# Inside Europe's Plan Z

**Peter Spiegel, *Financial Times*, May 14, 2014**

Every working day since the crisis struck, George Provopoulos, the silver-haired governor of Greece's central bank, summoned a small "emergency team" of aides to his offices at 6pm to review the health of the nation's banks. What he was told on June 15 2012 was enough to make the courtly central banker blanch.

It was the Friday before a parliamentary election – the second national vote in as many months – and the country appeared to be edging towards panic. On that day, Greeks withdrew more than €3bn from their bank accounts, or about 1.5 per cent of the country's entire economic output. The Bank of Greece had watched people moving money from their banks to their mattresses for nearly three years, but never on such a scale.

"In a matter of a few days, a full-blown banking crisis could have erupted," Mr Provopoulos said in an interview. At that rate, Greece would run out of bank notes in a day or two.

Unbeknown to almost the entire Greek political establishment, however, a small group of EU and International Monetary Fund officials had been working clandestinely for months preparing for a collapse of Greece's banks. Their secret blueprint, known as "Plan Z", was a detailed script of how to reconstruct Greece's economic and financial infrastructure if it were to leave the euro.

The plan was drawn up by about two dozen officials in small teams at the European Commission in Brussels, the European Central Bank in Frankfurt and the IMF in Washington. Officials who worked on the previously undisclosed plan insisted it was not a road map to force Greece out of the euro – quite the opposite. "Grexit", they feared, would wreak havoc in European financial markets, causing bank runs in other teetering eurozone economies and raising questions of which country would be forced out next.

But by early 2012, many of those same officials believed it was irresponsible not to prepare for a Greek exit. "We always said: it's our aim to keep them inside," said one participant. "Is the probability zero that they leave? No. If you are on the board of a company and you only have a 10 per cent probability for such an event, you prepare yourself."

Over the past six months, the Financial Times has interviewed dozens of officials directly involved in fighting the eurozone crisis to examine how, over the course of the conflagration's final year, those leaders transformed the European project into something entirely new: a far more centralised eurozone where EU institutions have assumed vast swaths of economic and financial authority that once rested with national governments. Voters seeking to reject this new concentration of power in Brussels and Frankfurt could be a significant force in next week's European Parliament elections.

### A new sense of urgency

It was yet another near-catastrophe in Greece – which by mid-2012 had experienced street riots, soaring unemployment and austerity that had produced four years of Great Depression-style economic contraction – that would spark European leaders to act decisively. Since 2009, Greece's economy had shrunk by 20 per cent.

At no time in the crisis was Europe's single currency more at risk of blowing apart than the weeks either side of the Greek parliamentary election in June. Grexit planning took on new urgency when it appeared that the leftist Syriza party – led by anti-bailout insurgent Alexis Tsipras – was on the verge of winning. "That was the time when we really said: We've got to finalise our work," said another person involved in Plan Z.

**Crisis takes its toll**

In the four years leading up to the 2012 general election in Greece

**-10%** fall in average wages

**+852,000** new unemployed people

With most of the world's economic leadership flying to Los Cabos, Mexico, for the annual Group of 20 summit the same weekend as the Greek vote, a small group of top EU officials stayed at their desks in case Plan Z had to be activated. They were led by Olli Rehn, EU economic commissioner, who cancelled his flight to Mexico to stay in Brussels. Mario Draghi, the European Central Bank chief, remained in Frankfurt and Jean-Claude Juncker, the Luxembourg prime minister who headed the eurogroup of finance ministers, was also on call.

Plan Z was never used. Mr Tsipras's Syriza party finished second, allowing Greece's mainstream parties to form an uneasy coalition that eventually agreed to stay the bailout course.

But senior officials said the near-miss that summer, and the ensuing debate about Greek membership, helped focus minds in capitals across the eurozone – particularly Berlin, where fights over the advisability of Grexit raged for three more months, before Angela Merkel, the German chancellor, finally put an end to them.

**A stunning reversal**

Greece's membership of the euro has been a contentious subject since the moment Athens joined the common currency in 2001. After years of raising alarms, Eurostat, the EU's statistical agency, conducted an investigation in 2004 that found Greece had misreported its financial data, producing figures that vastly overstated its fiscal health in the run-up to euro membership. Despite endemic mismanagement, Athens was able to take advantage of the low interest rates that came with eurozone membership to keep its economy humming on borrowed cash. EU leaders largely ignored the warnings about Greece from bean-counters in Brussels.

But when Greece's bailout began to falter in 2011, the issue moved from dust-covered EU reports to closed-door deliberations between Europe's most influential leaders. According to multiple EU officials, Wolfgang Schäuble, the powerful German finance minister, became Grexit's most influential advocate.

Until early 2012, however, much of the discussion remained theoretical, the province of competing economists within various finance ministries, as well as the commission's economics directorate, which attempted to model the impact Grexit would have on Greece and the rest of the eurozone.

Actual Europe-wide contingency planning remained limited, if it occurred at all. Jean-Claude Trichet, the ECB chief until November 2011, barred any discussion of Grexit for fear that even a hint the central bank was considering it could become a self-fulfilling prophesy, former ECB officials said.

In Brussels, a group directed by Marco Buti, head of the commission's economics directorate, had quietly compiled data aimed at convincing Germany and its allies that Grexit would wreak far more havoc than they were anticipating. But more concrete planning was curtailed for fear of leaks.

Only at the IMF, which had vast institutional experience gained from all manner of economic disasters, had any serious work begun.

When Grexit was first publicly broached during the November 2011 G20 summit in Cannes – where both Ms Merkel and host Nicolas Sarkozy, the French president, pushed for an in-or-out referendum in Greece – there had been no planning for an outcome in which Greece opted to leave.

Several senior officials said they were stunned Ms Merkel and Mr Sarkozy had aired the idea that the eurozone could be left voluntarily, something that had previously been vigorously denied. Even officials who had worked closely with the two said they were caught unawares. "I fell off my chair," said one who had participated in closed-door discussions with both leaders. "For the first time, instead of the word being expunged out of conversations, they were using it. I remember thinking then: we're heading for trouble now."

**Leaving the Greeks out**

Work on Plan Z began in earnest in January 2012, largely overseen by four men. Jörg Asmussen, a German who had joined the ECB executive board that month, was assigned by Mr Draghi to head a Grexit task force within the central bank. Thomas Wieser, a long-time Austrian finance ministry official, was appointed permanent head of the "euro working group" of finance ministry deputies and helped co-ordinate work in Brussels with Mr Buti. And Poul Thomsen, a Dane who had headed the IMF's Greek bailout team since the onset of the crisis, provided input from the fund in Washington.

Efforts to keep information from leaking from the small teams around the four men were extreme for the same reason Mr Trichet had banned such planning: public discovery could be enough to cause the kind of panic that would force them to put their plan into action.

**The Plan Z team**


According to one participant, no single Plan Z document was ever compiled and no emails were exchanged between participants about their work. "It was totally fire-walled even within [the institutions]," said the official. "Even between the teams there was fire-walling." A decision was made not to involve Greek officials out of fear of leaks.

Their firewalls worked. During a dinner between José Manuel Barroso, the commission president, and Ms Merkel at the chancellery in Berlin less than two weeks before the Greek vote, Ms Merkel asked for reassurance from Mr Barroso that a plan was in place in case Greece rejected bailout conditions and Grexit ensued.

Mr Barroso acknowledged the plan's existence and offered to show it to Ms Merkel but she said his word was enough, according to officials in the room. Under the German system, such documents can be requested by the Bundestag, and senior German officials were concerned they would be obliged to disclose such planning if they had it in writing.

**An argument and a plan**

Although the FT was not given access to Plan Z documents, officials who saw them said they amounted to a detailed script of how to create a new financial system from scratch.

In Washington, IMF officials prepared a 20-page matrix of actions. Drawing on their experience on bank runs and currency crises, officials said the detailed IMF blueprint included such drastic action as turning off all ATMs and reinstating border controls to prevent massive capital flight.

At the ECB, officials studied Argentina's experience of issuing IOUs during their 2001 currency crisis, since the euro notes and coins circulating in Greece would no longer be legal tender. Among the options was issuing Greek IOUs worth about half the value of those euros, since getting new bank notes to Greece would be a logistical nightmare.

ECB officials examined the US military's introduction of new dinars into Iraq in 2003 but were humbled by the logistical challenge; the US effort took only three months but relied on the air and land assets of the world's largest armed forces. Greece's capacity to print notes on its own was limited; since the euro was introduced, Athens had mostly printed €10 notes.

Equally complicated was the basic “plumbing” of the Greek economy. Greece, like all other eurozone countries, is connected by a network called Target 2, a giant proprietary computer system run by the ECB and national central banks that make most commercial transactions possible. Once Greece was disconnected from Target 2, it would have no way to clear transactions, grinding the economy to a halt. The entire system would have to be rebuilt.

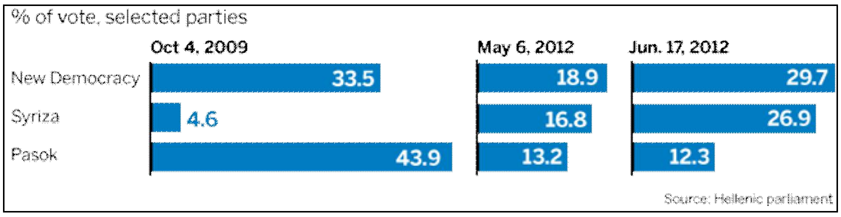
Similar work was occurring in Brussels. Some of it was thick in EU law: how can a ringfenced economy still be a fully integrated member of the EU’s internal market, which requires a free flow of goods? What were the legal authorities to set up capital controls? Other preparations were much more practical, such as which officials would appear in public to announce Greece’s new status.

“The people who would have been responsible for pulling a switch, they would have received in good time a paper saying: you’ve got to do this and this and this,” said a participant.

To many who worked on the project, Plan Z was as much an argument as an action plan. They wanted to demonstrate to those advocating for Grexit that the job was Herculean, something they could not conceivably back once they realised how difficult it would become. But in the summer of 2012, Greek voters almost forced their hand.

**A hard default**

With most of Europe’s attention focused on France, where Mr Sarkozy was fighting an unsuccessful effort to win re-election on the same day as Greece’s first parliamentary election, few outside Greece anticipated the storm that was approaching. Even within Greece many political leaders were stunned when results started rolling in on the evening of Sunday May 6.




For most of the four decades since its return to democracy in 1974, Greece’s electoral politics had been dominated by two parties, Pasok on the left and New Democracy on the right. But as the crisis deepened, amid accusations by bailout monitors of mismanagement under governments led by both parties, that status quo began to splinter.

Anti-government activists on the far left and right, once dismissed as radical fringe groups tossing Molotov cocktails in Athens' central Syntagma Square, began to gain support from a disaffected electorate. The neo-Nazi Golden Dawn party found a receptive audience among the alienated urban poor; the charismatic Mr Tsipras found his own fertile ground among supporters of Pasok, which had negotiated the hated bailout agreements.

As expected, New Democracy finished first in the vote but it polled less than 19 per cent – a stunning 14.6 percentage points less than it had received in national elections three years earlier. Even more remarkable was the complete collapse of Pasok. It finished third behind Syriza, with just 13 per cent of the vote – 31 points less than in 2009.

"We were not reading properly what was happening in Greek society," said a veteran Pasok politician. "We knew there was a lot of anger but when you're caught up in the [bailout] programme and wanting to make it a success and believing that the country needs to change, we did not pick up – nobody did, really – the rise of Golden Dawn, nor the spectacular rise of Syriza, nor our collapse."

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One person who was not surprised was Lucas Papademos, Greece's technocratic prime minister who had managed to hold the country together during a truncated six months in office. In an interview, the former central banker said opinion polling on the eve of the vote had made him so concerned the election would prove inconclusive that he remained in his office on the Sunday night of the election to prepare for the market shock.

According to Mr Papademos, Greek authorities were concerned in the vote's immediate aftermath that things could spin out of control if the antagonistic parties were unable to form a government for weeks. But they also feared that a new government, led by Syriza or even New Democracy, would reject the bailout deal, leading EU authorities to pull the plug. "The risk was that the constellation of election results would not allow the formation of a government supportive of the new economic programme," Mr Papademos said.

In a teleconference, the seven European leaders heading to the Los Cabos G20 summit agreed to stick to a common line: they would promise to support Greece – but only if it abided by the existing bailout's conditions. There would be no renegotiation.

Without bailout funding, Athens would no longer be able to pay its bills, and there was a €3.1bn bond due on August 20, a portion of which was held by the ECB.

A "hard default" – failing to pay an outstanding bond – was long seen as the most likely route to Grexit since, if there was no one left to lend to Athens, it would not be just the government that ran out of money.

At the time, Greek banks were relying on emergency central bank loans to stay afloat because private investors had stopped lending. To get those central bank loans, Greek banks had to provide some kind of collateral, which, for banks in most countries embroiled in the crisis, meant government bonds. But those government bonds would become worthless in a hard default, so central bank loans would be cut off. Without emergency liquidity assistance, Greece's banks would collapse. With no banks there was no economy.

This would not happen in a traditional monetary system. But Greece did not have a central bank in the traditional sense. Its central bank was in Frankfurt, run by officials who were mainly not Greek, and there was no way to compel the ECB to lend to Greek banks. The only way to restart the banking system would be for Athens to set up its own central bank and begin printing its own currency.

**'Kill the country in hours'**

But Mr Papademos and EU officials began to worry about a second "accidental" route to Grexit after the May election results: a bank run.

If panicked withdrawals began, it could lead to the same place as a "hard default". Greek banks would literally run out of cash, and the ECB would be unable to fund them because they would be insolvent. "Rules would clearly prohibit providing liquidity without adequate collateral, so that means you kill the country within hours," said an ECB official involved in the deliberations. To restart the banks, a new currency would be needed.

As Greece's political parties fought over whether they could form a government, Mr Papademos was receiving daily updates from the central bank on totals being withdrawn by depositors; the amounts were becoming so large that he wrote a warning letter to the Greek president. If no government was possible, elections had to be called quickly.

**Greek bank deposits**


Since the start of 2009, Greek authorities had successfully managed a slow-motion "bank jog" that had seen deposits fall from €245bn to less than €174bn on the eve of the 2012 elections. According to Greek officials, about a third of that money was pulled out of the country entirely; another third was spent to maintain rapidly falling living standards; and a final third was squirrelled away in mattresses and pillowcases for fear the euros could be turned into drachma if they were kept in banks.

Under Mr Provopoulos, the central bank went so far as to fly in extra euros from other parts of the EU to ensure even large withdrawals could be accommodated. A pattern was established: if a Greek depositor asked for a big withdrawal, they were told to come back the next day. For Greek central bankers, it was essential the account holder got the cash when they returned.

“What if a depositor had walked into a bank and asked for his or her money? What if the answer was: ‘I’m sorry, we are short of cash’?” said Mr Provopoulos. “Under the then prevailing conditions, it would have led to widespread concerns and very likely panic among depositors.” An astounding €28.5bn in new banknotes was pumped into Greece in the run-up to the 2012 elections.

But the feverish withdrawals between the May and June votes – the central bank was making shipments 24 hours a day – spooked officials, none more so than those watching from the ECB. A bank run raised questions of democratic legitimacy – should an unelected group of central bankers in Frankfurt, by deciding on their own that Greek banks were no longer solvent, really be the ones to force Greece out of the euro?

Inside the ECB, there was broad consensus that the call that would lead to Grexit should not be made by central bankers. Instead, they would pass the decision to eurozone politicians.


Amount of new banknotes pumped into Greece during the election period

During a June 25 meeting in Brussels with Mr Barroso and Herman Van Rompuy, the European Council president, with Mr Juncker joining by phone, Mr Draghi informed the leaders that eurozone politicians would be asked to guarantee emergency loans to commercial banks before the ECB pulled the plug.

Mr Draghi’s warning was not an academic exercise. One official said Mr Draghi had told the leaders a “period of uncertainty” would begin 30 days before the August bond was due, on July 20. Although Antonis Samaras had cobbled together a coalition the week before, the new government was still demanding renegotiated bailout conditions. And Ms Merkel had not yet decided whether Greece should remain a member of the eurozone.

**The infected leg camp**

For Germany, the Grexit debate echoed nearly every negotiation over Europe’s common currency since its founding document, the 1992 Maastricht treaty. Should it be a German-led monetary union made up of a small number of neighbouring states with similar economies or a broader political project that welcomed even those less competitive economically?

As a scientist trained to search for certainty, Ms Merkel began her own attempt to answer that question in the months leading up to her 2012 summer break. It would be an exaggeration to say she privately consulted every great economic and political mind in Europe during those weeks. But only a slight exaggeration.

During a Berlin meeting in early June with Mr Barroso, she solicited his view, fretting that Greek voters were about to force their hand by choosing a government that rejected the current bailout. When Mr Barroso told her Grexit would be a disaster and that Mr Samaras would probably win, Ms Merkel said it was Mr Samaras she was worried about, since he was on the campaign trail advocating scrapping the programme.

Two days later David Cameron, the British prime minister, engaged in a similar debate with Ms Merkel in Berlin, according to officials who participated in the meeting. Although Mr Cameron was less optimistic than Mr Barroso regarding Greece's ability to turn itself round, his advice was the same: the market reaction was likely to be violent and a eurozone bank run would be hard to stop, citing the UK experience with Northern Rock.

Ms Merkel's advisers were divided into two camps: the "domino" camp and the "infected leg" camp. The domino camp warned that Grexit would trigger panicked selling of all troubled eurozone government bonds, potentially followed by large-scale bank runs in Portugal, Italy and Spain.

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The infected leg camp argued that cutting off Greece would allow the rest of the eurozone to return to health. "You had these two camps and you had good economists in both camps," said a German official.

At the head of the infected leg camp was Mr Schäuble. Several people who spoke with him said he viewed a Greek exit almost idealistically, as something necessary to save a European project that he had worked for his entire political career.

"What is little understood is that this is because he is such a fervent pro-European," said one eurozone official who discussed the issue with the gruff German finance minister. "People think he doesn't like the Greeks. That's not true. It is because he so much loves Europe that anybody who's screwing European ideas is just so anti-European that they don't have a place in his scheme of things."

**Moral hazard**

That drive would occasionally lead to conflict with Ms Merkel, officials said. Where Mr Schäuble was far more prepared than his chancellor to cut Greece loose, he was also more willing to increase Germany's contributions to the eurozone's bailout fund to help create an impenetrable firewall to protect other euro members.


Within the German finance ministry there was a core group who took an even harder line. Most focused on the "moral hazard" that they argued was emerging in the eurozone, where countries believed there were no consequences to their fiscal mismanagement. Some senior aides felt that "you need to sacrifice one to scare the rest", said a person involved in the finance ministry discussion.

Ministry officials compiled analysis arguing that Grexit would cost less in the short term than trying to keep a fundamentally insolvent country on life-support indefinitely. Outside consultants were brought in to run similar studies.

Ms Merkel was being given conflicting advice by three central bankers whom she relied on heavily during her pre-holiday soundings and trusted implicitly: Mr Asmussen, who had been Mr Schäuble's deputy before moving to the ECB; Jens Weidmann, her former economic adviser whom she had named head of the Bundesbank a year earlier; and Philipp Hildebrand, former head of the Swiss National Bank.

All shared the concerns about moral hazard and felt it was unlikely Greece would live up to promises made as part of its bailout, which could lead to endless transfers of German taxpayer money to Athens. But they also told the chancellor that trying to predict the cost of Grexit was folly.

One eurozone official who spoke to Mr Asmussen at the time said his advice to Ms Merkel was: "You could have something which is priced in already, and then you could contain it, or you could end up with a eurozone of 10 [countries]."

Aid package released to Greece in late 2012 after Barroso urged Samaras to change his mind

The work of Mr Buti and his team in Brussels also appeared to have paid off. German officials said Ms Merkel was told it would be nearly impossible to get all 17 eurozone governments to agree to an exit plan, doing it all in secret without the markets catching wind of the effort, particularly with Greece showing no interest in leaving.

The political discussion in Berlin surrounding Grexit was the most subjective. Many EU leaders who dealt directly with Ms Merkel say she has less sentimental attachment to the European project than did her Christian Democratic predecessors, such as Helmut Kohl and Konrad Adenauer. EU leaders attribute that to her pre-politics life in communist east Germany, where she moved as an infant and lived into adulthood.

At the same time, several officials said they had begun to sense the weight of history on her shoulders. Did she want to be the German chancellor who "potentially breaks up Europe, even though it's not clear that would happen – but there's a possibility?" said one German official

In mid-July, Ms Merkel left for her six-week summer break to weigh the advice. Although the chancellor was undecided, the cacophony of senior German politicians publicly calling for Greece to leave had reached a crescendo. "If Greece no longer meets its requirements, there can be no further payments," Philipp Rösler, head of Ms Merkel's junior coalition partner the Free Democratic party, said as he prepared for his own summer holiday. "For me, a Greek exit has long since lost its horrors."

### A spectacular U-turn

One leader acutely aware of the debate going on inside the chancellery was Mr Barroso. The commission president told aides he believed one of his cardinal duties as guardian of the EU's treaties was to keep the eurozone and EU from losing members, be it Greece from the currency union or Britain from the EU itself.

With a massive, long-delayed €34.3bn aid payment hanging in the balance and Mr Samaras continuing to argue for big bailout revisions, Mr Barroso decided to become the first of the inner circle of EU crisis-fighters to visit Athens since the crisis began.

The talks between the two men went on for two hours. Sitting in front of an unlit fireplace in Mr Samaras' wood-panelled office, Mr Barroso told the new prime minister that demands for wholesale reforms of the bailout programme needed to stop. According to officials in the room, he urged Mr Samaras to spend at least a year executing the existing requirements. After that, the topic of revisions to the programme could be addressed, Mr Barroso suggested. But execution had to come first.

"Don't start asking for new conditions; there's no way," one person in the room recalled Mr Barroso saying. "The first message you have to convey to Germany . . . you have to say you are going to deliver."

Don't start asking for new conditions; there's no way. The first message you have to convey to Germany is that you are going to deliver

The blunt message from a political ally appeared to have the desired effect. Officials in the room said Mr Samaras began redrafting his press statement by hand even as Mr Barroso delivered his admonition, later telling gathered reporters he would begin "the implementation of agreed measures" immediately.

"Samaras did the most spectacular U-turn in history," said a minister in the preceding Pasok government.

**They just don't know**

Ultimately, however, it would come down to Ms Merkel herself, and after six weeks of contemplation, the German chancellor returned to Berlin with her verdict. There would be no certainty for the scientist. A cautious politician by nature, she could not abide Grexit if none of her advisers could agree on its consequences.

"You all say: 'Sorry, finally, we don't know'; If you don't know, then I won't take this risk," one adviser recalled her saying. "Her sense was: all these people, they might all be idiots, but they don't know."

Talk of Grexit within the eurozone receded. Ms Merkel made a highly symbolic trip to Athens in October. In Brussels, after a series of tendentious meetings of eurozone finance ministers, a revised bailout was agreed where Greece was promised more debt relief as soon as it achieved a primary budget surplus, which was projected by 2013.

The deal to release Greece's €34.3bn aid payment was struck just hours before an EU summit in November 2012. As he arrived, Mr Samaras made a quick statement: "Solidarity in our union is alive. Grexit is dead." Never again would Greece threaten the existence of the euro.