

15 June, 2011

Jacques DELPLA,

Member of the Conseil d'Analyse Economique, Paris

A French Friendly Suggestion on how to Save Greece from Default and Collapse

From a friend of Greece and of the Greeks¹.

My dear Greek friends,

We know what we owe to Greek ancient history and civilization. We know well the sufferings of the Greek people between 1821 and 1974. We see how the Greek people suffer now. But, with Greece now on the brink of collapse, bankruptcy and oblivion, you are at a crucial crossroad.

1) Greece's choice is clear and simple

- Either you truly reform your country and make it a modern and productive European country. That means no default, massive fiscal adjustment, vast structural reforms for the next ten years, and an end to corruption, tax evasion and nepotism. In the end, Greece will be back at the place she deserves in Europe: prosperous, well managed and integrated in Europe. This is the bitter medicine option, with hope and Europe at the end of the tunnel.
- Or, Greece defaults, leaves the Eurozone, goes bankrupt, experiences a 10% recession at once, and remains a pariah of Europe for decades, alone in South East Europe, with no European friends. That is the option of parachute diving without parachute and nobody to rescue you at the hard landing!

Hence, wake up, do not destroy your future by choosing the debt default. We, in the rest of the Eurozone, are ready to help Greece but *only if Greece helps herself*. The French are the main friends of Greece in the Eurozone. We will support you (in many effective ways) if you accept to reform comprehensively your country. If not, we will cut our support and let you collapse. The choice for Greece is either a significant but viable slide, with the IMF-EU program, with a European future ahead; or, otherwise, a lonely free-fall without parachute and no European prospect.

Greece cannot blame the rest of Europe for its current mess (it is due to Greece). Unlike what is said in Athens streets, Greek citizens cannot repudiate their sovereign debt by saying it is an odious debt (successive democratic-elected governments have voted the deficits which have benefited only to Greek citizens). Greece has massively mismanaged her economy and the public finances since Greece entered the EEC in 1981; this must change for your benefit. Indeed, you should be angry and demonstrate in the streets against the political system that has precipitated Greece on the verge of bankruptcy. But for the economy, the truth is that there no easy solution. There is no solution in which Greek citizens could retain their living standards, as now nobody is willing to lend to Greece for that. If Greece were to default and refuse her IMF-EU program, both the external and the public

¹ I write here on my behalf but I am sure I represent most of the French and EU views.

deficits would have to be closed overnight, triggering an unprecedented 10% recession and a financial meltdown of Greek banks and insurers. Greek hospitals would have no more money to import medical drugs and apparels. I am not sure that demonstrators in Syntagma square realize that.

The truth is that, we, in the rest of the Eurozone, are ready to help Greece *if Greece helps herself*. That is the European contract. We want and have a great interest to keep Greece in the Eurozone, but only if you do your part of the contract. But if you do not want the IMF-EU money and program, no aid from us and, at least, you should know the consequences. Hereafter, I offer some views on 1) How it is possible to pay down Greece's sovereign debt; 2) Why Greece will leave the euro if it defaults on its debt; 3) Consequences for the Europe of Greek default; 4) Consequences for Greece of Greek default; 5) MY MAJOR RECOMMENDATION.

2) Is it possible to repay Greek sovereign debt? Yes,

But to have Greek debt sustainable you need: a) low rates provided by the Eurozone governments and banks with low rates --that is possible in a private - public bail out. b) Public primary surpluses of 5% of GDP for 15 years; the Belgians did it (1995-2005), why not Greece? c) Large scale privatizations. d) Last, I would favour tax on Greeks property, like in the US (2% on the stock of housing, every year); that 2% tax could be collected at the next change of property (sale, legacy), so that there would be no cash constraint for the people who are rich in terms of housing, but poor in terms of revenues. That property tax would capture part of past tax evasion and is a kind of debt-equity swap and would not weigh on the young generations --who suffer the most. If the US has such a property tax, why not Greece? That property tax could allow Greece to balance its book in the medium run. In this case, the EU and the ECB are ready to provide help over one or two decades. That would leave 10 to 15 years for Greece to reform structurally (along the lines suggested by a number of contributors in the Greek Economists for Reform blog) and become a true modern and efficient European country.

So a **NO default is possible**. What really worries me is that the Greek economists believe that Greece cannot follow this path (they believe that Greek voters will not accept it). On that, they know much better than I do. If so, it is sad, very sad for Greece. But, instead of saying "we cannot pay", they should rather explain the consequences of a default and how to reform the Greek economy to avoid that and restore Greece.

3) Can Greece remain in the euro if she defaults? No.

This is essential for the ECB and its credibility. Some says that the ECB will not trigger the nuclear option of refusing Greek debt as collateral. I doubt very --very- much. The very logic of the EU Treaty would have been NOT to lower the level of ECB collateral in 2010. Greece would have then collapsed and left the euro in May 2010, after a bank run (Portugal, Ireland soon after). To avoid that, the ECB accepted to lower its collateral policy [on the explicit ground that Greece would follow its IMF/EU program and would not default](#) , giving a chance to Greece to reform and remain in the euro. If the ECB were now to accept Greek defaulted debt as collateral, it would lose any credibility (no decent Central Bank refinances defaulted debt). If the ECB accepted defaulted debt once, everybody would expect the ECB to accept defaulted paper from Portugal, Spain, Italy... That would be the end for the ECB and the euro. For that reason, other weak countries (to start with Italy) will vehemently oppose that the ECB refinances defaulted Greek debt. Hence, the ECB will not (and should not) accept Greek

defaulted debt. This would entail losses for the ECB and the EU, but manageable losses: we will overcome it and survive. On the other hand, accepting Greek defaulted paper would trigger the end of the euro, as everybody would expect Spain and Italy to follow Greece.

My message to the Greeks is the following: all the people in the EU that support you now and are ready to finance you now (in Brussels, Paris, Frankfurt, Rome, Berlin...) will not accept that Greece defaults. In case of default, A) the Europeans will stop lending further money to Greece at once -you do not keep on lending to a country that has just defaulted. B) The ECB will not hesitate stopping refinancing Greek debt. → Greece will be forced to leave the euro.

The only imaginable alternative I could see: Greek sovereign default → bankruptcy of all Greek financial sector → recapitalization of Greek banks by the EU *and* direct and total management of the Greek budget and economy by the EU. (But I doubt that the Greeks would accept such a scenario that would completely alienate their sovereignty –and I doubt that any government in the rest of EU would volunteer to manage Greece economy. So we are back to the fact that if Sovereign default → Greece leaves the euro and free-falls on its own.

4) Consequences for the Eurozone of a Greek default? Manageable

Sure, the ECB and the EU would lose money. But that would be a lesser evil than witnessing the whole euro breakup. The EU/ECB policy response would be to make of Greece a special case: she cheated all along since joining + she refused to make the necessary reforms to stay in the euro. We will say: “We will fight for any country that will really do her homework to remain in the euro; but if such a country were to refuse to comply with the rules and to make the necessary reform, so let her get out of the euro”. That will be very hard for Greece, but the rest of the euro will survive it. And it will be a very [useful device to induce other countries into accepting harsh reforms](#).

France has been a longtime friend of Greece (Giscard d’Estaing was the main driving force behind Greece’s EU membership in 1980-81), but France will not support Greece anymore if she defaults. You will be on your own for decades. That the choice, your choice. Germany may not be sad to see Greece leave. We, French will be. But *Quos vult perdere, Jupiter dementat* (I do not know how to say that in Ancient Greek).

5) Consequences for Greece of a Greek default

To be more explicit, if Greece defaults on its sovereign debt:

- Greece is out of the euro; and for decades, if not forever. We cannot afford to have countries in and out of the euro. That would trigger speculation like in the old European Monetary System.
- Greece is cut from any future EU financing (bar some Agricultural and structural funds). That would be foolish for Greece. Moreover, the ECB/EU implicit subsidies are huge (at least 15% of Greek GDP), they derive from the difference between market rates (*i.e.* the astronomic rates in the secondary market) and actual refinancing rates for Greek government debt (about 5% for EU and IMF loans) and Greek banks debt (1.25% by the ECB). Greece would lose a lot: you do not cut off links such a large lifeline support provided by your friends. If you do, it is collective Greek suicide.
- Greece will experience the mother of all bank runs. Greek financial system will be utterly bankrupt, likewise for Greek savers and Greek pension funds and insurers.

- Greece will experience a very sharp devaluation (-50%? -70%), implying a debt default of the same magnitude if not larger ;
- Greece will experience a very sharp recession, in the order of -10% of GDP at once, as she will be forced to run immediately a current account balance and a fiscal balance or surplus. No external help. The mother of all recessions will await you.
- Greece is out of the EU political map for decades. Just like Albania now.
- Greece will be seen as a pariah in Europe. Look at a map of Greece: if Greece destroys her friendship with the Eurozone countries, who will be your friends in the future? Turkey (you know the answer)? Macedonia (you cannot even agree on her name)? Albania? Serbia? Assad's Syria? Russia (maybe)? China (not interested in Greece if she is out of the euro and is the pariah of EU)? The US and the UK (yes in principle, but too large a deficit to help Greece now)? As Napoleon used to say: "Nations have the foreign policy of their geography"; so your choice is either the EU or Turkey.
- Next time Greece needs its European friends, too bad for Greece, but you should have thought of it in 2011 (and before).
- Cyprus will unfortunately be forced to follow Greece in its default and exit from the Eurozone.

6) MY MAJOR SUGGESTION TO MY GREEK FRIENDS

Greece is at a crucial crossroad, do not miss it. Do not play the Russian roulette (or the Greek roulette) by betting the rest of the Eurozone will accept a Greek sovereign default. We will not.

My main suggestion for you, the Greeks, is the following:

Instead of keeping on lamenting on your fate, blaming the rest of Europe for this crisis, and accepting your default, you should think otherwise:

- What are all the fiscal and public reforms needed for Greece to reach a decent public debt level (60% of GDP) by 2030? And what is the level of EU help needed to reach that?
- What are all the structural reforms (economy, education, regulations, political, investment environment, legal system...) needed to restore Greece growth and competitiveness and make of Greece the Denmark or Sweden of South East Europe, in 10 to 20 years? (After all, in 1993, Scandinavia was in a dire recession, with an economic model almost bankrupt).
- How to achieve that? Which sequencing? With which institutions?
- How to make that *credible* and durable?
- How to work out that strategy with the EU? Which help from the Eurozone do you need to fulfill that contract between Greece and Europe? Once again, if Greece chooses too reform massively herself, France and the Eurozone will be there to provide help.

I will publish my own technical suggestions next week.

Jacques DELPLA