Why the debt deal with the EU is bad for Greece

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Greek Prime Minister Alexis Tsipras holds his tie as he speaks at the parliamentary group of Syriza and Independent Greeks in Athens, Greece on June 22, 2018 [Costas Baltas/Reuters]

Shortly before coming to power in January 2015, Alexis Tsipras - then still known as an outspoken Greek opposition leader and unconventional anti-austerity firebrand - vowed not to wear a tie until international lenders agreed to cut his country's towering debt load to sustainable levels.

On Friday evening, the 43-year-old prime minister, who has since presided over three years of highly unpopular austerity measures in return for a third EU bailout, finally donned a burgundy piece of neckwear as he addressed a group of political allies in Athens to celebrate the conclusion of a new debt deal with European creditors.

The agreement, signed in the early hours of Friday, extends Greece's most pressing loan maturities by 10 years and provides a further 15 billion euros ($17.5bn) in EU financing. By boosting the government's cash reserves and pushing its first repayments back to 2033, the decision is expected to provide Greece with much-needed breathing room before a return to international capital markets following the expiration of its bailout programme in August

'The end of the Greek crisis'

In Athens, officials lauded the agreement as signalling the end of Greece's decade-long economic crisis. "I have to say, the Greek government is happy with this deal," Finance Minister Euclid Tsakalotos said after the marathon talks in Luxembourg. "I think Greece is turning a page."

The government's spokesman hailed the outcome as "a historic decision" that would allow "the Greek people to smile again", while Tsipras boasted that "Greece is once again becoming a normal country, regaining its political and financial independence."

Greece: Mixed feelings about the years of austerity

Buoyed by a similar triumphant mood, European officials fell over themselves to congratulate their Greek counterparts. Klaus Regling, the eurozone's bailout chief, even ventured the unlikely proposition that the deal constituted "the biggest act of solidarity the world has ever seen".

Unfortunately, the truth of the matter is somewhat more complicated. In reality, this hard-fought agreement is unlikely to restore Greece's debt to sustainable levels in the long term - nor does it demonstrate anything like a meaningful commitment to European solidarity.

On the contrary: The creditors' rejection of a formal debt write-down means that Greece's total debt load remains stuck at a staggering 180 percent of GDP, with the agreed extension of loan maturities merely pushing the problem further down the road.

As a result, rather than ending the crisis once and for all by cancelling part of the debt and thereby sharing the burden of adjustment equitably with European creditors, this deal simply shifts the burden of adjustment onto future generations of Greek workers and taxpayers. To understand why, we need to take a closer look at the small print of the agreement.

The limits of the deal

First of all, while Tsipras - with his falling approval ratings and next year's elections firmly in mind - is eager to portray the deal as constituting a clean break with eight years of punitive loan conditions and intrusive creditor supervision, the fact remains that his government has already agreed to introduce further tax increases, pension cuts and privatisation later this year.

Many of these far-reaching measures will come into effect after the third bailout programme formally expires on August 20, meaning ordinary Greeks are unlikely to experience any improvement in their living standards in the short term.

Nor are these fiscal pressures likely to ease in the long run. In fact, the terms of the latest agreement require the Greek government to continue running a primary budget surplus of 3.5 percent until 2022, followed by an average of 2.2 percent until 2060, effectively committing the country to 42 more years of austerity. To be clear, no sovereign state has ever managed to run uninterrupted primary surpluses for that long.

Moreover, even after exiting the current bailout programme, successive Greek governments will continue to be subjected to "enhanced surveillance" by international creditors for the foreseeable future.

The European Commission, European Stability Mechanism and International Monetary Fund will be sending special monitoring teams to Athens four times a year to make sure that Greece does not backtrack on its fiscal targets and pledged reforms. As one eurozone official put it, "this will be a short leash."

Finally, the hardline creditor countries - with Germany and the Netherlands in the lead - have once again managed to stave off the only credible alternative: meaningful debt cancellation, in the form of a significant write-down in the face value of Greece's foreign obligations.

What is worse - the deal stipulates that eurozone officials will only revisit the issue in 2032, meaning that Greece is likely to remain stuck in a debt trap for the next decade and a half at the very least.

At best, this agreement, therefore, serves to provide Greece with a financial buffer in the short term as it returns to international capital markets later this year. It also buys time for the rest of the eurozone to further delay an economically inevitable, but politically unpopular, debt write-down, allowing sitting governments - especially Merkel's increasingly precarious coalition in Germany - to push the moment of reckoning far beyond their short-term electoral horizons.

Who is to pay for the crisis?

But there is more to this deal than the arithmetic of long-term debt sustainability. At the heart of Greece's protracted fiscal crisis was always a highly contentious social and political question about the real meaning of European solidarity: Who should be made to pay for the presumed "profligacy" of successive Greek governments, or the "excessive risk-taking" of profit-hungry private creditors in the lead-up to the crisis?

The course of action that European leaders ended up settling on turned out to be very one-sided in this respect: Greece alone was to blame for its predicament, and therefore, Greece alone would be made to pay for it.

The real motivation behind the bailouts was always to safeguard the survival of a dangerously over-exposed European banking system - but this fact was quickly obscured. Instead, right-wing politicians and the tabloid media whipped up a frenzy of anti-Greek sentiment. The Greeks were widely portrayed as splurging the money on lavish pensions and long beach holidays - or on "booze and women," as former Dutch finance minister Jeroen Dijsselbloem infamously put it last year.

But as research by the European School of Management and Technology in Berlin has since shown, 95 percent of the bailout funds that were supposedly "given" to Greece actually went straight back to private creditors. Meanwhile, the bailout loans themselves were added to Greece's overall debt, and the country continued to pay interest on them over subsequent years.

In other words, the Greek people never received any handouts from their European creditors.

Meanwhile, the Greek government reduced the size of its public sector by 26 percent, cutting pensions and welfare spending by 70 percent and slashing the public health budget in half. As a result, incomes fell by one-third and unemployment skyrocketed to a peak of over 28 percent, unleashing a veritable humanitarian catastrophe.

The imperative of debt cancellation

The burden of adjustment for the crisis, in short, ended up heavily skewed in favour of Greece's foreign lenders. In a very critical report on its own involvement in the first bailout programme, the IMF later acknowledged this. The EU-IMF bailouts, in the IMF's own words, "served as a holding operation" for European banks to reduce their exposure to Greek debt before an inevitable future debt restructuring.

As it turns out, even Greece's official lenders ended up making significant gains from this creditor-friendly approach to crisis management. Last week, a parliamentary inquiry by the Green Party revealed that the German government made 2.9 billion euros ($3.3bn) in profits from its holdings of Greek bonds.

Even if Germany eventually returns these profits, as it has pledged to do under the new debt deal, a separate study by the Halle Institute for Economic Research has found that the country still "benefited substantially from the Greek crisis," saving over 100 billion euros ($116.5bn) - or three percent of GDP - on lower interest payments between 2010 and 2015, with most of this reduction attributable to investor flight from Greece and other peripheral eurozone countries.

In light of the above, it should be clear that Europe's endless game of "extend and pretend" has become utterly untenable on both moral and economic grounds.

The Luxembourg agreement may succeed in keeping Greece's seemingly interminable debt saga below the radar for a couple of years, but sooner or later its fiscal troubles are bound to resurface with a vengeance.

The only lasting solution to the Greek crisis would be to write down a significant chunk of the debt. In the absence of that, Tsipras' new burgundy tie may well turn out to be a noose for his people.

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