiations here. With regard to Poland, where now the power is virtually in the hands of one party, the Civil Platform or PO, it would require a concerted decision by the government, the parliament and the central bank, as well as president and a no-contest from the Constitutional Court. The case is similar for Italy, Spain, Hungary, Portugal and many other countries. Such unorthodox action is theoretically sound, practically desirable, economically sensible, and socially useful, but probably politically impossible, since real policy is more determined by the special interest groups than the general public.

The Greek Syndrome

(February 20, 2012)

How much is enough, or how much is not enough? This is the question…

The Greek drama evolves before our eyes like a slow motion train crash. On the one hand, there are the irrational expectations of the foreigners – be it the Eurozone finance ministers or the IMF, the private banks, driven by reckless greed in the past while borrowing too much and too easy, or certain opinion-influential media – which would like the Greek austerity measures to go yet further. On the other hand, there is a brave and responsibly acting new government of Greece, which seems to be pushing its society to the limits. How far can one go to this end?

I'm afraid there is no more room for further cuts of public expenditures. Enough is enough. Imposing the budgetary cuts the government is cutting the branch upon which it is sitting. The fifth consecutive year of recession has eroded the tax basis significantly and the fiscal revenue, instead of growing, can only shrink further, even taking the tax increase into account. Austerity is recessionary, which is now acknowledged even by the IMF. Three years of Greek austerity raised the debt over GDP ratio from 113 to 163 percent. The Greeks are spending less and their debt is higher by a half of their GDP! Such policy doesn't make much of sense.

As a consequence the rate of unemployment is one of the highest in the world among industrialized countries and stands at 21 percent, with a staggering 48 percent of young people out of work. Expecting that they will be watching TV, and not demonstrating and fighting in the streets is extremely naïve. The homelessness has jumped over the last three years by 25 percent. Furthermore, close to 28 percent of the population is on the brink of social exclusion…

Thus, expecting that the Greeks will tighten their belts more and more is unrealistic. One should not push the people beyond the limit of their tolerance. Such pressure is not a policy. This is stupidity. If one wants to have "the Greek Spring" – and, later, "the European Spring", why not? – one can continue an illusion that people of a great nation are so unwise that they will starve to pay an exorbitant debt to the foreign creditors forever. It must be stressed that a lion share of public debt results not from the fact that indeed the Greeks were living beyond their own means

for quite long, but from speculatively high interest rates imposed on refinancing credits. Therefore

a plan – or rather a fiction – that the Greek debt from a current 160 percent of GDP will be brought down to 120 percent by 2020 is another sign of a lack of pragmatism. Even if it would happen (and it won't), such financial burden would remain unmanageable.

It's true that Greek macroeconomic policy prior to the crisis was unaccountable. And the Greek people must pay for it dearly. They are already doing so. But is also true that the foreign bankers didn't show a great deal of intelligence and responsibility when they were lending too much money to Greece. And they must pay for it dearly too. So far they haven't. It is also true that the Western leaders – especially Chancellor Angela Merkel and President Nicholas Sarkozy – have made a series of policy mistakes by postponing the decision to cut down nonperforming Greek debt and by trying to protect the interests of private investors. As for the debt reduction too little has been done too late. Some politicians and policymakers must pay for their mistakes too, and the forthcoming elections in France and Germany make a good occasion to draw proper conclusions…

So, where do we stand now? We are certainly at a crossroads. But I think it is indeed the time to face the truth: the Greece syndrome is like a slow motion train crash. Is there still a chance to avoid it? Definitely not by believing in completely unrealistic scenarios that the Greeks will fast as much as it needs to pay the mounting debt, with completely unacceptable high private debt interest rates that would make a rich man poor. And not by lying and sweeping part of the challenge under the carpet, as the Eurozone finance ministers and certain leaders of the European Union are tempted to do again and again.

The only chance for a working solution is an escape forward. That implies a comprehensive – and executed very fast, in a matter of weeks, not months – reduction of 80 percent of foreign debt, and significant loan, provided by the EU, with zero interest rate. The easiest solution would be for the European Central Bank to buy new issues of Greek government bonds, but its hyper-liberal statutes and German establishment will not allow it to do so. The ECB has off-balance-sheet resources of 3.3 trillion Euros, an equivalent of the current value of its seigniorage (or

times Greece's GDP). If it is only used properly the issue of sovereign debt can be resolved for the whole Eurozone.

Otherwise there will be the misguided policy of restructuring the debt by raising it an amount that is already unsustainable. Hence the alternative is default and chaotic bankruptcy. It will be followed by serious and unpredictable consequences not just for Greece, but for the Eurozone and other partners from the EU and from elsewhere, starting from South East Europe, Turkey, and – due to the contagion, domino effect, and psychological influence upon the market expectations – from a number of other regions and countries. My point is clear: let's help Greece – and ourselves – now, with the lower price tag attached, or it will cost us much more, in the near future. Cheating the public, and miscalculating and misleading the market, is neither a strategy, nor a policy. It is sheer stupidity.

After the meeting of the Eurozone finance ministers and decisions about releasing the new tranche of Euro 130 billion bailout, we can continue saying that things are on the right track. No, they are not. They are on the track of a catastrophe which we are already witnessing, yet the picture is shown in slow motion…

Greece: Don't play with fire, but don't sweep it under the carpet

(June 12, 2015)

Greece's government is absolutely right that it cannot further cut budget expenses and raise taxes imposed already on the people in order to have funds to endless repaying of the foreign debt. That would be wrong, since it is not just socially unacceptable, but also economically irrational. Thus far, the implemented policies have succeeded in fundamental shift of the debt from private banks, co-responsible for the Greek crisis, on public organizations – the European Union and International Monetary Fund. Currently, up to 80 percent of debt obligations are due to the EU institutions, the European Central Bank and the IMF.

While on the one hand the Greek public debt increased from just over 100 percent of GDP in 2010 to almost 180 percent in 2015, and Greece was pushed by external pressure to a syndrome

of “triple 25” – 25 percent of recession, over 25 percent unemployment, and 25 percent of the population living below the poverty line – many banks, especially German, French, Swiss, Austrian and Cypriot, tricked out of shared responsibility, shifting the costs of their reckless lending to the European taxpayers. It’s a fact that some of them have already had to write down the loss of certain credits, but it costs them much less than are their profits accrued from this whole practices.

Who has now bear the costs of imprudence and misguided policy? Definitely a greater measure of responsibility than Greece must be taken by “troika” – European Commission, IMF and European Central Bank. Of course, the previous governments in Athens and part of the Greek society are complicit. No doubt that living beyond means, avoiding taxes, inadequate fiscal system, and too soft financial policies are the root causes of the crisis. However, Greece – unlike most EU countries, including France, Great Britain, Italy, Spain and Poland – already has a primary budget surplus, what implies that not counting the cost of servicing the public debt, more to the public purse pulls than is spent. Although, the Syriza government policy guarantees continuation of such welcome trend, one of the major points of contention in hard negotiations between the debtor and creditors is the scope of primary surplus; while the Greek Government intends to keep the primary budget surplus at 0.8 percent of GDP this year and 1.0 percent in 2016 – and this is indeed an achievement – the “troika” wants to force it up to 1.0 and 2.0

percent, respectively.

One should not blackmail the Greeks, yet that’s exactly what happens. The “troika” – especially Germany, which Greece owes 56 billion euros – is overly pushing them against the wall. If the Germans, and others, want their money to go back, they must finally understand that they can get only part of the value due to them. It is so, because Greece is in fact insolvent. And it is largely the fault of the countries and financial intermediaries lending in the past too easy and too much to Greece. The austerity measures imposed by “troika” have been going too far and they caused a perverse effect of long-lasting recession and shrinking of fiscal base. Indeed, the creditors have cut a branch they’ve been sitting on… Now the Greeks, using language of the street, are right while saying that they would be stupid to accept further cut of their pensions and the increasing bills for households’ electricity.

One should not play with fire. But one should not also be cheating by sweeping the mess under the carpet. Although Greece is insolvent, there is a solution. For a long time I've been postulating a reprofiling of Greek foreign debt by deleting a half of it. That implies that under the current conditions it ought to be reduced from €320 billion to 160 billion, or below 90 percent of GDP. It still would be half more than is permitted by the Maastricht fiscal criterion, however, in such an amount the remaining debt would be repayable. Otherwise, hardly.

Understandably, such reprofiling of the debt to actual long-term capabilities of Greek economy needs to be based on continuing hard financial adjustment and appropriate structural reforms. We, the Poles, know something about this, because 21 years ago, in September 1994, as Deputy Prime Minister and Minister of Finance of Poland I signed with the creditors of private banks grouped in the London Club agreement to reduce our debt by half. The deal was based on tough conditions and the progress in their fulfillment was relentlessly monitored by the IMF. If not for those decisions, and going afterwards smart policies, we would be by now much worse, because there would be neither normal trade relations with foreign countries, nor beneficial access to global financial markets, and both had a significant impact on the dynamics of growth in my country.

In short: Greece fails to repay the entire current debt. It's an illusion and waste of precious time to "stay the course" of ill-advised policies. Delaying a pragmatic approach only increases the costs of the crisis. We are facing acute alternatives: either Greece is allowed to fail to repay a substantial part of its external obligations in an orderly manner, dictated by common sense and realism, or it will occur anyway in a chaotic manner. The common sense choice seems to be clear: further pressure on the Greeks to keep bleeding, sweating, and crying, for the sake to satisfy reckless creditors, would be economic, social and political nonsense. Why pay more when you can pay less? Why succumb to chaos, when you can govern the process? Why fail, if you can succeed?

Africanization of Greece

(July 6, 2015)

In the early 1990s – during the infamous shock without therapy, which resulted in Poland's national income fall by nearly 20 percent, over 3-million unemployment and budget deficit 6.9 percent of GDP in 1992 – there was a talk about "Latinization" of my country, pointing to the increasing similarities with the then dysfunctional economies of South America. One prominent newspaper article wore eloquent title "In a moment like in Chile". Now you can talk about the danger of "Africanization" of Greece. The country has been placed in an extremely difficult situation, *de facto* without the possibility of getting out of the escalating crisis by itself. Since 2010 GDP fell by over 25 percent, more than 25 percent of population lives below the poverty line, unemployment exceeds 25 percent, and among the younger generation alarming 50 percent. In addition alone this year more refugees from the Middle East and Africa have arrived to Greece than to Italy. They will soon may feel there like in their own home…

Backchat

In the face of the inability to communicate with the so-called 'troika' (European Union, European Central Bank and International Monetary Fund), Greece has not regulated its obligations to the IMF. Although the amount is modest, just €1.6 billion, thus negligible 0.5 percent of total debt of Greece, the matter is significant. In this way Greece joined just three other states that are considered by the IMF to be insolvent. This are three African countries: Somalia, Sudan and Zimbabwe. Apart from the former failed country, in two other they cling to authoritarian regimes, while the economy is still somehow functioning due to the increasing presence of China. I've been there, I've seen it…

It's already very bad, and will be even much worse. The recriminations who bears the responsibility for this nightmare exacerbates. In the initial phase of the crisis, when Greece's public debt approached 100 percent of GDP, essentially the Greeks were to be blamed, because they had been living beyond their means. For the subsequent explosion of the crisis and its

present culmination far more than the Greeks themselves responsible is the rich West, with its banks and financiers, with its incompetent politicians and biased technocrats.

At my profile www.facebook.com/kolodko a surfer asks: "Why EU leaders, the President of France, Chancellor of Germany, head of the IMF, etc., still insist on their position of wishful thinking and want Greece fully repaid its debt? I assume one must be aware that in the current state the debt is unpayable, and policy being enforced on Greece calls into question the possibility of repaying even half of the obligations." Isn't it bizarre that what an internet surfer firmly understands the leaders of troika are not able to comprehend? Or they don't want to do so?

Why such irrationality?

The troika politicians behave irrationally because they are fivefold slaves of: (1) their reckless earlier announcements that they will not give up to Greece; (2) caring for their own interests and special interest groups, especially speculating financiers, which are corrupting politics; (3) surrounding media, which are stupefying public opinion and painting a negative stereotypes of "lazy and profligate" Greeks; (4) technocrats of the European Commission, and in particular the IMF, nominated in non-democratic manner and thus politically irresponsibility; (5) their advisers, supposedly knowledgeable on the technical side of the public finances and monetary policy, but understanding not much of the relationship of these policies with cultural and social spheres.

This does not mean that all major politicians of "troika" behave identically. A greater sense and the ability to seek a pragmatic compromise shows president of France, Francois Hollande, when he says "Let's be clear. The solution can be found right now, it does not have to wait" than his compatriot, doctrinaire head of the IMF, Christine Lagarde, when she says that "… it is not clear what are the latest proposals" of Greece. Everybody knows but the IMF does not know? Somehow wiser behaves Italian Prime Minister, Matteo Renzi – who seems to understand that if Greece falls, then his country, with public debt exceeding 120 percent of GDP and with stagnant economy, can quickly find itself in the grip of devastating wave of crisis – than the German

Chancellor, Angela Merkel, who is sitting on a barricade until that moment when it will be clear what prevails. Such "pragmatism" is quite peculiar, though it must be remembered that Greece owes Germany (indirectly, through the European institutions) over €62 billion. I would advise to recover in a civilized manner rather €30 billion than chaotically no more than €20 billion.

A request of Greece Prime Minister Alexis Tsipras for another bailout of € 29.1 billion for next two years, is not considered because the political situation is extremely dynamic; as in a war, not in times of peace. Syriza government may soon fall. The situation is complicated immeasurably due to convened *ad hoc* referendum, after which the controversies what its outcome implies will only multiply.

Someone may say again that this madness is a method, but is it? The Greek society is increasingly divided into the "for" and "against" camps, but the curiosity of situation lies in the fact that different people differently interpret "for" and "against". No matter which answer will take over on Sunday, July 5th referendum, "Yes" or "No", there will be plenty of interpretations what that means. Politicians will argue, the media will prey, and the Greek people will increasingly suffer. If only there were no tanks under the Acropolis in Athens and at the Sparta's market; one can't be sure will it be possible to maintain public order by democratic methods. In the eyes of the world the great idea of European integration is being discredited…

How to cut the Greek debt?

The Greek syndrome is becoming more and more rather political than economic challenge. The cradle of democracy is shattering; in Europe, in the country that the history of civilization owes so much. But let's leave the ancient Greek history where it belongs – at the spotlight of history – and let's concentrate at the present and a lack of vision for the future. As for the economic aspect of the case, the matter should be clear for every enlightened economist. Greece is insolvent and hence there is the pragmatic question how to reduce its still growing debt and how to reverse the falling output trend. In another words, how to raise the output and cut the debt.

What has led us to the current state of affairs, has been the ineffectiveness of adjustment policy imposed by troika, which assumed unrealistically that such policy is able to bring debt to 120

percent of GDP by 2020 on the a path of economic growth. It was troika illusory as it soon turned out, because the policies enforced upon Athens instead have led to a rapid increase in debt as a result of the cumulative economic recession. The years 2010-16 are indeed seven very lean years for the Greeks.

Thus the Greek debt must be reduced to sustainable level. There is no other realistic way out from the current mess. The debt consists in almost 80 percent of commitments to troika's public institutions, such as the European Union's financial vehicles, European Central Bank and International Monetary Fund. It is so, because the troika subsequent "assistance" packets for Greece were mainly provided for the purpose to enable Greece to repay the debts to private banks of the rich West. It is true that in the meantime part of Greek obligations to these banks have already been reduced, but too little, too late.

Now we are faced with the alternative: reduce the Greece debt, currently amounting to €323 billion, by at least half, that is to less than 90 percent of GDP, in an organized manner in return for agreed, economically viable and socially acceptable adaptation on the side of Greek public finances, or let's face a chaos. In the latter case, the Greeks will pay at the end of the day up to one-third of their obligations, if not even less than that. One more bail-out wouldn't change much, because the debt is simply in default and must be cut, provided that the Greeks will go a bit further in disciplining their finances and to pro-growth economic regulation.

What's next? Russia and China?

The national income of getting poorer and poorer Greeks makes just 0,25 percent of global ouptu. In other words, the world produces 400 times more than 10 million Greeks. And now this world, already plagued by enormous difficulties, has one more trouble, because the syndrome of Greece is not only a problem at local and regional level; it is a global case. Thus it is understandable that President Barack Obama has urged the ineffective politicians-bureaucrats from Brussels and major European capitals to find a solution, because the US have enough troubles and by all means do not need a greater turmoil in the euro zone, the second reserve currency of the world. To prudence urged Chinese Premier Li Keqiang, with whom I met last

week in Beijing, while saying: "Is Greece remaining in the euro, it is not a matter which concerns only Europe, but also it concerns China (…) [and] the stability of global finance and economic growth."

I do not think Chinese are passively watching the Greek disaster. If there is a chaotic and fatal Grexit, then China has more than enough funds to help Greece, for example by investing tens of billions of dollars in the Greek tourism sector, and significant segments of the logistics infrastructure. To the Chinese ports the Chinese ships will call, and we will rest in Chinese hotels. And as someone likes, he or she might even be eating at the island of Crete with chopsticks…

Either way, the Chinese, with their far-reaching policies, already invest in Greece. But China won't save the day. If the European Union can't do it, than there still is Russia. Recently, not without a reason, the elements of the cultural kinship, in the form of the Orthodox religion in both countries, has been emphasized. But this is of little importance. Politicians devoid of imagination – in Brussels and Berlin, in Paris and Warsaw – ought to realize that if their continuing mistakes will force Greece to exit the euro zone, it becomes probable that Greece vacates the European Union too. Further, the price of obtaining a hefty financial aid, of which Russia despite its economic problems is capable, Greece may turn its back against the West which indeed deprives Greeks from social and economic security.

What next, thus? Now all the scenarios looks black. One must escape forward from the darkest shade of blackness: from far-right fascist government or military dictatorship and Africanization of the Greek economy.

All these articles have been published on the portal ***Roubini Econo Monitor*** (http://www.economonitor.com/blog/author/gkolodko/).