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The Failure of the Troika in Athens

Foreign Assistance Does not Show Greece the Way out of the Crisis

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Even after the successful restructuring of Greek's sovereign debt in March 2012, most economic problems of the country remain unsolved. The non-competitive economy of the EU member country requires a comprehensive transformation. Many observers agree that a fundamental restructuring of the Greek economy is essential to ensure future prosperity. However, the troika – composed of the International Monetary Fund, the European Commission, and the European Central Bank – hitherto concentrated on telling Greek society what ought to be done. Despite sufficient evidence that such an approach has failed many times in development cooperation and in the transformation of economies in eastern Europe, the troika continues to implement its flawed approach. Greece does not need more foreign advisers but rather has to develop macro- and microeconomic concepts and strategies for the improvement of the competitiveness of enterprises. The country has to develop ownership of its reform process, instead of fighting recipes imposed by the troika. There are many examples of successful economic development in recent economic history, but foreign help and recipes never played the decisive role.

When the aid programs for Greece started almost two years ago, the troika initially was optimistic. Proposals for an immediate restructuring of Greek sovereign debt were considered alarmist and overly skeptical. The IMF, for instance, suggested in September 2010 that the default of an industrial country was "unnecessary, undesirable, and unlikely." Once again, the IMF has demonstrated that its ability to forecast future developments is comparatively weak, and this weakness has cast a shadow over the credibility of the IMF's expectations of the remaining program for Greece.

Interim results of the troika

At the beginning of March 2012, after considerable pressure from European governments, Greece's private creditors agreed to one of the largest debt cancellations in economic history. Greek society was provided with an enormous haircut of more than € 100 billion. To put this debt cancellation into perspective: The sum represents more money than all industrialized countries spend on development aid each year. Why exactly private creditors were willing to cancel such a substantial sum is difficult to evaluate. One explana-

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tion could be that this happened in recognition of own faults in the run-up to the crisis. A second explanation emphasizes the interest of the financial sector to please European governments in order to avoid future comprehensive regulation of financial markets. Whatever the motives, the restructuring of Greek debt has not been a voluntary process. Some form of pressure has been put on holders of Greek bonds. The private creditors did not have any chance to succeed with their legitimate economic claims against a Greek government willing to get a reduction in debt levels that was supported by the troika.

The previous crisis management has only partly been successful: Contrary to the forecasts of the IMF, the bankruptcy of Greece was not avoided but only postponed. The private creditors had to accept considerable financial losses; in return they could get rid of their risky assets and are no longer exposed to potential further financial turmoil in Greece. Henceforth, the creditors of Greece will be predominantly public, and these will have a strong interest in the recovery of the Greek patient.

With this haircut within the eurozone, the troika has set a dangerous precedent. Today, the assumption of private investors – that also other EU members can slide into bankruptcy – appears to be absolutely conclusive. The dramatic increase of yields of Italian and Spanish government bonds in late 2011 was interpreted as an irrational response of financial markets, but in fact these investor reactions reflect the failure of the troika in the first two years of the implementation of the program for Greece.

The strategy pursued by the ECB since the end of 2011 poses considerable risks. The ECB is providing financial markets with enormous amounts of liquidity at negative real interest rates. In essence, the ECB continues to implement the very strategy that already failed in Greece.

The central bank is trying to support both the European financial sector and the over-indebted states in southern Europe. The ECB's hope is that banks will use the liquidity provided to buy government bonds. With this European monetary policy, it is hoped that the combination of consolidation efforts at the national level and the provision of liquidity to the private sector will enable the return to a more sustainable policy over time. The failure of the troika in Athens gives rise to considerable doubts whether this plan will provide the expected results.

Both the continued existence of the eurozone and the recovery of the Greek economy are not at all ensured with the measures already implemented. In particular, it is still quite unclear how the Greek economy can return to a path of steady economic growth under the given conditions – particularly the high level of wages and the low levels of productivity. Moreover, in order to stabilize the country's external debt, it will be necessary that the Greek economy generates at least a modest current account surplus in order to reduce the debt levels gradually. Given the underdevelopment of the Greek economy – in particular the weakness of the manufacturing sector – the generation of substantial exports seems an ambitious goal.

Until now, the troika has regarded the case of Greece primarily as a problem of the European Union but not as a task of development policy. It wants to set benchmarks that will contribute to the recovery of the Greek economy, for example extensive privatization measures, the dismissal of public sector workers, and the opening up of professional services. Will this part of the crisis management of the troika be successful at least? How probable is the success of a restructuring of an economy that is ordered by outside players? Can Greece achieve the economic turnaround and become a successful and dynamic economy?

Experiences from development policy and transformation processes

More than any other European economy, Greece needs a fundamental revision of its economic policies. The country needs a new concept for its future economic development, and that blueprint has to be developed by Greek society. This restructuring is not a task for politicians only. The entire society has to make sustained efforts for economic development, similar to those implemented in other European countries, in particular in eastern Europe. Essential are not just smaller corrections in some parts of the economy but structural changes. Greek authorities and citizens face a task that is comparable with the transformation processes in eastern Europe in the 1990s and other former socialist economies. Greece does not suffer from a short-term liquidity crunch; the Greek economy needs an extensive transformation to maintain the current standards of living.

Historical experience provides clear evidence of what is necessary for success in the event of a major restructuring to a successful market economy: The key ingredient is so-called ownership. Reforms ordered by foreign players regularly fail. Even plausible ideas will not lead to success if the society itself interprets these reforms as sanctions ordered by other governments. The World Bank acknowledged this problem several years ago. It insists that states formulate their own development strategies. If governments and citizens do not accept the responsibility for their own economic development but leave it to foreign experts, the transformation will fail. In other words: There will not be success without ownership.

The absence of direct responsibility has therefore been the biggest omission in the "rescue packages" for Greece. While complaining about the rapidly deteriorating living conditions, Greek society has failed to do two things till now: First, Greek society has not yet sufficiently discussed its own contributions to the crisis. Greece's current troubles are no accident, but rather the result of the failure of many Greek governments and their economic policies. For decades, Greek companies have failed to develop competitive products and services.

It is not just the voters who exhibit this inability to reflect on own mistakes – it includes high-ranking government officials as well. In February 2011, the Greek Minister for Economic Affairs, Michael Chrysochoidis, suggested that the main culprit for the economic underdevelopment of Greece is the European Union. He suggested that the subsidies of the EU are the cause of economic inertia. While it is true that subsidies can lead to distortions, it is also true that other societies, for instance Ireland, Spain, or more recently Slovakia, have been able to use European aid much more effectively. Current financial troubles in some of these economies notwithstanding, they have been able to create their own dynamic companies, for instance Ryanair and Zara, or have been able to attract foreign direct investment. In the last 15 years, Slovakia, for example, has become a major manufacturer of automobiles.

Second, there is no major public debate in Greece on the opportunities and risks of future economic development. Greek society apparently opposes the programs designed by the troika, but the resistance against this imposed restructuring impedes the development of indigenous concepts for economic development. Greek society knows better than foreign advisors how to solve the chronic problems of the Greek economy. In this context, the recent proposal to send German tax collectors to Greece seems almost bizarre. Perhaps Greek tax inspectors could be trained in countries with a better public administration, but both the lessons of history and the above-mentioned experiences in development cooperation are reminders of the drawbacks of such an approach.

Would a new "Marshall Plan" help to solve the crisis?

In the debate on the restructuring of the Greek economy, some observers have suggested that a new "Marshall Plan" would resolve the crisis. Like the United States, which supported the postwar reconstruction of Europe with a rescue package, other European states could provide a plan for the recovery of the Greek patient. The followers of this idea argue that Greece needs massive structural aid from external players, without which the patient cannot recover.

However, Marshall's therapy is completely misunderstood by today's supporters. US Foreign Minister George C. Marshall had proposed a plan that provided aid for self-help. Marshall asked the Europeans to take the initiative of coordinating and developing new economic concepts for Europe's reconstruction.

Considering today's case, it is important to note that Greece already benefited from the process of European integration and brought those opportunities to the country that the Marshall Plan intended to create for Western Europe: Greece has been part of the European Community, with all the opportunities of a common market, aid payments, and support for business. In other words: Greece has already enjoyed a Marshall Plan and does not need a new one.

Membership in the EU offered Greece primarily two advantages: On the one hand, Greek companies have had access to the world's leading economic entity since the country joined the EC in 1981. However, Greek companies have not seized the opportunities presented by this situation. On the other hand, Greece has received nominal help (not adjusted for inflation) of about € 120 billion since joining the EC.

In addition, membership in the eurozone brought enormous benefits to the Greek government and domestic companies, benefits that again were not utilized. Between 1994 and 2007, interest payments on government debt dropped from 11.9 percent of GDP to 4.2 percent. But not only the Greek state benefited from the reduced interest payments; due to membership in the eurozone, Greek companies also had access to comparatively cheap loans. But a big investment push failed to appear, and the necessary modernization of production plants did not materialize. The supporters of new foreign aid for Greece have to explain why this approach should work in the future when it has failed time and again since 1981.

Responsibility and failure

New ideas are essential if Greece is to grow and reach a path of sustainable economic development. In other regions of the world, many examples of economic development can be found. Numerous societies have conceived and successfully implemented economic reforms within the last decades. In Asia, from Singapore to Vietnam, countries that developed their own strategies prospered. South Korea, today a dynamic and affluent society, pursued a custom-made development path that took into account the needs and interests of the country. In Africa, where foreign advisors, including the IMF, played a much more prominent role, failure is much more widespread.

The European Union can support a recovery plan developed by Greek society, but it should refrain from telling the Greeks what they should do. Thus, a radical revision of policy appears necessary. The responsibility for success – or potential failure – should be transferred to where it belongs: To Athens.

Therefore, the path pursued for the last two years will probably not lead to the economic recovery of Greece. The country is a developmental cul-de-sac, from which it can only escape when it mobilizes its own resources. The troika – first and foremost the IMF – should have known that economic success cannot be engineered from abroad. Continuing with this approach will only result in the perpetuation of debt restructurings. However, the troika achieved one goal: Financial markets have been able to prepare themselves for a Greek default. From the perspective of other European countries, this achievement is not a small one. A second Lehman-style shock was avoided. Nonetheless, Greek society has not been a major beneficiary and still has to find a way out of the conundrum.

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