

Germany: the dispute with Greece is entering a decisive phase

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Germany is working on a plan which would allow Greece to remain in the eurozone, even if the government in Athens announces that the country is bankrupt. The German media have also speculated widely on this issue (such information was published, for example, by *Die Zeit* weekly on 15 April 2015). One way to put this scenario into operation could be for the European Central Bank (ECB) to continue financing Greek banks also after Greece's bankruptcy. Without drawing conclusions as to whether this is a feasible plan of possible measures to be taken by the federal government or merely an element of pressure on the Greek government, it is quite clear that the room for manoeuvre for both eurozone member states and the government in Athens is shrinking. According to various estimates, the Greek Ministry of Finance will be able to make payments until May or June this year, and chances that other countries, such as Russia or China, will lend it money are very low. In turn, eurozone member states are insisting on the preparation of a plan of thorough reforms which in principle will be a continuation of the austerity policy adopted by the previous Greek government, which might lead to a fall of the present government in Athens. Meanwhile, the Greek government is insisting on consent from eurozone member states to alleviate the restrictive austerity policy in Greece, for example, through raising the minimum wage and the level of public investments, and through a reduction of the Greek debt.

Germany has lent Greece more money than any other eurozone member state and the stance it adopts will bear great influence on the decision as to whether Greece remains in the eurozone. It appears that Germany wants to send a clear message: unless the Greek government unambiguously makes manifest the political will to implement economic reforms, Germany will not rule out the risky scenario of excluding Greece from the eurozone.

The terms of the previous deal between Greece and the eurozone

In 2010, as part of the deal between the eurozone and Greece, the government in Athens agreed to adopt the reform package imposed on it in exchange for financial aid and retaining its membership in the eurozone. It was revealed then that the Greek government had submitted false financial data to the European Commission. Greece's fiscal situation brought the country to the verge of bankruptcy and proved that it had been unprepared to join the eurozone. The recovery programme – initiated mainly upon Berlin's initiative – above all covered the so-called structural reforms based on cutting labour costs in Greece and streamlining the operation of state institutions. Improving Greece's trade competitiveness

was a priority at that time, since this was intended to boost its income from exports and thus enable it to repay its debts. Both parties have complied with the terms of the deal, even though the cabinets have changed on several occasions in Greece, and above all owing to the reduction of Greece's debt in 2012. This country has received subsequent portions of financial aid and, regardless of the painful social costs, has been implementing the austerity programmes negotiated with representatives of the eurozone and the IMF. Between 2008 and 2013, the total production level in Greece dropped by 26%. Over the same timeframe, the unemployment rate rose from 7.5% in 2008 to 27% in 2014, and has remained above 20% for last four years.

Last year it looked like the much maligned plan for the restructuring of Greece had finally begun to bear fruit. In 2014, its economy saw a growth in GDP (of 0.8%) for the first time since 2008, and the unemployment rate fell from 27% to 25%. However, the very high level of debt, equating to 176% of GDP, still posed a serious problem for Greece. It was able to service these debts only because eurozone institutions had greatly reduced the interest on the loans and extended the repayment period by many years.

New Greek government – new problems

However, relations between Greece and the eurozone underwent a serious change towards the end of last year. The parliament in Athens was unable to reach a compromise over the election of the president, and this triggered a new parliamentary election. The radical left party Syriza, opposing the previous political establishment and the "eurozone's dictate", took power in January this year. One of the first decisions the new government made was to fulfil one of its manifesto promises by halting the process of privatisation of Piraeus port, which was to be sold to a Chinese investor and thus bring in significant funds. Since the economic reform policy changed, investors began to withdraw from Greece again, and the country's economic situation deteriorated. Syriza formed a government coalition and adopted a tougher stance on the eurozone, demanding that its member states reduce Greece's debt and grant consent to make the reforms less radical. The eurozone member states upheld their previous stance, insisting that the new Greek government should continue the reforms accepted by its predecessors. The new Greek prime minister, to emphasise his will to become independent from Berlin, visited Russia and China in April this year, where he held talks regarding the possibility of receiving financial aid.

What makes the Greek government's situation even worse is the fact that it has no sufficient funds to finance the country's current spending without external loans. Furthermore, left-wing radicals form a significant section of Syriza party members. If the government continues the reforms imposed on Greece by the eurozone, this could bring about a split inside the party and the need to schedule another snap election.

Germany's interests in the dispute with Greece

In its dispute with Greece, Germany has from the outset stuck to the principle of minimising the impact of the Greek crisis's costs on German public finances. One of the main reasons why the financial aid package was offered to Athens in 2010 was the desire to rescue German banks, which had tied up significant financial assets in loans given to Greek banks.

Over the past few years, the government in Berlin has dispelled speculations that Greece could leave the eurozone. However, since the change in government in Athens, the German press has published what seem to be controlled leaks that Germany is considering its acceptance for Greece leaving the eurozone. The German minister of finance, Wolfgang Schauble, has also strongly criticised the Greek government's policy over the past few weeks, accusing it of being unreliable. *Die Zeit* weekly has recently reported that the government in Berlin is considering new scenarios. If the government in Athens accepts a compromise, it might be allowed to declare bankruptcy without the need to leave the eurozone. Otherwise, Berlin expects that Greece will leave the currency union in an "ordered manner".

German politicians are aware of the fact that, even if Greece remains a member of the eurozone, their country will not recoup the full debt of 86 billion euros it has lent Greece. It is impossible for Athens to repay a debt worth 176% of the country's GDP. It is still difficult to estimate how the financial markets might react to the information that the principle of irrevocable membership in the currency union is no longer valid. This may fuel up the speculations that other countries could also leave the eurozone. However, Germany may also pin reasonable hope on the fact that other countries, which also have problems with debts, have launched reforms and strengthened their fiscal situation to a sufficient extent to remain reliable on financial markets. Furthermore, a new instrument for alleviating crisis situations is now available; these are moves made by the European Central Bank, which may temporarily reduce eurozone member states' fiscal problems by "printing" more money and buying bonds from governments facing financial problems (introducing debt monetization). Regardless of this risk, Germany would not allow the Greek government to dictate the conditions on which financial loans will be granted to it. Concessions made with regard to Greece might result in the election of Eurosceptic governments in other countries which need to deal with the painful consequences of the anti-crisis policy, such as France, Spain and Portugal.

The political consequences of Greece's dispute with the eurozone

An analysis of the Greek crisis based on economic criteria might make Berlin inclined to allow Greece to leave the eurozone. In the longer term, this might contribute to an economic strengthening of the eurozone and could have a disciplining effect on other countries dealing with debt problems, motivating them to stick to austerity policy. However, Germany may fear that the eurozone crisis will have consequences which extend far beyond the economy. Therefore, it wishes to keep up good relations with Greece, even should it go bankrupt.

Even if Greece leaves the eurozone, it will remain a member state of the European Union, and will still be able to block various EU initiatives, such as extending the economic sanctions imposed on Russia. A Greece pushed out of the eurozone might also become a bridgehead for Beijing's or Moscow's expansion in the EU. Furthermore, Greece has a strategic location from the point of view of the development of energy infrastructure in Europe. During the Greek prime minister's visit to Moscow, Russia expressed its interest in building a gas pipeline in Greece that would connect with Turkish Stream, a gas pipeline promoted by the Kremlin. However, previous experience with the financial crisis in Cyprus

has shown that Russia is not interested in real financial engagement in those EU countries which have fiscal problems. Moscow wants to have strong political and economic influence in these countries in order to be able to control the EU's decisions. Without, though, incurring any major costs.