A Programme of Social and National Rescue for **Greece**

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Legal addendum by
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index

1. The failure of the EMU 07
2. The contrasting trajectories of Greece and Germany 09
3. Neither a political union nor a transfer union are plausible solutions for the EMU 12
4. The SYRIZA programme and its weaknesses 13
5. SYRIZA confronts the "impossible triad" within the EMU 15
6. A programme of social and national regeneration for Greece 16
i.National debt: The imperative of a deep write-off 17
ii. Lifting of Austerity: Neither Fiscal Surpluses, nor Balanced Budgets 20
iii. The banking system: Failure of private banking and the need for nationalisation 22
iv. Relieving the worst of the crisis and restoring labour market conditions 25
v. Medium-term restructuring of the productive sector 27
vi. Democratisation and state transformation 28
7. Aiming for a negotiated exit from the EMU 29
8. Confrontational exit from the EMU: Vital steps to social and economic regeneration for Greece 30
The technical aspects of exit 32
APPENDIX A - A legal addendum on the complexities of EMU exit 38
APPENDIX B - Restrictions applied in Cyprus, March 2013 41
APPENDIX C - The risk of inflation following devaluation of the new currency 43
References 45

1. The failure of the EMU

By the middle of 2015 the EMU is approaching a state of complete failure. Growth is stalling, deflation has become a real threat and unemployment stands at more than 10 per cent with rates of more than 25 per cent in Southern Europe. The failure of the EU to tackle the Eurozone crisis is becoming obvious. The root of the problem lies in the great gap of competitiveness in favour of Germany that has been generated by German neo-mercantilist policies since the first days of the Euro. Put briefly, Germany has systematically suppressed growth in domestic wages to obtain huge surpluses in its international transactions. The gap in competitiveness remains glaringly wide, while Germany has emerged as a major lender in Europe.

The decision by the European authorities to force the countries of the periphery – and especially the South of Europe - to adopt pro-cyclical policies on a scale that was last seen in the 1930s has proven a fatal error. The German mantra of "austerity as the only solution" was applied to all countries that were forced to ask for financial help when their access to the global capital markets ceased, or was blocked de facto by very high interest rates during 2010-11.

But even the countries that were not constrained by the financial markets are under scrutiny and are pushed towards restrictive policies in the midst of the biggest recession the entire region has witnessed for eighty years. Obsession with apparent fiscal problems, debt phobia and concern to protect the interests of banks and other big business dominates the debate and prevents a socially beneficial solution.

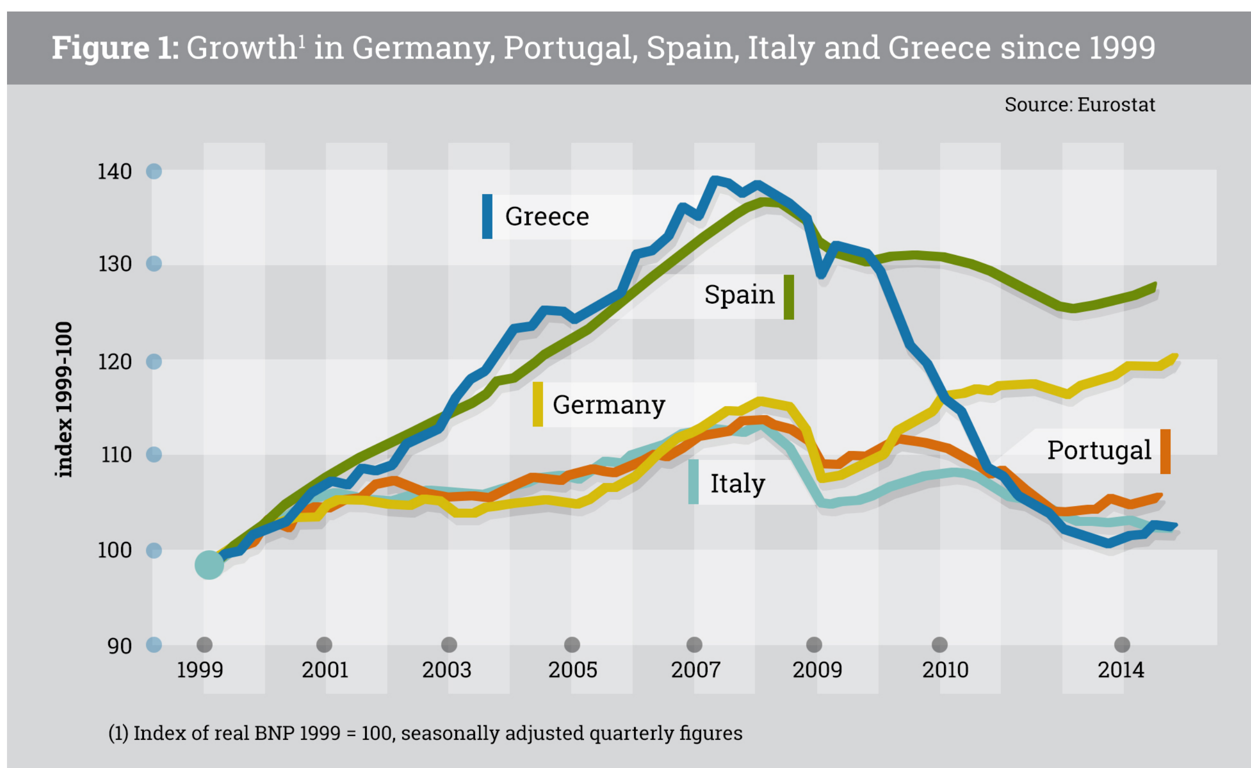
With persistent German dominance over export markets and given Germany's refusal to adjust its own economic model the future looks bleak for the Eurozone. The lack of policy instruments to tackle the recession, the conditionality attached to the adjustment programmes imposed on the economies facing crisis, the dysfunctional "structural" adjustment itself, and the prospect of looming deflation have raised the costs of remaining within the EMU to the point where political upheaval mostly led by the Right threatens democracy and the very existence of the EU. Failure to address the high rate of unemployment as well as rising poverty has paved the way for radical right-wing and populist parties in creditor as well as in debtor countries. Against this danger, the benefits of being a member of the EMU are small and, more importantly, they are shrinking fast.

The disintegration of the capital markets in the EMU following the financial crisis has drastically reduced the benefits of belonging to the monetary union and accepting a common monetary policy. Nearly five years after the outbreak of the Eurozone crisis things have not changed significantly. The partial return of Ireland, Spain and Greece to the capital markets came at an incredibly high price, these countries having had to pay a very high rate of interest on their bonds considering that they were in recession and deflation. But even worse has been the historically

unprecedented costs of the adjustment that they have had to accept to reach that point.

Furthermore, the limited ability to raise funds in the capital markets has not removed the constraints on domestic economic policy. Neither fiscal policy nor any other normal economic tool is available to these countries to stimulate their economies that have gone through a sharp recession, indeed, in the case of Greece, facing a great depression (see Figure 1):

Figure 1: Growth of Several EMU Countries (1)



exceeds foreign demand (for example, in France, Italy, Portugal and Spain domestic demand amounts to three quarters of total demand; by contrast, in Ireland the export share of GDP is more than 100%) has directly reduced aggregate demand. In this way, the imposed flexibility of the labour market in the form of wage cuts has increased unemployment rather than, as the troika expected, reducing it.

Consequently, there has been a remarkably strong correlation between the adjustment demanded by the troika and economic decline in peripheral EMU countries. The more closely countries have followed the troika prescription, the more their economies have shrunk and even collapsed. France and Italy, who until now have refused to follow the "flexibility" recipes of the troika (with wage growth and growth in unit labour costs only slightly reduced), have seen a strong deceleration of growth but not a sharp recession. All those countries that have actually undergone the troika "treatment" since 2010 have faced stunning decline.

At the same time, monetary conditions (real interest rates and real exchange rates) are clearly worse in the countries that have faced external deficits compared to those that have surpluses. Record low interest rates on government bonds in the surplus countries have laid the ground for easy consolidation of their budgets, while benign monetary conditions have helped to stimulate their economies.

For the EMU as a whole, applying "structural reforms" simultaneously to the labour markets of several countries has entailed a dramatic drop in domestic demand, and contributed to a collapse of trade flows. The effect of wage cutting in countries where domestic demand strongly

Paradoxically, those countries that have gone quite a way toward improving their competitiveness by reducing wages offer the final proof that this has been exactly the wrong way to proceed

in the EMU. Indeed it is even worse than that: the brutal logic of the adjustment imposed on some smaller countries has meant that the others, including France and Italy, could not apply the same adjustment without risking major political destabilisation. If France and Italy went the way of the troika, it is almost certain that the entire Eurozone would be thrown into depression resulting in a sharp drop of prices and long-lasting deflation.

It is hard to imagine that the democratic regimes in these countries would survive such an event. It is even likely that radical parties of the extreme Right would become dominant by campaigning against Europe and the Euro. On the other hand, if France and Italy do not adjust, their economies would be eventually destroyed by low competitiveness making it impossible to prosper on the basis of balanced trade. Their deficits on current account would continue to grow putting their entire economic edifice in jeopardy. But then, if France and Italy did not apply the troika adjustment programme and Germany did not change its stance on economic policy, the end of the Euro as a common currency would be only a question of time.

In short, the accumulated divergences during the first years of the EMU and the terrible nature of the adjustment programmes have put the very survival of the EU in question. And yet, European policy makers appear to be oblivious to this fact. They are even less willing to engage in a policy effort to turn around the overall economy and to stop the growing divergences within the EMU. The prospect of disintegration and eventual collapse of the union can no longer be ignored.

2. The contrasting trajectories of Greece and Germany

On 16 February 2015, at the beginning of the negotiations of the new SYRIZA government in Greece with the European institutions, the German Finance Minister Wolfgang Schäuble, in an interview to Deutchlandfunk, made it clear that[1]:

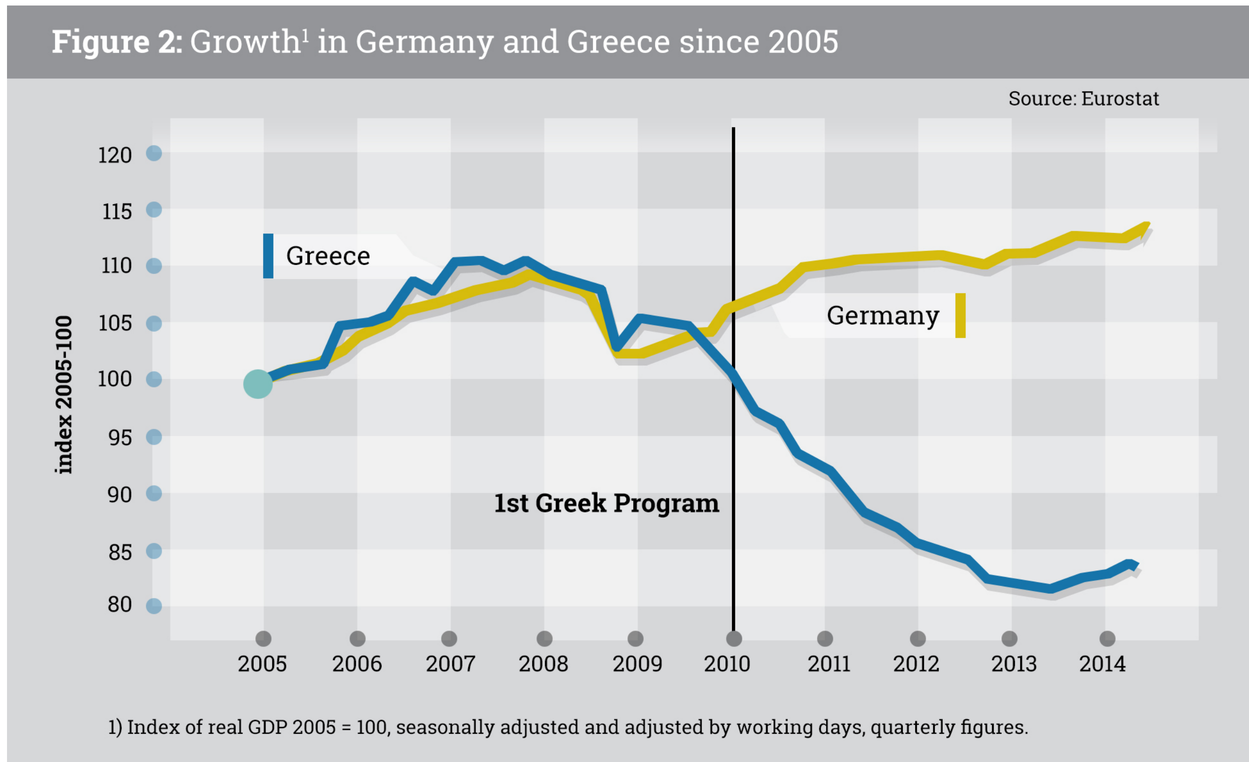
“Greece … (has to continue) upon the path that will gradually restore a competitive economy…. Greece has been on the right track and must continue along the policies that it has followed during these last years, unemployment has to decrease, the Greek economy has to rebound and work well again. If they follow this track, they will succeed …”

If it were true that the Greek economy was recovering, that Greece was on its way up again, that unemployment was truly going down (and not very marginally in the statistics) and that the living conditions of people in Greece were indeed finally improving, then Schäuble might have had a valid point. His insistence that Greece has to fulfil its obligations and continue to abide by the austerity set out in the adjustment programme would have made sense. But the position of the German Finance Minister was wrong from the outset. The consequences of the austerity measures applied for nearly five years have been almost the complete opposite of what the German Finance Minister believed, or wished the rest of the world to believe, they were. His appraisal of Greek reality could hardly be farther from the truth.

Since the beginning of the 2000s and up to the global crisis of 2007-9, the Greek economy performed remarkably well, as was already shown in Figure 1. The real problems of Greece started with the global slump in the wake of the financial crisis of 2008. The Greek economy went downhill much faster than the German economy and never recovered, as Figure 2 shows:

1* http://www.deutschlandfunk.de/schuldenstreit-mit-griechen2land-schaeuble-bin-sehr-skeptisch.694.de.html?dram:article_id=311734

Figure 2: Growth in Greece and in Germany since 2005 (1)



The "rescue" of Greece by the Troika took place in this context, and the administered medicine was to a large degree of German origin. In May 2010, Greece signed the first Memorandum of Understanding and acquired funds necessary to maintain its solvency. However, the medicine proved to be toxic. Between May 2010 and December 2013, total economic output and real average incomes fell by nearly 20 per cent. As the latest indicators show, the situation had not improved significantly by the beginning of 2015.

The clear and undeniable truth is that the "right track" that the "saviours" forced upon Greece has led to an unprecedented economic disaster. This is, of course, the point that Wolfgang Schäuble, and with him many other European politicians, including in Greece, continually refuse to admit or even to contemplate. In their view, the Greek economy was already performing poorly before the outbreak of the crisis in 2008; Greece apparently existed in a bubble of easy credit, widespread corruption, and persistent tax evasion, while all Greek citizens lived beyond their means. However, all these arguments are entirely flawed.

Widespread corruption is indeed reprehensible, but it occurs in many countries that nonetheless seem to have no problems in obtaining adequate liquidity from the international capital markets. As long as a country achieves a trade surplus, borrowing is never a problem, whether there is corruption, or not. Moreover, if it is possible for several countries across the world to be economically successful despite relatively high levels of corruption, it follows that the mere existence of widespread corruption in Greece could never have caused a crash in economic output by more than 20 per cent of GDP in 2010-13. Corruption did not abruptly increase in Greece from 2010 onwards. Corruption was already there when then the Greek economy was booming in the 2000s, without constituting an obstacle to growth. Corruption has nothing to do with the crash of the Greek economy.

The same argument applies to widespread tax evasion. Tax evasion is probably an even greater ill than corruption, but even widespread tax evasion could not possibly lead to the collapse of the economy of a country in just two or three years. Tax evasion could not account for the extreme downturn of the Greek economy because there is no reason to believe – and nor is there any supporting data – that the problem of tax evasion worsened significantly and suddenly after

2010. Tax evasion existed in Greece long before the financial crisis of 2008 broke out, perhaps for decades, if not generations. Weak fiscal morality was widespread during the early 2000s, when the Greek economy performed pretty well.

The same reasoning applies to all other phenomena that are sometimes cited as causing, or contributing to, the Greek downfall, such as inadequate public administration, lack of a land registry and inefficient state-owned enterprises. All these factors are indeed dysfunctional for a modern economy, but they do not constitute a valid explanation for the sharp and tragic downfall of the Greek economy.

Nonetheless, Wolfgang Schäuble's argument that the Greeks have lived above their means and their economy has not been competitive, has an element of truth to it. It is important to understand that declining Greek competitiveness within the EMU has indeed played an important role in the crash of the Greek economy, and continues to play it to this day. For many years in the 2000s – that is, after joining the EMU – Greek inflation rose significantly faster than the ECB target of 2%. The result was that foreign consumer and investment goods became systematically and greatly cheaper than Greek products. Therefore, Greece started to accumulate a large trade deficit that had reached the extraordinary level of 15% of GDP by 2008-9. It is undeniable that in the 2000s Greek products became very expensive within the EMU, and thus the Greek economy was not competitive when the crisis hit.

However, if Schäuble is partly right about Greece living "above its means" – in the sense that it accumulated trade deficits in the 2000s – it is equally true that Germany has lived below its own means. It is a simple rule of the world economy that a country can systematically consume more than it produces only if another country systematically consumes less than it produces. There are no deficits without surpluses in the world economy; by this token, there are no international debtors without international creditors. Analogously, competitiveness is relative: one country's competitiveness is "too low" only the competitiveness of its trading partners is "too high."

Such fundamental problems were not supposed to emerge within the EU, and much less within the EMU. After all, differences in productivity levels as well as differences in productivity growth among countries belonging to a monetary union need not be a problem as long as the level and the growth of wages stay in line with the level and growth of productivity. The systematic emergence of competitiveness gaps within the EMU could have been avoided if all countries complied with the inflation norm of 2% set by the ECB.

The real cause of the malfunctioning of the Eurozone lies in Germany, given its economic importance and size. Germany has undercut its trading partners by putting enormous pressure on German wages since the late 1990s, and German wage growth has lagged behind productivity growth by a wide margin. This is the flip side of the crisis and its real cause, though it is something that the German government is not willing to consider. It seems that the government considers the competitiveness of a country to be an absolute and not a relative concept. That is why, in its view, growing surpluses in Germany never seem to pose a problem for others. According to the same "logic", if other countries and the Eurozone as a whole were unable to escape the longest recession in history, the reason must have been their unwillingness to do what Germany has done.

The loss of competitiveness is a problem that Greece could not have solved on its own, and nor is it something for which it is solely responsible. Since 2010 Greece has been forced to close its competitiveness gap through a deflationary strategy imposed by the Troika of the EU, the ECB and the IMF. By early 2015 it had not truly succeeded, and remained unable to compete with Germany. But as long as Greece could not successfully compete – both within and without the Eurozone – it would find it impossible to repay its foreign debts. Meanwhile, Germany has done almost done nothing to curb its destructive policies of "wage moderation" which mean that the country has continued systematically to violate the European inflation target in a downward direction. Without Germany correcting its own policies, there could be no effective end to the crisis in Greece, but also to the other countries of the Eurozone, including France and Italy.

The new SYRIZA government in Greece was elected in order to end the disastrous economic policies imposed by the Troika. After all, it is not possible to inflict such a huge and socially destructive adjustment on a country and believe that its people will not react. In 2015 the Greek people used the only democratic avenue available to them: they voted out the compromised government of New Democracy and PASOK. Since then, however, it has become clear that politicians of core Eurozone countries, and especially Germnay, have engaged in a strategy of doing whatever it takes to sabotage SYRIZA. The message to the new government has been clear and straightforward: surrender! It remains a moot point whether the leading countries of the Eurozone will ever seriously negotiate, much less compromise, with a government from the Left. From their perspective, if SYRIZA failed, that would be a clear disciplining signal to the European electorate as a whole.

Responsibility for the destructive developments in the Eurozone lies mainly with Germany, which has, from the very beginning of the monetary union, failed to recognise and adhere to the basic rules of the European construction. The simple truth is that Germany has persistently refused to acknowledge that the main cause of the economic, political and social chaos that has been plagued Europe for several years is its own unwillingness to comply with the rules by systematically keeping domestic wages low and undershooting the ECB inflation target.

3. Neither a political union nor a transfer union are plausible solutions for the EMU

Several normally realistic people – even within the Left – still dream of a fully politically unified Europe that would help overcome the difficulties currently faced by EMU. There is little doubt that this is just a dream that should not be allowed to guide political action. Its key weakness is that there is no European 'demos' that could support the functioning of political union across Europe. And nor is there any realistic prospect of such a 'demos' emerging in the foreseeable future.

Indeed, the democratic rights of the European people would be severely compromised by any further attempts to bypass the nation states of Europe in the hope of creating a European "superstate", or a political union. The performance of the EU machinery in the course of the crisis, often by-passing the democratic process in the member states of the EMU, and even helping appoint unelected prime ministers in Italy and Greece, is a sobering omen.

In point of fact, the obvious inability and unwillingness to discuss honestly the reasons for the failure of the EMU during the last five years demonstrates the extent of divisions that exists among European countries in reality. To believe that these countries, with their existing political systems, could create a commonly held perception across Europe that genuine political union is the way forward and, moreover, that this perception could be translated into enhanced democratic practice, is plain silly.

Current experience indicates that, given the obvious inability of European institutions to manage a complex system like the EMU appropriately, the currency union was far too ambitious a goal for the EU. The implicit attempt to advance more rapidly towards political union by first forming a currency union has largely failed, leaving Europe in a worse state than before. Paradoxically, if there is to be further progress to-

ward solidarity in Europe, it is important for Europe first to retreat.

At the root of the failure of EMU lies the German economic model, as was explained in the previous section. Other European countries have been unable to question the German model openly and to persuade Germany that it is not even in its own interest to opt for competition rather than cooperation among nations in Europe, particularly among the members of the currency union. Germany has emerged as the dominant power of the EU, dictating terms to others, crucially influencing policy debates at the level of the EU, and jealously guarding its advantages. Acknowledging that lack of cooperation will be a fact of life for the foreseeable future would be a necessary first step toward reshaping the institutional arrangements that are required for a new division of labour in Europe that avoids national friction.

If the currency union was dismantled it would again become possible for individual countries to use currency devaluation as an instrument of economic policy, and thus to fend off attempts by some countries economically to dominate others. Devaluation has indeed been the most frequently used mechanism in modern economic history to respond to the behaviour of an aggressive trading partner without engaging in outright protectionism. A system of orderly devaluations (and revaluations on the other side) might preserve the core idea on which economic integration in Europe has been founded, namely that some degree of free trade is better than autarchy.

Finally, forming a transfer union to support the EMU would be neither a feasible, nor a desirable step among independent and sovereign nations in Europe. Even in Germany – a single country, with the same language and the same history – the transfer union that was put in place to confront the problems created by the German Monetary Union of West and East Germany, has failed to deliver harmonious co-existence of the two constituent parts, and has frequently provoked political tensions.

There is no member state of the EU whose people would accept becoming dependent on German transfers as a way of consolidating the economic imbalances that currently exist, and in order to avoid relying on the capital markets. Equivalently, Germany and other surplus countries already face enormous difficulties (objective and subjective) to persuade their citizens temporarily to finance the presumably "lazy Southerners", and right-wing parties are able to exploit the festering tensions. Institutionalising a system of fiscal transfers to deal with budget and/or current account imbalances in the EMU would be a recipe for profound nationalist friction in the future.

4. The SYRIZA programme and its weaknesses

If the response of the European authorities to the Eurozone crisis has been appalling, the response by the European Left to the challenge thrown by the turmoil and by the conservative hardening of the EMU has not been exactly impressive. The Left has generally lagged behind events and failed to capitalise on the most profound crisis of European capitalism since World War II. Characteristic of the Left has been its inability to put together a persuasive economic programme that could resolve the crisis and lead to growth, while improving the condition of working people.

To be fair, the Left has certainly offered sharp critiques of austerity, liberalisation and privatisation; it has shown the emptiness of neoliberal economics; it has decried falling wages as the answer to unemployment; it has advocated

financial controls and public investment. But it has also failed to put these ideas into a coherent whole that could provide a persuasive answer to the crisis. And it has failed to join forces politically to challenge the dominant German view. The bulk of the European Left has not addressed directly either the vexed issue of the common currency or the root causes of the crisis. Instead, it has largely followed the path prescribed by the creditor countries.

The task for the Left in Europe is to develop the outline of a plan capable of dealing with the Eurozone crisis primarily in the peripheral but also in the core countries of the EMU. A broader objective of the plan would be to outline some necessary and fundamental steps, if European societies are to move in the direction of growth with social justice, thus shifting the balance of class forces in favour of labour and channelling social development in a new direction. Achieving these objectives would require confronting directly the institutions of the EU and in particular the failed mechanisms of the EMU. More broadly, it would require adopting a clear social perspective that would confront directly the utterly dysfunctional capitalism of our age.

SYRIZA is the great exception among the European Left. It won the Greek parliamentary elections on 25 January 2015 on the basis of its full programme, and more particularly on the basis of a short, electoral version of it called the "Thessaloniki Programme" that was announced by its leader, Alexis Tsipras, in September 2014. Briefly put, the "Thessaloniki Programme" had two parts: first, negotiating "hard" to achieve a deep write-off of the Greek public debt; second, immediately launching a Plan of National Reconstruction that would be implemented irrespective of the path of the debt negotiations. Furthermore, SYRIZA promised, both explicitly and implicitly, to implement its programme while the country remained a member of the EMU.

The Plan of National Reconstruction comprised, first, confronting the humanitarian crisis caused by the Greek crisis; second, restarting the economy through a variety of measures that would include restoring the 12000 Euro tax-free threshold on income tax and abolishing the extortionate real estate taxes imposed by the Troika, writing off private sector debts, establishing a Development Bank, and restoring minimum wages to the pre-Troika levels; third, launching a programme of Public Employment that would create 300000 jobs over two years; and fourth, transforming the institutions of the political system. The total cost of the Plan for the first year was estimated at about 11.5bn. Funding was expected to come from clearing the backlog of tax and other obligations to the state, from reducing tax evasion, from some of the monies kept by the Greek Financial Stability Fund established as part of the bailout programme and, finally, from EU development funds.

It was publicly argued well before the Greek election that such a programme would lead to bitter conflict with the EU and the EMU for reasons that have been called 'the impossible triad' faced by a peripheral country within the EMU[2].

To be specific, the Greek bailout has included loan facility agreements that were well-supported legally as well as Memoranda of Understanding on "conditionality" that Greece was legally obliged to follow. Thus, the austerity policies deployed by Greece since 2010 have been framed by a legal and institutional framework that was mainly aimed at protecting the interests of lenders and enforcing the continued servicing of the national debt. More broadly, the conservative restructuring ot the EMU, undertaken at the behest of Germany since 2010, has hardened the legal and institutional framework of the EMU and the EU with regard to both austerity and liberalisation, summed up in the Six-Pack and Two-Pack frameworks[3].

Consequently, the "Thessaloniki Programme" directly challenged the entire framework of the EMU and the EU. By this token, the mechanisms of the EU have inevitably responded aggressively, and insisted that the SYRIZA government should persevere with austerity, particularly as fiscal rigidity is now formally embedded in the structure of the Union with monitoring and fines for 'delinquent' countries.

Furthermore, while there is little doubt that effective debt restructuring is a necessary condition for the SYRIZA government effectively to

2* Flassbeck and Lapavitsas, 2015. - 3* The so-called "Six-Pack" comprises five Regulations and one Directive. See, Regulation (EU) No 1173/2011, Regulation (EU) No 1174/2011, Regulation (EU) No 1175/2011, Regulation (EU) No 1176/2011, Regulation (EU) No 1177/2011, Council Directive (EU) 2011/85/EU. The "Two-Pack" consists of two Regulations. See, Regulation (EU) No 472/2013, Regulation (EU) No 473/2013.

lift austerity, it is equally true that debt restructuring would involve losses primarily to official lenders to Greece, thus to taxpayers/voters of the EU and of other countries. For the lenders these costs would entail shoring up banks and pension funds as well as writing off loans made entirely out of public funds. For European countries to accept these costs, it would first be necessary to secure the approval of their political systems, something that would require a complex political process of weighing losses and benefits. For these reasons too Greece has faced severe opposition from its lenders within the EU.

In short, the SYRIZA government has come face to face with the "impossible triad" of the EMU, that is: first, achieving effective restructuring of the debt, second, abandoning austerity and, third, continuing to operate within the institutional and policy framework of the EMU. The SYRIZA government has in practice discovered that it is not possible to have all three of these policies.

5. SYRIZA confronts the "impossible triad" within the EMU

In view of the preceding analysis it is hardly surprising that the SYRIZA government has faced severe conflict in negotiating with the EU immediately after the election and implementing the "Thessaloniki Programme". Thus, on 20 February 2015 Greece appeared to have agreed with the EU that:

1. There would be a four month extension of the existing loan agreement to allow for the full review of the current agreement and to provide time to prepare a new agreement.
2. Greece would submit a list of 'reforms' that would be reviewed by the 'institutions' of the EU, the IMF, and the ECB and finally agreed in April 2015. On this basis Greece would receive the monies owed to it from the existing loan agreement plus the profits made by the ECB on its holdings of Greek bonds.
3. The unused funds held by the Greek Financial Stability Fund (roughly 11bn Euro) would be placed completely outside Greek control and would be used exclusively to support Greek banks.
4. Greece would fulfil its financial obligations to its partners fully and promptly.
5. Greece would produce 'appropriate' primary surpluses to guarantee the viability of its debt.
6. Greece would not take unilateral actions that might disturb fiscal targets, economic recovery, or financial stability.

This agreement, which evidently has little to do with the "Thessaloniki Programme", resulted after enormous pressure was applied on the SYRIZA government by the EU on two fronts. First, the ECB drastically limited provision of liquidity to Greek banks banks by the ECB; second, official lending to the Greek government by a variety of bodies completely dried up. There was no real surprise in this regard as the experience of Cyprus in 2013 had shown clearly that both policies were likely to be used as blackmail tools by the EU.

By far the most powerful lever of pressure has been the restriction of liquidity supply to the banks by the ECB. Greek banks have been leaking deposits and other forms of liquidity in a sustained way since December 2014: from December 2014 to March 2015 they have lost roughly 30bn Euros of deposits. Meanwhile, normal liquidity provision has been suspended as on 11 February the ECB refused to apply the so-called waiver to Greek collateral assets.

Consequently, Greek banks have been forced to rely on Emergency Liquidity Assistance (ELA) which is expensive and its quantity is very tightly controlled by the ECB. In March 2015 the reliance of Greek banks on the Eurosystem for liquidity had exceeded 100bn Euros, while in November 2014 it was only 45bn Euros. The great bulk of the increase was ELA, which approached 70bn Euros in March 2015, from almost nothing in November 2014. By April 2015 the Greek banks were totally dependent on ELA which is being provided in carefully regulated and small amounts by the ECB. The result is that the provision of credit to the economy has effectively dried up.

Equally important is that the ability of the Greek government to borrow from the banks has also been drastically curtailed, thus exacerbating the shortage of public funds. Three months into government, SYRIZA has been forced increasingly to mobilise available reserves of public funds to meet debt payments to the IMF, while continuing to pay public sector wages and pensions. Toward the end of April the shortage of public funds had reached extreme levels and the government was forced to mobilise the reserves of local authorities and universities. Projected current expenditures for May, including payments to the IMF, are estimated at 4bn Euros and it is highly debatable that the government will be able to generate enough funds to cover these. The situation has reached critical point.

In short, the EU has applied the liquidity vice on Greece, throttling the banks, paralysing the economy and effectively bankrupting the state. Unfortunately for the SYRIZA government, there could be no effective response to the weapon of liquidity as long as the country remained within the confines of EMU. Lack of monetary sovereignty is ultimately the reason why the ‘impossible triad’ holds. The aim of the EU has been clear in applying the liquidity vice: to force the SYRIZA government completely to surrender, or collapse, by facing default. Closely associated with default is, of course, the prospect of exit from the EMU which has been used as the ultimate threat by the EU against SYRIZA. SYRIZA has thus come face to face with the “impossible triad“ within the EMU. Confronted by the absolute hostility of the EU, it has gradually moved away from its programme and has lost political momentum. Public finances have worsened and the economy has begun to stagnate. By early May 2015 there is an urgent need for a rapid change of direction, if Greece is not to face economic and social retrogression, and if the Left government is not to collapse in ignominy. SYRIZA must realise that it has to break out of the “impossible triad“ and seriously contempate taking Greece out of the EMU.

Exit from the EMU, however, is neither an end in itself, nor a full solution for the problems of Greece. It is, at best, a first step in implementing a programme of economic and social regeneration for the country that would lead to growth with social equality. Greek society needs to be placed on a different social basis that favours the working people and the poor. Before examining the modalities of exit, therefore, it is vital to discuss the fundamental parameters of the programme that a Left government needs ot put in place in Greece. For exit from the EMU to have positive results, it must be the first step in a broader transformation of Greece in the interests of working people. This is, properly speaking, the historic task that now confronts SYRIZA.

6. A programme of social and national regeneration for Greece

In the first instance, Greece requires urgent action to reverse the damage wrought by the inherent dysfunctionality of the monetary union, the recession and the adjustment policies of the troika. It is equally clear, however, that the required programme must simultaneously set the terms for a deep social transformation of the country in the interests of working people,

shifting the balance away from big business and other forms of capital that have dominated and benefitted from the policy agenda for decades. There are six integrally connected issues to such a programme:

i.National debt: The imperative of a deep write-off

No alternative programme would be plausible in Greece without first settling the debt issue. This is not only because of the heavy annual cost currently imposed by the debt but also because the policy framework imposed by the troika is fundamentally shaped by the requirement of servicing the debt.

The sustainability of public debt is primarily a matter of economic flows. To be more specific, the flow of national income must be restored through growth to provide the wherewithal to service debt. The flow of fresh debt and of debt repayments must also be managed appropriately to prevent future debt crises. The appropriate policies to deliver these results clearly go beyond the topic of debt and also relate to the topics of growth and public finance, both of which are discussed below.

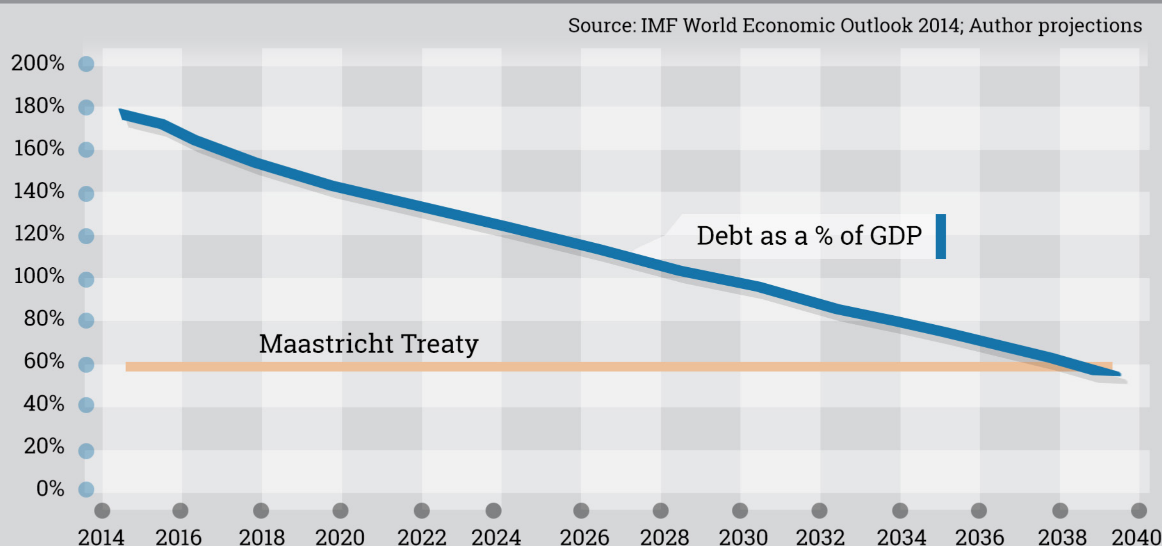
Debt sustainability, however, also refers to the stock of debt which has become unmanageable in Greece. Restructuring the stock of Greek debt will require write-offs, a policy that is inevitably confrontational since it would involve default, extended negotiations and usually considerable legal proceedings. It is of paramount importance, therefore, that the restructuring of debt should be handled with full transparency by a government of the Left. This means direct involvement by the citizenry, opening the books of the national debt to public scrutiny, and exercising democratic control over the entire process or restructuring.

A useful step in this process would be the establishment of a Debt Audit Commission, and it is encouraging that the SYRIZA government has already taken some important steps in that direction.

Since 2010 Greece has tried the solutions for its debt problem that were recommended by its creditors, but to little noticeable effect. Securing resources to ensure the payment of debt has been the overriding concern of budgetary policy.

The country has implemented harsh austerity measures and negotiated with its creditors an organised debt restructuring in 2011-12 that basically imposed a significant haircut on domestic holders, including banks. And yet, precisely because of the disastrous nature of troika policies, by 2014 the debt had reached 177% of GDP, or 4% higher than at the previous peak reached in 2012[4]. Even worse, as Figure 3 shows, under the policies determined by the bailout agreements, the future path of Greek debt would be simply appaling:

Figure 3: The path of Greek debt under current policies - Debt as % of GDP



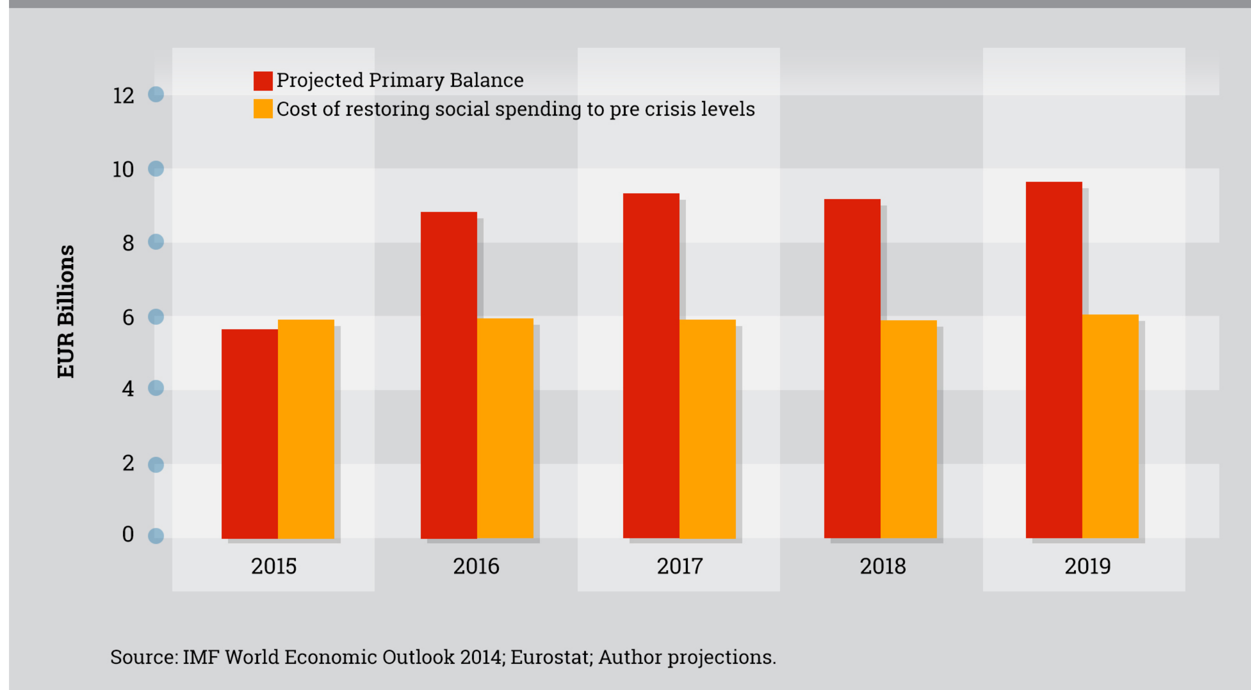
4* See, European Commission, 2014b

Figure 3 demonstrates the projected evolution of Greek public debt based on IMF assumptions. Without a change in current policies, it will take 26 years of austerity for Greece to reduce its debt to levels consistent with the Maastricht treaty. The assumptions made for this projection include average annual interest rate of 3.6% (consistent with current levels and with the IMF projections), growth rate of 2.8%, and a primary surplus of 4.2% of GDP. Note that the growth rate projected is slightly above the historical average of the last 50 years. Furthermore, no country in history has been able to sustain primary surpluses for periods over 10 years. In short, the conditions under which the country would reduce its debt to Maastricht levels by 2040 on the basis of IMF assumptions could only exist on an excel sheet.

Despite its inability to control debt as proportion of GDP, the Greek government has continued to commit increasingly large volumes of resources to servicing a debt that realistically cannot - and should not - be repaid for economic, social and political reasons. Even after the debt restructuring in 2011-12, the government has devoted the staggering sum of 146.6bn Euros servicing debt in 2012 and 2013. Taking only interest payments into account, for each Euro that the government has devoted to investment in 2012 and 2013[5], it has paid its creditors 1.43 Euros. A country that systematically devotes more resources to its creditors than to public investment and to the provision of public goods cannot be expected to grow, much less to overcome an economic crisis of historic proportions.

Furthermore, the welfare cost of continuing to impose austerity to service the debt in the future will be staggering. As Figure 4 shows, the country is expected to save roughly 40bn Euros in the next five years to pay its creditors. But it would take only 30bn Euros to restore expenditure on health, housing and education to pre-crisis levels. This is the quantitative side of debt peonage.

Figure 4: The Cost of Debt-Related Austerity in Greece - Projected Official Primary Balance (EUR Billions)



Source: IMF World Economic Outlook 2014; Eurostat; Author projections.

Specifically, Figure 4 shows the cost in billions of Euros of the savings imposed on Greece by the Troika to fulfil the conditions of debt sustainability according to the bailout programmes. They are compared to the cost of restoring health, housing and education spending to pre-crisis levels. Thus, during the next five years, Greece is expected to save around 40bn Euros to repay debt, while it would take 30bn to restore vital public services.

5* Debt service comprises amortisations and interest payments; see, Ministry of Finance of Greece, 2014.

It is sometimes suggested in current political debate that Greece should have a reduction on the interest rates of its loans. By any reasonable calculation, if that were accepted, it would probably mean no more than an additional reduction of gross debt by 5% of GDP by 2019[6]. Furthermore, it would require an additional 26 years of austerity to bring down public debt to a level consistent with the Maastricht treaty. An alternative is required. Greece cannot and should not be forced to pay its public debt under current terms. The Greek people cannot be expected to submit to an endless process of decreasing living standards in the name of a goal that is economically impossible to achieve.

The alternative must start with a decisive reduction of the stock of debt, a deep write-off that could even amount to hundreds of billions of Euro. A write-off that would, for instance, be commensurate with the currently disastrous state of Greek society would be to reduce debt to Maastricht levels of 60% of GDP (a reduction of roughly 200bn Euro). In that case the government would have at least an additional 10bn Euros annually to ensure the adequate provision of public goods and services required for the attainment of the economic, social and cultural rights of Greek citizens, while maintaining a prudent fiscal stance[7].

A write-off would, of course, involve losses for the creditors to Greece. It is, therefore, necessary at this point to have a closer look at the composition of the public debt of Greece[8]. In 2009, as the Greek debt crisis was about to burst out, Greek public debt stood at 300bn Euros (130% of GDP); it peaked peaked in 2011 reaching 355bn Euros (170% of GDP) before falling to 304bn EUR (or 157% of GDP) in 2012. However, by the end of 2013 Greek public debt had again risen to about 320bn Euros (174% of GDP).

The drop of public debt in 2012 was the result of restructuring, the so-called Private Sector Involvement (PSI), which affected roughly 200bn Euros of privately held debt, imposing a deep write-off in the region of 50% of nominal value as well as a debt buy-back. The bulk of the losses fell on Greek holders, including banks, social security institutions and small bondholders. Losses to banks were made good through fresh public borrowing, thus limiting the final reduction of public debt.

Apart from the PSI default, Greek public debt has been thoroughly restructured during the years of the crisis in four important ways:

(i)The composition of the debt has been altered dramatically since 2010, when debt comprised primarily bonds governed by Greek law. At the end of 2013 Greek public debt comprised mainly long-term loans provided by official lenders under the terms of the two bailout programmes in 2010 and 2011. To be more specific, out of 320bn Euros of Greek debt at the end of 2013, roughly 65bn (20%) was still in the hands of private lenders, another 65bn (20%) was held by the ECB and the IMF, and the remaining 190bn (60%) had been advanced by the EU and the European Financial Stability Facility (EFSF). Thus, about 80% of Greek public debt is currently in the hands of official lenders and the governing law is typically non-Greek.

(ii)The weighted average annual cost of Greek debt fell precipitously from just over 4% in 2009 to just over 2% in 2012, though it seems to have crept up above 3% in 2013.

(iii)The weighted average maturity of Greek debt was extended significantly, rising from a little under 8 years in 2009 to 16 years in 2013.

(iv)EU loans have provisions for extended grace periods, and therefore the maturity profile of government debt has improved substantially. During 2016-2036 Greece will face reduced annual repayments varying mostly between 5bn Euros and 10bn Euros.

Despite these profound changes in the volume and composition of debt, the Greek economy has been extremely weakened and can hardly cope with the current burden of public debt, as has already been shown. A deep write-off is called for and given the composition of the debt the bulk losses will fall on the public purse of EU countries, mostly those of the core. Needless to say, this would be a very difficult objective to achieve politically, and would require unilateral action by Greece, including declaring a temporary cessation of payments and implementing an integral public audit of the debt. Drawing on the results

6* See, Lapavitsas and Munevar, 2014. - 7* Ibid. - 8* Analysis below draws heavily on Lapavitsas and Munevar, 2014.

of this audit, but also mobilising the historical experience of several previous debt write-offs, it would be possible to reduce the stock of Greek debt to a level that would be compatible with the needs and rights of the Greek people. Europe must understand that public finance should be deployed to satisfy the needs of the people and not of big capital. Only by releasing Greece from the shackles of debt could the country return to growth and a dignified standard of living.

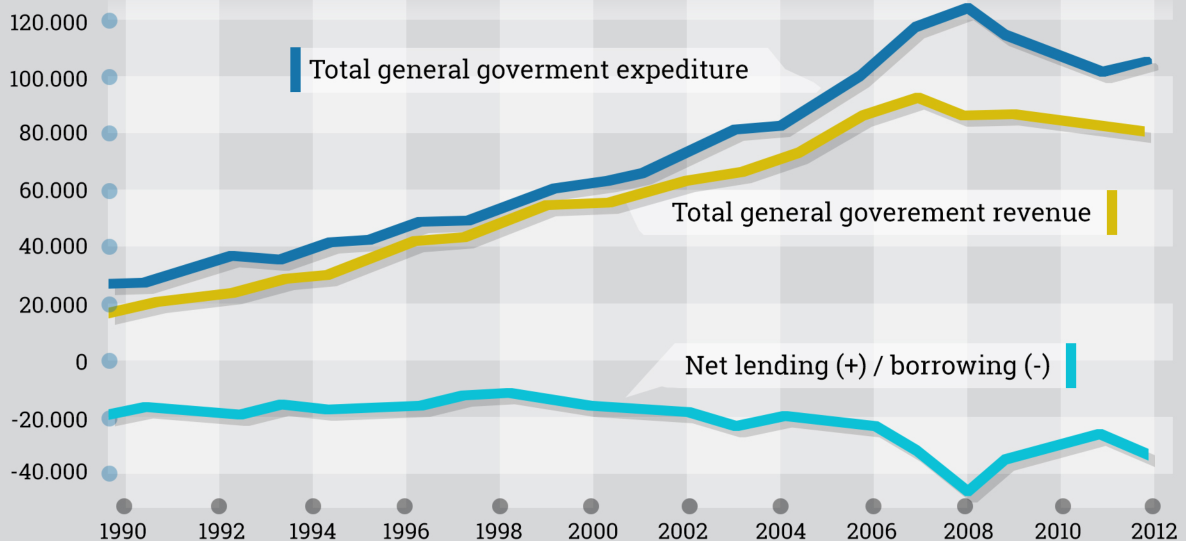
ii. Lifting of Austerity: Neither Fiscal Surpluses, nor Balanced Budgets

The current framework of Greek fiscal policy is determined, first, by the requirement of servicing the national debt and, second, by the strict rules of the EMU. Therefore, Greece has applied tremendous austerity by cutting expenditures and imposing tax increases on already reduced incomes.

The short-term aim ofthe bailout programme has been to achieve very large primary surpluses (up to 4.5% of GDP in 2016) to continue to repay the national debt. In the longer term the country will have to follow a tight fiscal policy under the auspices of the EU, thus permanently avoiding deficits.

Figure 5 shows clearly the collapse of government expenditure after 2009 but also the decline in aggregate tax revenue, despite the tremendous increase in rates and forms of tax, as the economy went into severe recession.

Figure 5: Greek Government Revenue and Expenditure, EUR Millions

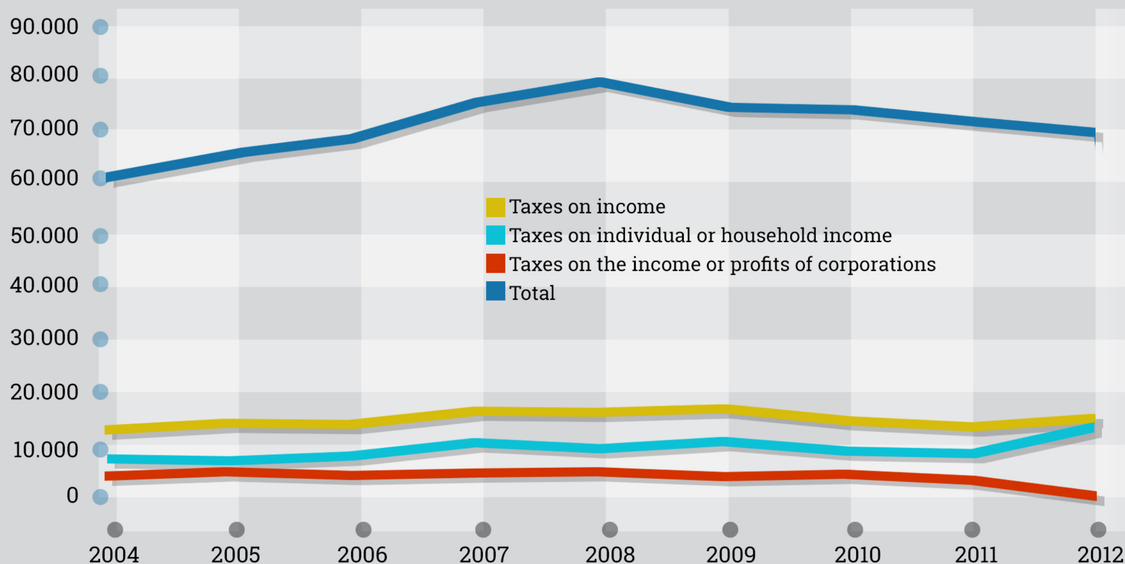


Source: Eurostat; Author calculations

The underlying reality of the tax storm imposed on the economy is apparent in Figure 6, which again shows the decline in aggregate tax revenue, while revenue from individual and household income rises and revenue from corporate profits falls. There is little doubt that is an economy that is basically killing itself.

The adoption of such gigantic austerity in the midst of a deep recession represents very bad economics indeed, and has been tremendously destructive in terms of output, employment, the welfare state and the general capabilities of the state apparatus. A government of the Left coudl not but reject wholesale the policy of fiscal tightness, and even of balanced budgets. The main aim of fiscal policy ought to be the revitalisation of the economy, rather than servicing the debt, or complying with disastrous EU rules. In a depressed economy

Figure 6: Greek national accounts tax aggregates; Breakdown of taxes on income, EURMillions



Source: Eurostat; Author calculations

such as Greece, with 1.3mn unemployed and vast un- or underutilised resources, expansionary fiscal policy is absolutely necessary. Budget deficits for limited periods of time should be tolerated as they are likely to generate tax income once the economy picks up speed.

There would be two immediate sources of finance for an appropriate fiscal policy adopted by SYRIZA government. First, a significant debt write-off and the attendant cessation of payments would provide substantial resources, as was shown above; second, there could be emergency public borrowing in the internal market with special purpose bonds. Writing off a large part of the national debt, in particular, would be a decisive step in adopting a fiscal policy aiming at generating employment, improving the living conditions of the people, strengthening the vital areas of health and education, and revitalising the economy. As was already mentioned above, a write-off compatible with Maastricht levels of national debt could provide Greece with an additional 10bn Euro (5.4% of GDP) of fiscal space per year for the implementation of fiscal measures that could repair the damage done by austerity, while rebuilding public provision.

If, finally, the SYRIZA government also acquired monetary sovereignty, there could be monetisation of fiscal deficits for limited periods. There is no evidence that the issuing of money in extraordinary volumes as part of Quantitative Easing in Japan, the USA and the UK at various periods during the last two decades has boosted inflation significantly. The least of the worries of a government of the Left in Greece at the present moment should be inflation, particularly as the country is already in a state of deflation.

In a little more detail, on the expenditure side, the focus of fiscal policy must be on helping the Greek people to get back to work, while also restoring the welfare state. An initial set of measures should revolve around the implementation of a Job Guarantee Programme to create publicly funded employment at the community level. A recent study – that provided some technical support for the "Thessaloniki Programme" – has offered carefully derived estimates that such a programme could help create up to 550 thousand new jobs at an estimated net cost of 4.2bn Euros[9]. It has to be observed that the study is not particularly clear on the likely sources of funding for such programmes, which would naturally require a significantly higher initial outlay than

9* See, Antonopoulos, 2014.

the net expenditure of 4.2bn until tax revenues from expanded employment started to come in. It is highly unlikely, for instance, that European funds would be available to this purpose. If, however, there was a deep debt write-off, the SYRIZA government would have immediately access to funds that could be used to boost employment through such programmes. In this context, priority should clearly be given to community projects in tackling local unemployment.

A further set of expenditures should be aimed at re-building the Greek welfare state. The objective would be to increase the coverage and quality of the provision of public goods to regenerate trust in public institutions while also boosting the disposable income of households. Urgent and large-scale measures would include restoring primary health care and social support, providing relief to homeless families and individuals, whose numbers have increased in an unprecedented way for a European country during the crisis, providing food support to meet the wide and chronic demand, particularly in urban centres, and reconnecting the electricity network those who have been cut off.

Once the immediate need of assuaging the destruction of social life by the austerity policies will have been dealt with, fiscal policy would have to turn to rebalancing of the economy in the direction of growth and social justice. A well-specified industrial policy would be vital in this regard. The main aim of fiscal policy as part of industrial policy would be to support a programme of public investment in infrastructure, research and development and education. Some further aspects of these policy aims are discussed below.

On the revenue side of fiscal policy, measures should be immediately taken to reduce the tax burden on households and SMEs with the aim of promoting employment and boosting disposable income[10]. Several options are available, which need careful costing to ensure neutrality in terms of revenue. These include:

i)An increase in the threshold of taxable income to boost the disposable income of households including those at, or near, the middle of the income distribution.

ii) A reduction of the VAT rates focusing particularly on items of popular consumption.

iii)Abolition of the recently approved general tax on real estate, to be replaced by a tax on households owing large real estate. Inheritance duties must also be raised for households that own large real estate.

iv)Rebalancing of Corporate Income Tax to favour SMEs and the creation of employment. A progressive tax scale should be designed to raise the burden on MNCs while lowering that on SMEs. Furthermore, the employer contributions by SMEs could be lowered and the revenue loss could be compensated by higher corporate taxes on MNCs. These measures would foster capital formation in the economy as a whole.

v)Raising the tax rate on dividends, interest and capital gains.

vi)Introducing a wealth tax.

To countermand the impact of tax-reducing policies on the revenue side complementary strategies should be adopted aimed at tax evasion. Even four years into severe austerity and bailout policies, most of the burden of adjustment has been borne by easy-to-tax salaried employees and pensioners, while the rich have continued to stay out of the tax net, as even the IMF recognises[11]. It is imperative to alter this state of affairs, as it has been estimated that tax evasion by the well-off amounts to 7-9bn Euro per year[12]. At the very least, there must be a strengthening and refinement of the penalties for large-scale tax evaders. The National Tax Agency should continue to be reformed and strengthened by increasing its personnel and improving its remuneration.

iii. The banking system: Failure of private banking and the need for nationalisation

Private banking has failed in Greece and the costs to the country have been substantial. Prior to 2008 the balance sheets of private banks grew rapidly, from 181bn Euros in December 1999 to 544bn Euros in June 2010, however this lending was not directed to socially important activities and much of it was of poor quality.

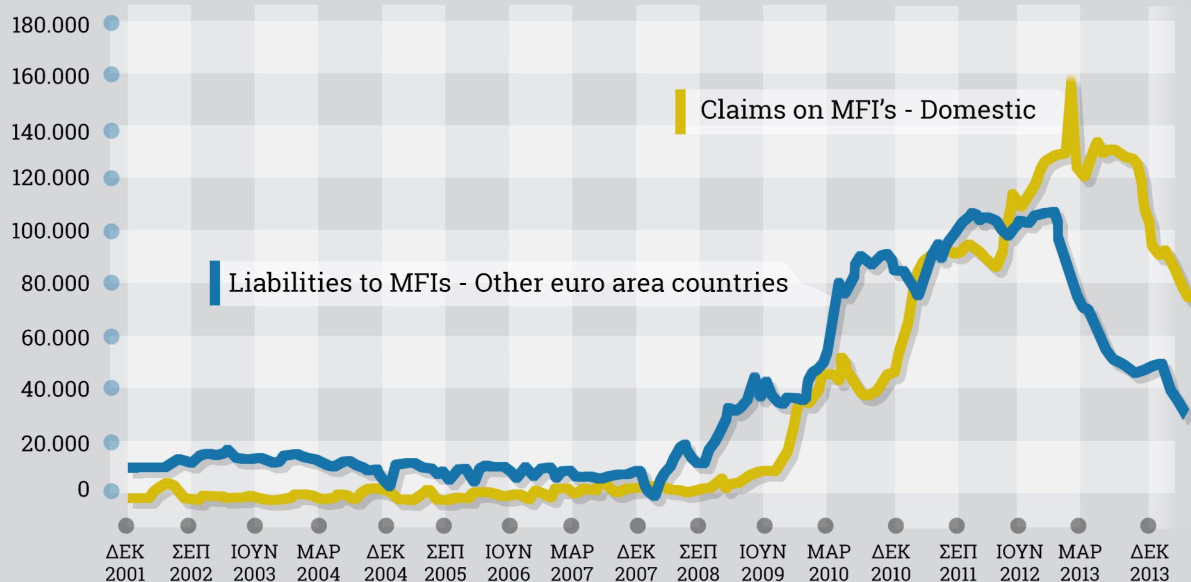
11* In view of the destructive impact of heavy taxation on the Greek economy, shown above, a government of the Left would do well to be careful about proposals to raise taxes, particularly if it is imagined that tax increases could be a solution for the crisis. An economy as depressed as the Greek one needs a lessening, not an increase, of the tax burden. 11* See, IMF, 2013. - 12* See, Artavanis, N., Morse, A., and Tsoutsoura, M., 2012

First, only a small part of bank balance sheets was dedicated to lending to non-financial enterprises. The balance of such lending grew from 53bn Euros in January 2001 (the earliest available data by the ECB) to 123bn Euros in June 2010 – comprising just 23% of total assets at that point[13].

Second, the crisis has revealed that the investments that fuelled the growth in total bank assets were of poor quality: private Greek bank capital needs were estimated at 50bn Euros in December 2012[14]. As a result the banking system has been repeatedly bailed out using a combination of funds from the troika and the Greek state. The bailouts of banks were a key reason for the tremendous austerity imposed on the country. Specifically, Greek banks have received ample central bank liquidity without which they would have failed completely. At its peak, in July 2012, the Greek central bank had claims on domestic Monetary Financial Institutions that were valued at 135bn Euros as well as 13.2bn Euros of loans and securities to the domestic Government.

Figure 7 shows the extent of liquidity support provided by the Bank of Greece to domestic banks and to the government up to the peak of the financial crisis in 2012. The Bank of Greece has obviously relied on liquidity received from the ECB and the ESCB, as is apparent from the rapid increase of its liabilities during the same period. The turning point at the end of 2012 came when Germany, through its Chancellor Angela Merkel, essentially let it be kown that it would not force Greece out of the Eurozone for the time being. After that the extent of support given to private banks but also the liquidity received by the Greek Central Bank from the ECB and the ESCB has declined precipitously.

Figure 7: BoG Balance Sheet - Liabilities to MFIs in other Euro area countries & Claims on Domestic MFIs; EUR millions



Source: Bank of Greece

Moreover, Greek private banks have received enormous capital injections from both the Greek state and the troika. By the end of 2013 the Hellenic Financial Stability Fund (HFSF, the capital of which was provided by the EFSF and increased to 49.7bn Euros in 2013) held: invested capital in the four systemic banks valued at 22.5bn Euros, undistributed EFSF securities for further capital injections valued at 10.3bn Euros, a derivative liability of 2.2bn Euros and accumulated losses of 15.3bn Euros. A good proportion of the losses arose from recapitalising banks which were subsequently sold at a loss to the four systemic banks to whom the HFSF provided capital[15]. Despite this assistance, in 2014 the state of the banks was far from healthy. Greek

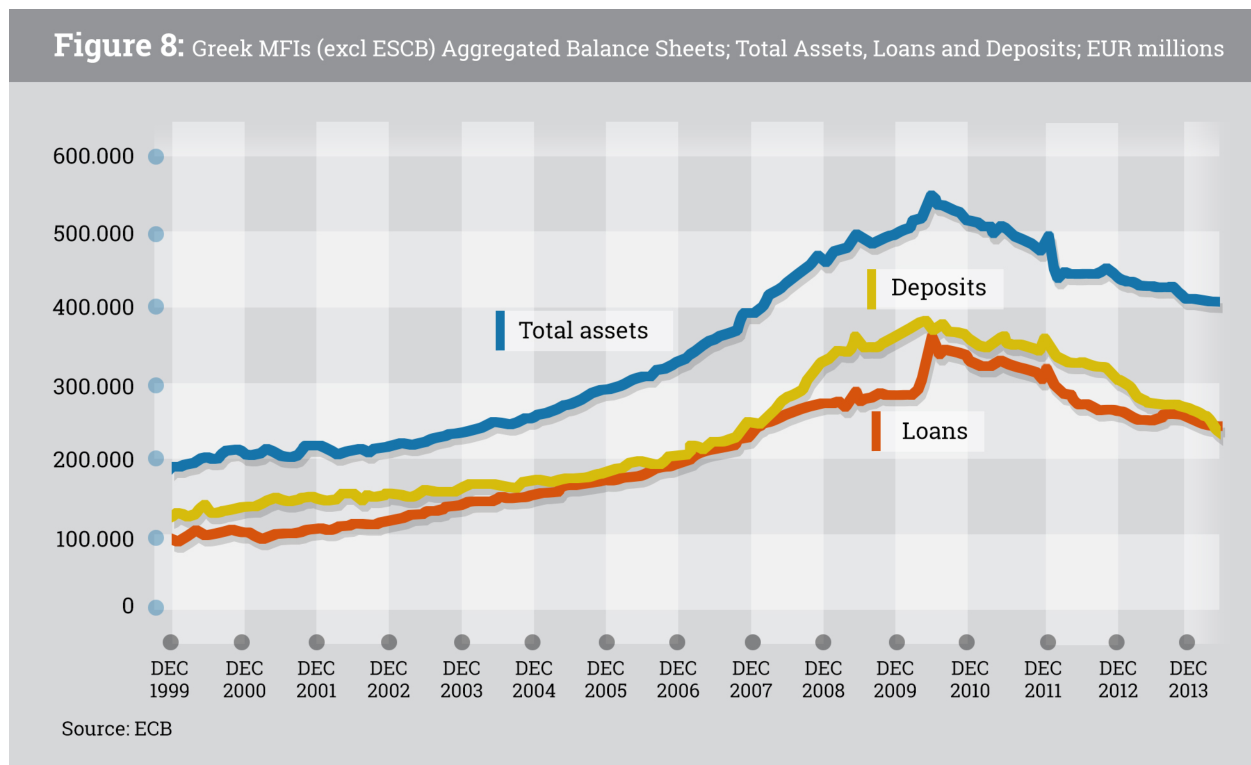
13* Figures estimated by the authors from the ECB Statistical data warehouse. - 14* See, Bank of Greece, 2012. - 15* Hellenic Financial Stability Fund, 2013

banks had one of the highest ratios of non-performing loans in the world at 31.3% of total gross loans at the end of 2013. Non-performing loans increased tremendously in the course of the recession, reaching perhaps 80bn Euros in 2014, perhaps 45bn of which comprised business loan and the rest household loans (mortgages and consumer loans)[16].

Furthermore, banking is a business founded on the confidence that bank liabilities will be paid in full and on time. One barometer of this confidence is the volume of money that banks - the economy's arbiter of credit worthiness - lend to each other. its size has been falling steadily since the onset of the crisis despite the efforts of the troika and the Greek state to rejuvenate the banks and the interbank market. Greek private banks owed to other domestic private banks 9bn Euros in June 2010 but just 2.7bn in June 2014[17]. Similarly, they owed to private banks of the Other Euro area 60.4bn Euros in June 2010 but only 8.1bn Euros in June 2014. In short Greek banks appeared to be carrying a huge proportion of non-performing loans, while being largely cut off from other European banks and lending very little to each other. These were unmistakable signs of a failing banking system.

The result has been that, after intensifying the economy's dependence on debt during the boom years in the 2000s, the banks have found themselves trapped in a spiral of deleveraging that has denied credit to the economy during the recession. Thus, fiscal austerity has been reinforced by a bank credit crunch. Figure 8 shows the rapid shrinkage of both assets and liabilities by Greek banks. Decline of bank lending together with a high interest rate on new loans has crippled economic activity.

Figure 8: Greek MFIs (excl ESCB) Aggregated Balance Sheets; Total Assets, Loans and Deposits; EUR millions



Source: ECB

In a little more detail, bank balance sheets have shrunk from 544bn Euros in June 2010 to 397bn Euros in July 2014, and lending to domestic non-financial enterprises has fallen from 124bn Euros to 95bn Euros in the same period. The trend is similar for bank lending to households: there was too much – badly judged – lending during the boom (from 31.9bn Euros in January 2003 to 124bn Euros in June 2010) while tight conditions have prevailed during the bust (lending falling to 112.7bn Euros in June 2014)[18]. The result was that households have been squeezed by the banks, and in turn have become ever worse credit risks and thereby increasing non-performing loans. To cap it all, the private banks have entered a spiral of deleveraging, their weakness has led to a restriction of credit, the economy has been further weakened, and this has led to further worsening of the position of the banks.

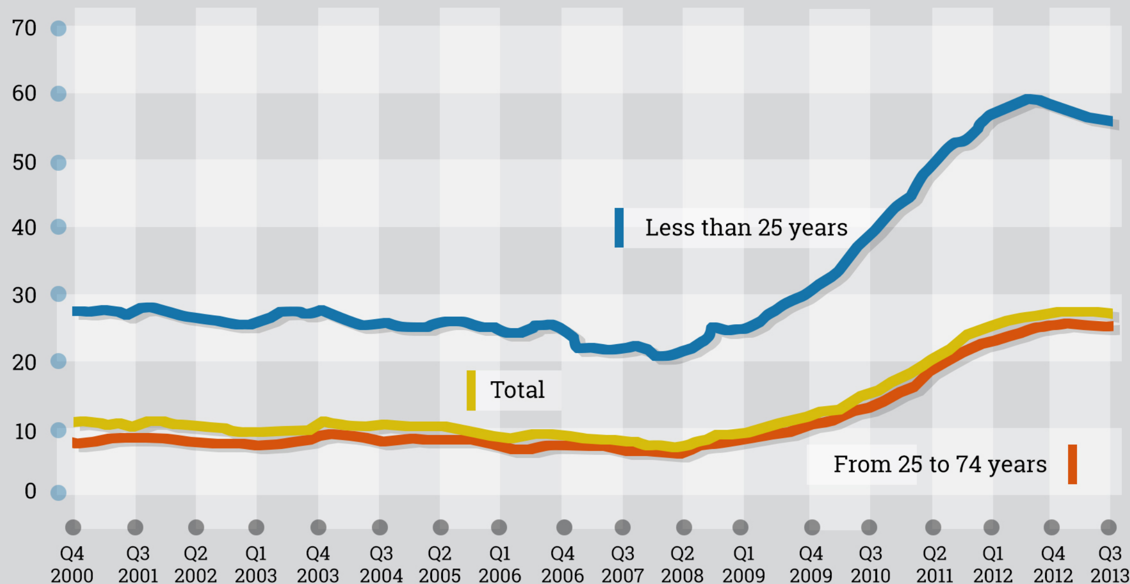
16* Figures estimated from the ECB Statistical Warehouse. See also World Bank http://data.worldbank.org/indicator/FB.AST.NPER.ZS - 17* Figures estimated from the ECB Statistical Warehouse. - 18* The figures have been estimated from the ECB Statistical Warehouse

With few prospects of breaking out of this vicious cycle under current policies, and with still fewer structural changes undertaken by the EU to prevent the pattern from repeating itself, it is time for a change of direction. The banks ought to be properly nationalised and placed under public administration and democratic control. After a full public audit, bad debts would be removed and a healthy banking system would be created based on public capital. A national development bank would also be created to support long-term growth projects. Moreover, debt forgiveness for households ought to be introduced on the basis of public guarantees/capital for the lenders. The nationalised banking system would engage in expansion of short-term credit and liquidity provision, particularly to SMEs that comprise the backbone of the Greek economy. The purpose would be to revitalise economic activity in the short-term and to boost employment.

iv. Relieving the worst of the crisis and restoring labour market conditions

Unemployment has ravaged wage earners in Greece and the collapse in incomes has negatively affected those still in employment. Figure 9 shows the explosive increase in unemployment in the course of the crisis, which has reached extraordinary levels for young people:

Figure 9: Greek Unemployment rate by age group (quarterly average, %)



Source: Eurostat

The OECD notes that ‘the largest impacts of the crisis on people’s well-being have come through lower employment and deteriorating labour market conditions [and] ‘the poor employment situation had a major impact on life satisfaction’.

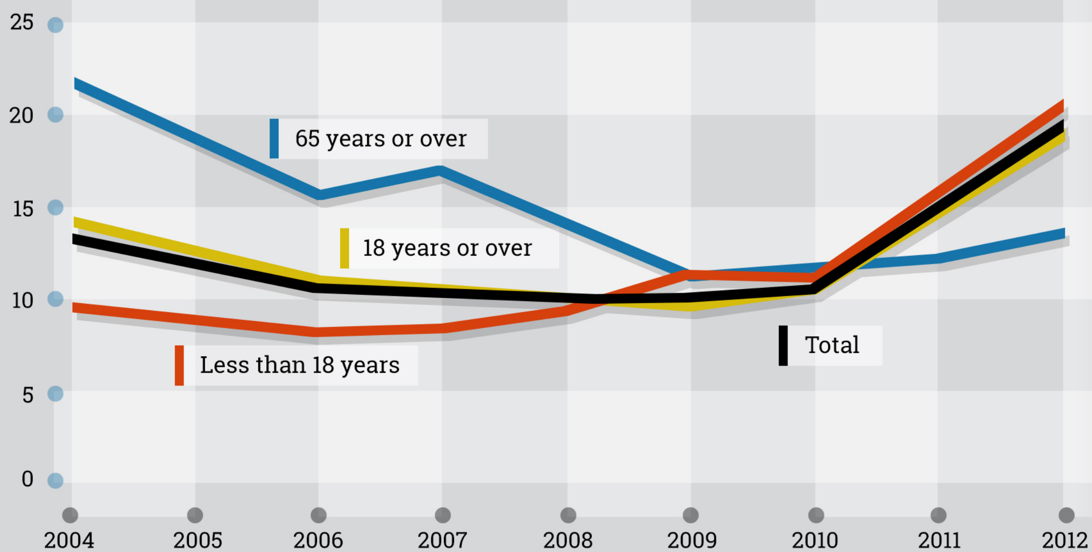
The loss of employment, the fall in wages, and the decline in public provision have created dramatic conditions for much of the population with regard to basic goods, such as food, energy, medicines and housing. Official statistics struggle to capture the misery in which a large swathe of the population finds itself.

However, Figures 10 and 11 (next page) show, respectively, the extraordinarily rapid increase in severe material deprivation and the collapse in health expenditure per capita since the adoption of the bailouts. The sudden emergence of these trends has pushed Greece violently in the direction of developing countries.

Further sources of information paint an even worse picture:

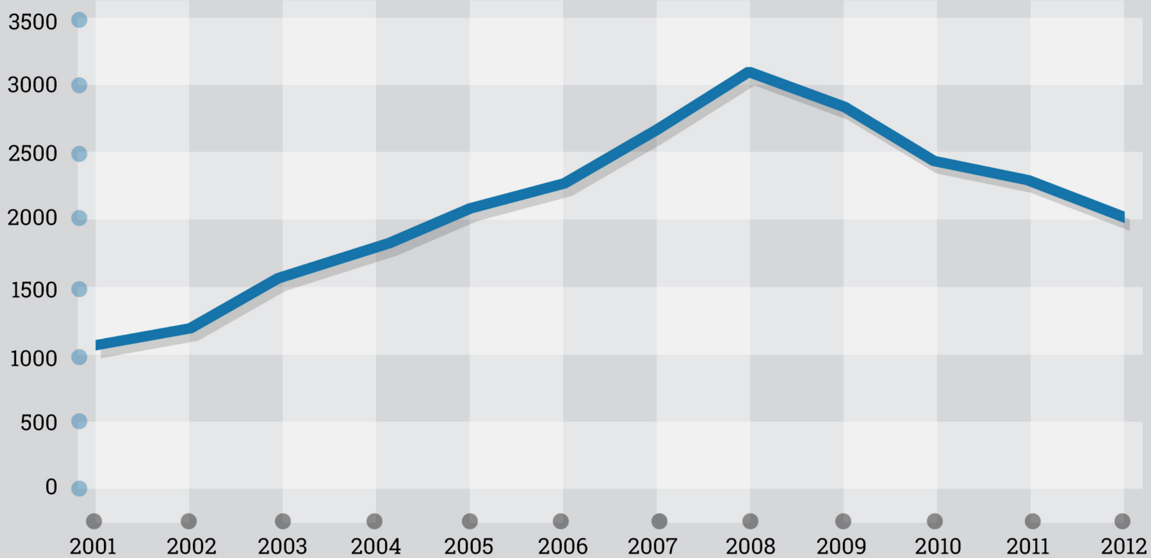
i)Homelessness has risen markedly: the Red Cross quotes a 20-25% increase in the numbers

Figure 10: Severe Material Deprivation, Greece, (% of total population)



Source: Eurostat

Figure 11: Health expenditure per capita, Greece, (current US$)



Source: World Bank

of people living on the streets, and the organisation has expanded its social programmes to try and cope with the emerging humanitarian crisis[20]. In addition those that are not actually on the street are often living in crowded conditions. Young people in particular, with very little chance of employment and falling benefits, are staying at home, often surviving on the falling pensions and incomes of their parents.

ii)Turning to health, there appears to be a chronic drug shortage, while official statistics show that health expenditure per capita, rising throughout the 2000s, has fallen from US$3000 to US$2000 since 2008[21]. Deep cuts in public health care provision have resulted in long waiting times and re-

20* See, International Federation of Red Cross and Red Crescent Societies, 2013. - 21* Estimated from data at http://data.worldbank.org/country/greece

duced accessibility amidst clear signs that 'health outcomes have worsened' already in 2011[22].

iii)Perhaps even more alarming is that significant sections of the population are suffering from food poverty, with increasing numbers relying on food banks and around half of poor households with children finding themselves unable to supply a healthy diet, according to UNICEF[23].

iv)Finally, fuel poverty has drastically increased, in regard to both heating homes and using private cars. Air quality in Athens and other large urban centres declines dramatically in winter as residents have taken to burning wood, rubbish, and other materials for warmth.

A Left government would have to confront the immediate reality of such poverty as well as dealing with its underlying causes. In that context, the inability of the SYRIZA government to implement even the modest provisions of the "Thessaloniki Programme" regarding the humanitarian relief that is necessary for the country speaks volumes to the devastating effect of the "impossible triad". A Left government must immediately take steps to restore the quality of life of working people in Greece, if it is to retain popular support. The state should take the initiative, together with community and associational organisations and international NGOs, such as the Red Cross, to cover the basic needs of Greek citizens, including shelter, food, medicine and energy at a basic level.

At the very least food provision to those facing severe food poverty should be nationally coordinated, and homelessness should be assuaged through the creation of shelters. On health care, the focus must be to reverse the negative trends of increasing child mortality and decreasing life expectancy that have occurred with the implementation of austerity. To this purpose, insured coverage must be increased to protect vulnerable households, eventually aiming at proving universal coverage. Expenditure must also be increased to provide primary health care with the added benefit that it would lower the expense of long-term medical care.

The fiscal cost of such policies would be modest, but it would still be necessary to abandon austerity, if they are to be implemented. The economic and political benefits, moreover, would be substantial. On the one hand, a boost to welfare would increase the disposable income of households, thus strengthening the recovery. On the other, stronger provision of public services and a supportive role for the state would be vital steps toward restoring the trust and confidence of the Greek people. Confronting tax evasion and immediately improving provision of public goods must go hand in hand.

More broadly, however, the SYRIZA government should tackle the causes of poverty and this implies three vital forms of action. First, reducing unemployment, as was discussed above. Second, raising wages and immediately restoring collective bargaining in the labour market by annulling the anti-labour laws passed since the bailout. Minimum wages should be restored from 586 Euro per month to the original 751 Euro. Once again, the difficulty that the SYRIZA government has faced in implementing this component of the "Thessaloniki Programme" is revealing of the absolutely constraining effect of the "impossible triad". SYRIZA should proceed regardless of the objections of the EU and the IMF. The impact on private enterprises, particularly SMEs, would be partly offset through tax relief, but also through the boost in demand that will result from the abandonment of austerity. Wages in general should be set in line with productivity growth and considerations of income redistribution in the future. Third, rebalancing the pension system to support the lowest pension holders, and thus to confront pensioner poverty. It ought to be stressed, however, that there could not be a long-term solution for the generally parlous state of the pension schemes in Greece without boosting employment. The ultimate answer to pension poverty is to lift austerity and boost growth.

v. Medium-term restructuring of the productive sector

The SYRIZA government would have to abandon the current neoliberal development strategy imposed by the troika which essentially comprises lowering wages, liberalising, privatising and hoping for spontaneous increase of domestic investment and FDI to generate growth. Greece needs a medium-term development strategy

22* See, Kentikelenis, et.al., 2011 - 23* See UNICEF, 2014.

that would be based on industrial policy to boost growth rates, reduce unemployment and raise incomes, in an ecologically sustainable way. Formulating such a strategy and bringing it to bear woudl require the collective effort of social organisations, parts of the state apparatus, academics and organisations of civil society across the country. The most that could be done at this point is to spell out some of fundamental issues involved.

The required industrial policy must first take into account the protracted deindustrialisation oft he country, which started in the early 1980s and has become dramatic following the massive destruction of industrial capacity since 2007. It must also take into account the problematic nature of EU and EMU institutions and policies, which have led Greece to the current development impasse. Finally, it must be fully aware of the domination of key parts of the world market by large MNEs, which control technology and command supply chains.

It would be a fallacy, however, to think that under conditions of global financialised capitalism it is impossible to implement a development strategy for a medium-sized economy, such as Greece. The experience of the last three decades across the developing world shows that it is perfectly possible to devise an effective strategy for development and growth provided that the state and the private sector strike an appropriate balance. More specifically, Greece would need to boost its industry by paying attention to domestic demand as well as by changing the composition of output in favour of tradable goods. Such a strategy would inevitably depend on strengthening the SMEs that are still the backbone of the Greek economy, at the expense of large capital. It is also imperative for Greece to strengthen its agricultural sector which has steadily declined during the years of EU membership.

In the long term the appropriate required development strategy for Greece would require a thorough revamp of the education system. In the shorter term, however, the strategy would rely on a coherent programme of public investment as well as a programme of public support for R&D. Fundamental to putting such a strategy in place would be the nationalisation of the banking system as well as the creation of publicly-owned development banks. The development banks could be originally instituted as deposit taking institutions but eventually, and as their loan portfolios would expand, they could issue bonds to provide a stable and sustainable basis for lending. Priority on loans should be given to SMEs in the tradable sectors, particularly those that would have the potential to insert themselves in international chains of value added.

vi. Democratisation and state transformation

The current state apparatus and the political parties and personnel that have run Greece for several decades are absolutely incapable of delivering these necessary changes. A Left government that sought to transform the country by relying on existing institutions would fail, and probably rapidly. Greece needs root and branch reform of both its state and polity in a democratic direction, if it is to enter on a different path of development.

In particular, the Greek state has been critically weakened during the last three decades losing a range of capabilities as a result of relying increasingly on EU mechanisms. Corruption has grown, shaped by big business interests, and frequently related to public procurement for the bloated military sector. The mechanisms of state have become increasingly authoritarian and the security forces appear to have become permeated by extreme right-wing networks. The state machinery has to be cleansed and democratised while also improving its capabilities in designing and delivering economic and social policy.

A vital part of this process would be re-establishing capacity in the economic arms of the state, above all, for the central bank and the economics ministries. Equally important would be re-establishing technical know-how on the Greek economy by reviving a host of publicly-supported research institutes that have withered away during the last three decades. Even more important would be revamping the system of justice to deal with institutional delays, corruption and inability to enforce laws in a variety of areas, including that of honouring commercial and other debts.

Political reform would be paramount to effect

these changes since the political system has thoroughly failed the country prior to and during the crisis. Greece needs new and participatory political mechanisms that are accountable and incorruptible. It also needs a new political dispensation that would include changes in the institutions of political representation, changes in its constitution and, at long last, a proper separation of church and state. Finally, the pockets of extreme right-wing authoritarianism, and even fascism, in the security forces will have to be confronted directly.

7. Aiming for a negotiated exit from the EMU

In view of the broader economic and social transformation that is necessary for Greece, the SYRIZA government should not be cowed by the prospect of default and exit from the EMU. Indeed, these steps could open up the path toward social and national regeneration by implementing the programme outlined above. Clarity is fundamental on what is possible, bearing in mind the 'impossible triad' as well as placing priority on writing off debt and lifting austerity. A government that draws its strength from its own people should not fear a potential exit from the Eurozone, if it wishes to achieve its fundamental aims. Moreover, if it succeeds, it could change Europe in favour of working people in general.

When examining the complexity and difficulty of the exit process it is important to bear in mind that, if Greece continued with the policies adopted during the last five years as a result of the bailouts, the results would be simply disastrous. "Internal devaluation" has still not given Greece an advantage in competitiveness, particularly in relation to Germany. Internal devaluation has basically meant a sharp decline of salaries, wages and pensions, which has led to a collapse of domestic demand, a vast contraction of output and eventually to falling prices. The brutality of the process in Greece has been caused, first, by the huge extent of the required adjustment – fiscal and current account deficits were at about 15% of GDP each in 2010 – and, second, by the simple fact that membership of the EMU meant that devaluation was impossible Unfortunately, it is likely that wages and salaries will have to fall further and stay low for several years, if Greece is to acquire and sustain a competitive advantage under current policies.

Thus, even after the disaster that both the Greek economy and society have suffered since 2010, the best that the country could hope for during the next five years would be average annual growth of around 2%. It is likely that prices would continue on a downward path with an inflation rate of perhaps -2%. Given the state of the current account and the persistent difficulty of increasing exports, there will be a continuing need for internal devaluation that would reduce nominal wages still further. In short, under EU policies, Greece can expect low and unstable growth, falling prices, high unemployment, falling incomes and persistent poverty. That is the true picture against which we should asses the costs and benefits of exit.

Any reasonable assessment of the current state of the Greek economy and of the general direction of the EMU during the last five years would lead to the conclusion that the preferable path for Greece in the medium term would be to exit and to restructure its economy in the interests of its people along the lines discussed in section 6 above. If exit was managed in a controlled way it could open a path to growth and social transformation by making it possible for a Left government to apply the programme of section 6. On this basis it could be reasonably expected that Greece would soon grow at a sustained and high rate for several years that would be in the inter-

ests of working people. But first it must exit the straightjacket of the Euro.

It is conceivable that determined use of state power plus social mobilisation plus some international support (the extent of which must not be exaggerated) would help the SYRIZA government to achieve a negotiated exit that would lessen the difficulties for Greece. It is also conceivable that the EU would find this prospect acceptable since the 'problem' country would exit - inevitably bearing some costs - thus leaving the rest of the EMU 'healthier'. Exit could be seen as the price paid by Greece for a debt write-off.

If exit proceeded on a negotiated basis there would be several technical ways in which the EU could ameliorate the difficulties for Greece. The legal and technical arguments circulating in 2009-12 and aiming to 'prove' that exit from the EMU was impossible, or that it would also inevitably bring exit from the EU, were largely nonsense. Exit is perfectly feasible, particularly if the EU was prepared to facilitate it. Exit from the EMU, furthermore, is not tantamount to exit from the EU, as is shown in some detail in Appendix A. When it comes to facilitating exit, moreover, note that the mechanisms of the European Monetary System, the previous system of fixing exchange rates, are still extant, and could be re-activated.

Without any illusions regarding the political disposition of the EU, which is likely to prove hostile in practice, the SYRIZA government could, therefore, propose exit from the EMU that would be beneficial to all parties and would be facilitated by the EU. More specifically, facilitation could take the form of continued provision of liquidity by the ECB to the banks for a period of, perhaps, six months to a year. Critically, facilitation of exit could take the form of supporting the exchange rate to prevent collapse until the country became capable of defending it itself. An outcome of this nature would be, by far, the optimal solution for peripheral countries and it might also be the least problematic solution for the EU itself.

Given the political and economic interests involved in the EMU, however, it is far more likely that negotiated exit would prove impossible. The lenders are unlikely to tolerate, much less to help, a Left government that would have insisted in writing off debt as well as abandoning austerity and turning economic policy into a completely different direction. Consequently, a Left government should be prepared for confrontational exit, which would also be fully feasible, though more costly. The parameters and the basic steps of confrontational exit are discussed in section 8 below. The economic conclusions are broadly applicable to negotiated exit too, though the potential friction would obviously be much less.

Finally, it cannot be overstressed that the path of confrontational exit requires political legitimacy and active popular support, if it is to be handled successfully by a government on the Left. It is important that the government should make it clear that exit would be forced on it by the EU refusing to accept reasonable terms on writing off debt and lifting austerity. It is also important to obtain open political support by putting the issue squarely to the electorate and the organised labour movement. For a Left government, securing political legitimacy and active popular support for potential EMU exit would be tasks requiring immediate political planning.

8. Confrontational exit from the EMU: Vital steps to social and economic regeneration for Greece

Confrontational exit would be a difficult process but certainly manageable as long as there was sufficient awareness of the likely problems, a degree of preparation and clear popular support. If, moreover, the issue was well understood and there was no fear of its implications, exit from the EMU could open a path to social transformation in favour of labour and against capital. Much would depend on the preparatory actions.

Some preliminary observations are necessary to put the plan of confrontational but controlled exit in context:

First – and as already noted above – exit is not in itself a solution for the problems of Greece. Exit should be understood as a difficult step forced upon Greece by the failure and intransigence of its EMU partners, which could nonetheless open a path to growth with lower unemployment and rising incomes as well as a new development path for the country with social justice. After several months of SYRIZA in power it is apparent that the programme on which the government was elected cannot be implemented within the confines of the EMU.

Second, if exit from the EMU was successfully managed by a SYRIZA government that had the strong support of the people, it could provide a historic opportunity to put Greece on a different trajectory of national independence in international relations. It could also lead to sustained growth that would place Greece in a much stronger position in the world division of labour. Exit from the EMU is a path that involves confrontation with powerful domestic and foreign interests. However, this is also the reason why exit offers Greece a unique opportunity to change its social structure in favour of its working people while entering a path of rapid growth and rising incomes. The alternative of remaining within the EMU and applying the policies designed by the 'institutions' is long-term decline for the country with rising inequality, mounting social tensions and constant pressure of debt. Greece would become an insignificant pariah in international affairs.

Third, the major difficulty of exit lies in the transition to a new and stable monetary regime that opens up fresh possibilities of development. It should be stressed that historical experience from other major monetary events indicates that the greatest difficulties would last for a relatively short period, and improvement would begin to show after a few months. In the case of Greece, which has enormous underutilised resources due to the disastrous policies of the last five years, it is reasonable to expect that the economy would begin to turn around strongly perhaps within six months.

Fourth, the difficult initial period of exit could be significantly ameliorated by clear planning and taking several decisive measures that are indicated below. The most important factor in confronting the difficulties of exit is popular determination and will. It should be clearly explained to the Greek people that, the country returned to some version of the failed policies of the last five years, the only plausible outcome would be long-term national and social decline. Exit is a short and sharp shock that is certainly manageable and could open up a new path for Greece.

Fifth, in the first one or two years following exit Greece could expect a recovery mostly based on SMEs as domestic demand would revive and the currently underutilised resources (labour, plant and equipment) would again be deployed to recapture the domestic market. The return of domestic production plus the boost to exports would reduce unemployment as well as allowing incomes to recover after the huge decline of the last five years. Given the extreme levels of pent-up demand in the country (unemployment still being above 25%) it is reasonable to expect strong growth rates soon after the exit shock.

Sixth, the recovery that would follow exit would provide the basis for the medium-term restructuring that the country desparately needs, along lines discussed in section 5 above. Greece must have a sustained investment effort supported by reform of its education system, its judicial system, the regulation of its markets and the functioning of its state. Long historical experience shows that sustained investment efforts are always based on domestic efforts and do not originate in foreign investment. Investment funds provided from abroad could play a complementary role at best.

Seventh, to generate a medium-term investment boom Greece must immediately strengthen its programme of public investment. It must also restructure its failed private banks bringing them under public management with a new spirit of supporting the reconstruction of the country's productive sector. Revived public investment and a restructured banking system would create conditions for a sustained recovery of private investment. Greece could then have a new relationship between its public and its private sector. The resources for investment, as is always the case when there is sustained development, will be primarily domestic. They will originate in the active mobilisation of saving to support credit for productive restructuring rather than for consumption, real estate and financial speculation. Restoring national sovereignty over monetary policy would allow the government to begin to generate liquidity independently and thus to facilitate the mobilisation of saving for investment. The role of a healthy and incorruptible public sector in this respect is of paramount importance as the experience of global development during the last five decades has shown.

Eighth, it is important to bear in mind that devaluations generate new and promising productive opportunities - Finland acquired Nokia following its devaluation in the early 1990s, while Iceland appears presently to be creating an electronics/IT sector following its own devaluation and banking collapse in the 2000s. There is no reason why Greece could not create new and dynamic industries in view of its highly trained and motivated workforce.

Exit from the EMU, finally, is just one step in achieving the social and economic transformation of the country – but it is a vital and necessary step. For this reason, the following steps to manage confrontational but controlled exit would be a quide to policy by the SYRIZA government.

The technical aspects of exit

1.The change of currency from the Euro to the New Drachma should take place at the close of business on a Friday evening at a time when Wall Street is closed and there is a "gap" before the opening of the Asian markets. The government should announce that:

1. All redemptions of principal and payments of interest on sovereign debt outside of the Greek payment system are suspended.

2.Greek participation in the EMU is suspended.

3.All bank operations and financial markets are closed for several days in the coming week.

4. The Greek Central Bank is placed under government control.

5. A Commissioner for Banking is appointed with full plenipotentiary powers over private and public banks.

6. A system of capital and bank controls based of the experience of Cyprus in 2013 is to be implemented for the next six months.

7. All accounts and all debts in the Greek payment system that are governed by national law are to be redenominated in the new currency at a rate of 1:1.

8. The government pledges to fulfil its obligations to all Greek agents.

2. The Lex Monetae allows a sovereign state to choose the currency it will use. Naturally, there should be no advance warning of the adoption of the new Drachma. All important decisions - from the choice of principles to be applied in the introduction of the national currency to the resolutions to be passed by Parliament - should be made over a single weekend. Parliament should give to the Government (particularly to the Prime Minister and the Minister of Finance) the widest possible powers to implement the currency reform.

3. On Saturday, the Commissioner for Banking supported by an Executive Committee should send teams of civil servants to take provisional control of Greek banks and the Central Bank to ensure:

1. Effective compliance with the system of capital and bank controls along lines specified in more detail below and in Appendix A.

2. Re-denomination of all accounts in the new currency.

3. The introduction of Drachma banknotes into the vaults of banks to begin to use in the following week.

4. Possibly the ”voucherisation” of existing banknotes by using a special stamp to allow Euro banknotes held by banks to be provisionally used as “New Drachma”.

5. In coordination with the Central Bank, the preparation of a list of Greek enterprises who have borrowed from non-Greek agents. The process should take no longer than two or three days.

4. On Saturday the government should pledge the country’s willingness to remain in the European Union and to apply its laws following the change of currency. The government should also request a conference with other EMU members to decide what support Greece could be granted for a negotiated and consensual exit. The government should furher state that Greece would also request a conference to achieve the restructuring of its national debt. The government should finally declare that any threats against Greece would have serious consequences for Greek membership of the EU and NATO.

5. The decision to suspend external payments thus allowing the national debt to go into arrears in practice means that Greece would be failing to redeem outstanding bonds held by the ECB, and failing to repay IMF loans. Debts to the EFSF and bilateral/multilateral debts arising from the bailout programme have a significant grace period; major repayments of principal and interest do not arise until 2021. After going into arrears, Greece should issue a call for an international conference to settle its debts, including a substantial write off, along lines discussed in section 5i. The Audit Commission that has already been established by the Greek Parliament could play an important role in this process, strengthening the moral and legal arguments of Greece.

6. The conversion of all bank liabilities and assets that are governed by Greek law into the new Drachma should take place at the rate of 1:1. On Monday the government will announce that it will no longer either accept or make payments in Euro. The New Drachma will have effective monopoly of legal tender by the end of the week. The government should immediately issue a full guarantee of the new Drachma-denominated deposits. During the initial weekend and for the first few days while the banks were closed, all charge and credit card transactions would be converted into the new currency. It is vital to stress that the government should take urgent steps to have new Drachma banknotes printed in secret during the period immediately before the announcement of currency change. New Drachma banknotes would be introduced into the vaults of banks to be used in ATMs and at cashier’s windows on Tuesday of the first week. Depending on the ability to print sufficient volumes of new banknotes, it would be advisable also to stamp existing Euros within the banking system to be as Drachma “vouchers“ in ATMs and at cashier’s windows.

7. During the initial weekend, the performance of banking IT systems should be audited with regard to two things: first, to determine how quickly Euros could be converted into Drachma for purposes of interbank and other electronic payments; second, how Euro cash withdrawals could be limited shortly before and after the changeover. Compatibility with the IT systems of the banks of the Eurozone should also be examined.

8. On Monday the Public Commissioner for Banking would announce the full nationalisation of the four systemic banks by converting the existing public holdings of equity into common stock with voting rights. The government should simultaneously announce the imposition of banking and capital controls to be operated by the Commissioner for a period of six months. The template would be the controls imposed by the EU on Cyprus in March 2013, which proved very effective; a summary is provided in Appendix B. It should be stressed that, unlike Cyprus, there will be no ‘haircut’ of deposits – the government will fully guarantee existing Drachma deposits.

9. For demonstration purposes, a brief example of the proposed measures for Greece would be as follows:

i.Cashless payments or transfers by natural persons of up to 50000 Drachmas (converted at 1:1 from Euros) per month are allowed.

ii.Cashless payments or transfers by legal persons of up to 200000 Drachmas (converted at 1:1 from Euros) per month are allowed.

iii.Cashless payments or transfers abroad are not allowed except for normal business activities and up to 1000000 Euros per month.

iv.Living expenses and tuition fees of people studying abroad of up to 5000 Euros per quarter are allowed.

v.Transfer of deposits/funds abroad of up to 5000 Euros per person per month regardless of purpose is allowed.

vi.Transfer of Euro notes and/or foreign currency notes originating in salary or pension payments of up to 200 Drachmas (converted at 1:1 from Euros) daily is allowed.

Anything above that would require the Commissioner's approval.

10. After nationalisation of the four systemic banks, existing management should be immediately replaced and the process of bank restructuring should commence. The restructured banks would be fundamental to providing liquidity and credit for purposes of investment and consumption, thus restarting the economy along lines discussed in section 7iii. Private banking has failed entirely in Greece. The regeneration of the economy requires healthy banks operating in a new public spirit that would be capitalised by newly issued public securities It is expected that creating such banks would take a period of several weeks. The state should also create specialised banks for long-term investment and for agriculture.

11. Fundamental to restructuring the banking system would be establishing a "bad bank" that would relieve banks from the bulk of the stock of 80bn problematic debts (enterprise, housing and consumption, roughly split into 45:25:10). The "bad bank" would be capitalised by newly-issued public bonds, after imposing losses on the private owners of banks. A committee would be appointed to apply social and economic criteria to the allocation of problematic debts to the "bad bank". It is vital in this respect for households as well as SMEs to be freed from the burden of ecxessive debt. At the same time, it important to avoid saddling the public sector with the bad debts of dishonest private operators. Equally important, nonetheless, would be not to destroy the remaining vestiges of trustworthiness among transacting parties in the various markets by appearing to favour bad debtors. That is why it is vital to establish social criteria in deciding how to write off bank debts.

12. During the initial weekend the balance sheet of the National Central Bank will be redenominated and its management will be changed - the Bank will be transformed fully into a public institution. The Greek Central Bank will remain a member of the European System of Central Banks, even after exiting the Eurosystem. However, legal advice would be necessary with regard to repaying its liabilities to the Eurosystem as well as with regard to ELA. Default for a central bank is a much more complex legal issue than for a regular bank and clearing its debts can be expected to take a long time. Finally, the Central Bank wil be recapitalised with newly issued state securities.

13. Immediately after the announcement of the change of currency, the government should offer assistance to companies and physical persons who hold contracts governed by foreign law. There will be extensive litigation involving private and public bodies for months and years to follow, and the government should be prepared to facilitate the process.

14. More generally, there will be need for economic help to SMEs, households and large enterprises for weeks and months ahead. The aim would be to avoid bankruptcies and to deal with legal complications of making payments to and receiving payments from abroad. Several among the larger Greek enterprises with activities abroad already manage their financial affairs from outside Greek territory. During the first week the government should hold a meeting with representatives of SMEs to discuss mea-

sures of support. Small and medium enterprises would be able to cover the bulk of their needs within the parameters of bank and capital controls outlined above. Individual borrowers who might hold housing and other debts governed by foreign law would also be offered help, including state guarantees.

15. Greece will regain monetary sovereignty and as long as the state persevered with making and accepting payments in the new currency, the Drachma would be rapidly re-established as the functioning money of the country. The memory of using the Drachma and its historic association with the country should greatly facilitate this process. The needs of monetary circulation will be rapidly covered by the restructured banks that will create liquidity in Drachma backed by the restructured central bank. Banks will begin current account transactions already on Tuesday of the first week. They will also begin to provide new Drachma banknotes, or stamped Euro banknotes through ATMs at the same time. They should reopen their doors to the public after the first week.

16. However, since it takes time to produce new banknotes and particularly since it takes time to acquire trust in a new currency, it is likely that during the initial period there will be parallel circulation of several forms of money. Thus, there will be new Drachma banknotes and electronic Drachma created by banks, but also regular Euro banknotes and perhaps stamped Euro banknotes circulating among private transactors. Note that at present there are roughly 40bn Euro banknotes in circulation as liabilities of the Greek Central Bank, a large part of which is certainly hoarded. The state needs to devise incentives to attract some of these banknotes into the formal banking system over a period of several months following the change of currency. It would be illegal to take these notes physically out of the country in any case.

17. Parallel circulation is likely to create transactions costs as goods will probably be valued differently in different currencies. These costs are likely to be small and would not last longer than a few weeks. They are yet another unfortunate price that Greece must pay for the disastrous decision to join the EMU. These costs would be minor and under no circumstances would they justify remaining the failed EMU.

18. The new currency would have an international exchange rate after the initial administrative conversion with the Euro at the rate of 1:1. The global markets will immediately start pricing the Drachma relative to the Euro and other currencies, as for instance happened when the rouble zone and the Czech currency unions fell apart in 1993. It is certain that the new currency would be devalued.

19. Devaluation would act as a vital lever for Greek enterprises to recapture the domestic market – since it would act as barrier to imports – and to expand exports. The retreat of real wages during the last five years has been so severe that even a relatively modest devaluation would be enough to secure a tremendous advantage for Greek producers. If the new currency stabilised at a value perhaps 20% lower than the initial floating rate of 1:1 the boost to production, employment and income in the medium terms is likely to be significant.

20. Devaluation can be expected to have beneficial effects on output and employment in Greece, for reasons that are discussed in more detail in Appendix C. The recovery of the Greek economy will probably begin within six months of the change of currency, if historical experience is a guide. There is, of course, no doubt that the initial period of disturbance will affect output and production negatively. However, the combined effect of restoring liquidity, lifting austerity and devaluing the currency should act as a strong boost to the economy. Given the highly depressed state of the Greek economy, the unused and wasted resources and the repressed demand, it is reasonable to expect the growth will be strong and sustained for years once the economy recovered from the shock of changing the currency and begins to implement the programme that was outlines in section 6. There will be strong benefits to wage labour in terms of employment and income; benefits to SMEs in terms of expanding domestic markets and sustained finance; and benefits to pensioners in terms of pension support.

21.It is unlikely that the positive effect of the change of currency will be negated by high in-

flation for reasons that are again more fully discussed in in Appendix C. It is, of course, inevitable that devaluation would also entail an increase in import prices. However, the structure of the Greek economy is such that this increase will not be fully passed through to final prices. More generally, the impact of the devaluation on inflation will depend on the response of labour costs and thus on the support offered to the government by the labour unions. Judging by the current state of the economy, which faces entrenched deflation of about 2%, and in view of the unused resources in the economy, it is unlikely that inflation in the year following the change of currency would exceed 10%.

22. It is possible, nonetheless, that in the short run the new currency would decline severely relative to the Euro and other currencies, thus having negative effects in the markets for both final goods and inputs. This risk is real in view of likely speculative attacks against the Drachma during the initial period, but it should not be exaggerated. In 2015 Greece's current account is broadly in balance due to 7 years of recession – there is no comparison with the likely effects of returning to the Drachma in 2010, when the current account faced a gigantic deficit as a result of the failed membership of the EMU. By this token the threat of a sharp contraction of domestic demand as a consequence of Greek default on external creditors and exit from the EMU is significantly lower than in 2010. Even so, it is likely that the exchange rate of the new Drachma will follow a J-curve path, declining sharply in the initial period and rising gradually toward a new equilibrium that would perhaps be 15-20% below the 1:1 conversion rate. The initial period of sharp decline, which might even reach 50%, is unlikely to last longer the two or three weeks, while the adjustment period overall will probably extend to six months.

23. There is no doubt, however, that during the time that it would take for the exchange rate to find its new equilibrium trade and financial relations with the rest of the world would be disrupted and the negative impact on GDP would be significant. That is the most difficult part of exit and it would require preparation and full information given to the public. The ability to defend the exchange rate in the short run would, therefore, be very important. Capital controls would, of course, act as a significant barrier to speculation. Nonetheless, it would be highly desirable if a stabilisation fund was put together, perhaps with support from key central banks. It is of paramount importance for the SYRIZA government to make whatever efforts it can even at the final hour to secure such support. Note also that capital controls are likely to prove important in the medium term if the balance of trade turns in favour of Greece and capital inflows occur that are likely to boost the Drachma, thus eliminating the positive effect of the devaluation.

24. Following exit, Greece would recover monetary and fiscal sovereignty. This would immediately create domestic ability to generate liquidity and thus to remove the stringency from the Greek economy. Furtheremore, austerity should be lifted, but the country should also commit itself to pursuing a disciplined financial and monetary policy particularly in view of the small size of the Greek economy and its membership of the EU. Some guidance in dealing with a floating exchange rate could be obtained from other countries, including Sweden which operates a floating currency within the EU. It is important that minimum wages are raised but, equally, the trade unions must lend their active support to the effort to put the country on a new foundation. It would also be important to adopt measures to protect workers' incomes by abolishing high taxes on consumer goods (for instance, food, electricity, petrol), by providing increased social protection to the weaker strata of wage labour and the middle class, and by regulating key prices, inclusing the rental cost of housing. Once the country begins to recover from the disaster of EMU membership, incomes can be expected to enter an upward path, especially if the alternative programme is implemented.

25. Currently Greece is close to a primary fiscal surplus, following years of recession and heavy cuts in public spending, as was explained in section 7ii. Following exit the country would not have to make the damaging debt payments to the ECB and the IMF, but it is likely that the primary surplus would disappear in the short run as tax revenue would probably decline. In the medium term, however, Greece needs a strong policy of public investment to improve its infrastructure

and to give a boost to private investment and to output. To deal with its financing needs the government might have to seek recourse to central bank financing, in view of regaining sovereignty over monetary policy. There is nothing inherently wrong with issuing money to support fiscal expenditure, if it is done carefully and for short periods of time, as recent experience in the USA, Japan and the UK has shown. There is little reason to expect that it would lead to rapid inflation, particularly in view of the heavily depressed state of the Greek economy that has faced 25% contraction in output since 2008.

26. The huge stock of 77bn Euros of unpaid obligations of the public to the state (taxes, fines and so on) should be cleared by applying social criteria. The great bulk of the individual cases of unpaid obligations comprises sums below 5000 Euros that have accumulated during the crisis. Equally though, the great bulk of the debt in money terms (perhaps 60bn Euros) is owed by a few thousand large debtors, mostly enterprises but also natural persons. In practice very little of the 77bn is actually collectible – perhaps up to 10bn Euros. The SYRIZA government has already made progress in this regard by passing legislation that relieves the great bulk of small debtors, while encouraging large debtors also to pay. It is also clear, nonetheless, that the tax-collecting processes of the Greek state and attendant corruption must be rapidly confronted along lines discussed in 7ii.

27. Finally, provisioning of key markets – medicine, food and fuel – would become a significant issue in the very short run. Administrative measures would probably be necessary to secure access to key goods for industry and the most vulnerable social groups. There would be no need for rationing in the sense of coupons, or ration cards for the population. The measures should be taken to ensure preferential access to medicine, food and fuel of the most vulnerable and economically important groups. It will be a case of prioritising need and economic importance. Note that access to fuel, medicine and food have already become deeply problematic for vast layers of working people as a result of the collapse of incomes. Note finally that the current account is practically balanced, and thus the country has reasonable ability to pay for its imports.

28. In dealing with the problem of key markets it is also important to realise that there is currently huge underutilised capacity in terms of both labour power and means of production, which could be rapidly put to use to provision domestic markets. Greece already has significant coverage of key food supplies from domestic sources. Moreover, it has good domestic coverage for energy to produce electricity, but it would certainly need an interstate agreement to boost the availability of car fuel. Greece, finally, has good domestic coverage of medicines, and it would be possible immediately to prioritise key imports of urgently needed drugs, including cheaply available generic drugs from a variety of suppliers across the world.

29. Exit and the social transformation that would follow it would create winners and losers across the country. Note first that the austerity policies followed since 2010 have imposed the great bulk of costs on wage labour and on the middle class, leaving the upper middle class and the rich practically unharmed. Exit would give the opportunity to deal with the crisis by imposing the costsoin the rich, while supporting working people and the middle class. To be sure, exit would lower the purchasing power of bank deposits relative to imports, but it would also lower the value of bank loans, thus benefiting the middle class. The rebound of production would protect wage labour by lowering unemployment and gradually leading to higher incomes. Recapturing the domestic market would be in the interest of SMEs, which are the backbone of the Greek economy. In the medium-term the winners from exit, assuming that the alternative programme discussed in section 7 is implemented, will clearly be the workers and the middle class of Greece. By this token, the losers of exit will be the banks and the associated big-business interests that have run the country for decades, which are the strongest supporters of remaining in the EMU.

APPENDIX A

A legal addendum on the complexities of EMU exit

The «euro» constitutes the introduction of a federal element into the structure of the European Union. Therefore the course of the single currency is inalienably associated with the Principles and Values (1) of the European Union with regard to operating a free market through undistorted competition but also to providing for the well-being of the people, full employment, social cohesion and solidarity among the member states.

It is certain that on issues concerning imperium for persons and dominium for things, on issues, that is, which concern sovereignty (2), the legal side also comes forth in addition to the political issue. Namely, whether the renunciation of sovereignty serves the imposed «federal rationale», or whether the renunciation of sovereignty by a member state, especially concerning its currency, entails a corresponding increase of sovereignty by a third member state, within the framework of the Monetary Union.

Certainly, for accession to EMU, in addition to the stages that had been provided for, certain criteria had also been stipulated concerning inflation, budget deficiys and the public debt (3). As to the part that concerns Greece, despite the fact that it did not initially meet the criteria to join the Eurozone, nonetheless, Greece "succeeded" in adopting the euro as its national currency by subsequent decision of the Council -2000/427/EC (4).

• The issue of withdrawal

In view of the overall structure and the regulations of the Monetary Union, it is clearly feasible for a country to exit, both in the instance of failure of the Stability Pact due to weaknesses in budget discipline, and in the instance of a more general financial disturbance that would perhaps lead to the inability of a member state to respect its commitments, or even worse it drive its society toward a humanitarian crisis. It should be noted that the emergence of a humanitarian crisis goes against the principles and provisions of the EU legal system (5).

In this context, the question arises on the "technical manner", from the legal point of view, of exit of a member state from the euro area.

The feasibility of exit, which includes even the unilateral withdrawal of a member state from the euro area, may be based by the member state, initially, on the provisions of art. 61 and 62 of the Vienna Convention on the Law of Treaties. These articles provide, within the framework of pragmatic Public International Law, the possibility of termination of a Treaty on the grounds of radical and unforeseen situations (clausula rebus sic standibus).

This means that the member state wishing to withdraw from the Eurozone unilaterally may claim subsequent failure to implement the Convention, as well as fundamental change of conditions compared to those prevailing at the time of stipulation, and moreover that such a change was not provisioned for, nor was it possible to be provisioned, by the parties. Therefore, the member state wishing to withdraw unilaterally from the euro area, may advance the essential consideration of radical change regarding the extent of obligations remaining to be fulfilled.

That having been said, three timely and dominant legal questions could be raised a priori:

> A) whether legal provisions are in place, on the basis of which a member state of the Eurozone could possibly be expelled from the union
>
> B) whether legal provisions are in place on the basis of which a member state of the Eurozone could possibly withdraw voluntarily from the union
>
> C) whether a voluntary withdrawal from the Eurozone assumes or requires necessarily theexit of the member state from the European Union.

The answers are given by the overarching stringent provisions of the Lisbon Treaty, which is composed of two equivalent Treaties (of equal

validity), that concern the primary EU law. Therefore mention is made: a) of the rules of the Treaty on European Union (TEU) and b) of the rules of the Treaty on the Functioning of the European Union TFEU).

• To the first question the answer is as follows:

The overall articulation of the relevant provisions of TFEU creates an unyielding set of legal rules which expressly check the expulsion of a member state from the Eurozone.

Out of the overall articulation of the relevant provisions the expulsion of a member state without its joint action is not provisioned and is not legally possible. Such a conclusion results primarily from para. 3 art. 140 TFEU (6), as well as from the Regulation of Introduction of the Euro (974/98), with which the parity at which the euro replaces the currency of the specific state is stipulated “irrevocably”.

The Regulation on the introduction of the euro (974/98) could be substituted only through an actus contrarius. However the primary EU law does not provision authorization for initiating such an actus contrarius.

Potentially it would be “advanced” that the expulsion of a member state from the Eurozone may take place through recourse to art. 352 TFEU. This provision stipulates the necessity for fulfilment of the EU objectives for which, however, no Action of the EU Organ has been stipulated. However this provision stipulates unanimity. Further, such a procedure that concerns expulsion of a member state from the Eurozone, infringes also the provision of art. 5 TEU regarding delimination of competences, under the principle of conferral.

Therefore the EU law and order does not provide legal basis for expulsion of a member state from the euro area.

However within the framework of the Public International Law the EU Organs cannot invoke the Vienna Convention, which nonentheless could be invoked by the member state alone wishing to withdraw from the Eurozone. The EU Organs cannot take recourse to the provisions of arts 61 and 62 of the Vienna Convention as they are bound under the more specific provisions of the primary EU Law, more specifically so by the provisions of articles 7 TEU and 126, 258 and 259 TFUE which void the right of the EU Institutions to invoke the above mentioned Vienna Convention provisions.

Therefore withdrawal from the Eurozone at the initiative of the EU Institutions is expressly excluded.

On the contrary, a consensus decision based on art. 50 TEU and art. 352 TFUE in conjunction with articles 61 and 62 of the Vienna Convention, without prejudice to para. 2 art. 4 EU Treaty, constitutes an adequate legal basis for withdrawal of a member state from the Eurozone.

• To the second question – which correlates with the third one – the answer is as follows:

1) TEU (7) for the first time lays down the possibility (of total) withdrawal of a member state from the European Union, in accordance with its constitutional requirements (8). Such a possibility concerns a member state that participates in the Eurozone and also a member state which does not participate in the Eurozone.

2) In view of the above, regarding the withdrawal of a member state from the Eurozone, recourse can be sought by analogy with the current provision of art. 50 EU Treaty. In this provision the major is stipulated, that is, the total withdrawal of a member state from the European Union. In the major is, evidently, incorporated the minor in relation to withdrawal from the Eurozone (partial withdrawal). This ratio is provisioned by the standards of jurisprudence based on the principle that: since no express provision exists to the contrary, it is certain that the minor is incorporated in the major. Therefore it is an inalienable right to exercise the minor right that concerns unilateral withdrawal of a member state from the Eurozone, without implying the that the member state will be separated from the legal personality (9) of the European Union.

Express annotation –ad rem

1) While the accession of a member state to the

European Union does not necessarily involve its accession to the Eurosystem, in a like manner, a contrario, the withdrawal of a member state from the Eurosystem does not necessarily involve its exit from the European Union.

It should be noted that the German Constitutional Court (10) in its well-known decision on the Maastricht Treaty, took a clear stance on the possibility of Germany leaving the Maastricht Treaty, if it is ascertained that the EMU goals have failed.

2) In any case the withdrawal from the Eurosystem does not lead to exit from the Ecofin, to which all member states of the European Union participate. In the instance of withdrawal from the Eurosystem, however, the participation of the member state to Eurogroup (11) is annulled, to which only the Eurozone member states participate.

3) Also, in so far as it concerns the Central Bank of the member state withdrawing from the Eurosystem it is clear that it continues to be integrated and operating within the framework of the European System of Central Banks – (ESCB) (12), in which all countries of the Europoean Union participate, whether or not they have adopted the euro as their national currency. It should be noted that the European Central Bank and the National Central Banks constitute the European System of Central Banks (ECB). The European Central Bank and the National Central Banks of the member states within the Monetary Union constitute the Eurosystem and implement the monetary policy of the Union. The European Central Bank has been accorded a legal personality.

Finally, neither the Eurogroup, nor the Ecofin or the ESCB form institutions of the European Union according to article 13 of the EU Treaty. On the contrary (for the first time under the Lisbon Treaty) the European Central Bank is an institution of the European Union.

In conclusion, the basic duties of ESCB are defined in para. 2 article 127 TFUE.

In addition to the foregoing, the overall concept of withdrawal from the Eurosystem falls under the Principle of Proportionality (13) where the strict requirements of the EU law and order are in force, according to the provisions of article 5 para. 4 TEU of Protocol 2.

The content and the form of action of the European Union in the instance of withdrawal of Greece from the Eurozone may not exceed the measures required for the attainment of this goal, nor to infringe indirectly the strict provisions of the EU law and order since the target of the European Union is to promote its values and the prosperity of its citizens in accordance with para. 1 article 3 TEU.

It should not be forgottent that, historically, a consensual exit from the European Union has already been recorded, that of Greenland (14).

NOTES

1. See. Arts 2, 3 and 6 TEU.

2. Besides: «the power of the state to mint a currency is derived only from its imperium, which constitutes an element of the concept of the State (sic)» see H.Krispis "The payment obligation", 1964, p. 4.

3. See article 126 TFEU in conjunction with Prtocol No. 12, also comp. articles 3 para. 1, item c, 119 para. 2, 128, 137, 140, 219, 282 para. 3 and 320 TFEU.

4. E.E. 2000, L 167/1

5. See, indicatively, arts 2, 3 para. 1,2 and 3 and art. 6 TEU as well as arts 151 to 161 TFEU.

6. Also see indicatively arts 120, 126 and 137 TFEU.

7. See art 50 EU Treaty

8. Comp. Art. 4 para. 2

9. See. Art. 47 TEU in conjunction with art. 335 TFEU.

10. See BVerCE89, 155. Also see D.Papagiannis, European Law, 2011, p. 602.

11. See art. 137 TFEU and Protocol 14.

12. See arts 127, 129, 282 para. 1, 284 TFEU.

13. See. G.De Burca, "The Principle of Proportionality and Its Application in EC Law," 13 Y.B. Eur. L. 105, 1993, N.Emiliou, The Principle of Proportionality in European Law: A Comparative Study, London: Kluwer Law International, 1996, T.Franck, "On Proportionality of Countermeasures in International Law," 102 Am. J.Int'l L. 715 , 2008, V. Jackson, "Being Proportional about Proportionality," 21 Const. Comment, 803, 2004, M. Kumm, "Democracy Is Not Enough: Rights, Proportionality and the Point of Judicial Review", New York University Public Law and Legal Theory, Working Papers, Paper 118, 2009)

14. Withdrawal of Greenland took place prior to the Maastricht Treaty and prior to enactment of the Lisbon Treaty rule where (as previously stated) for the first time are instituted provisions of voluntary withdrawal.

APPENDIX B

Restrictions applied in Cyprus, March 2013

a) The cashing of cheques is prohibited.

b) The following are permitted:

(i) cashless payment or transfer of deposits/funds to accounts held in other credit institutions within the Republic up to €50.000 per month per natural person in each credit institution regardless of the purpose.

(ii) cashless payment or transfer of deposits/funds to accounts held in other credit institutions within the Republic up to €200.000 per month per legal person in each credit institution regardless of the purpose.

(iii) cashless payment or transfer of deposits/funds to accounts held in other credit institutions within the Republic for the purchase of goods and or services regardless of the amount :

Provided that the cashless payment from one credit institution to another, for a person's own account is not permitted:

Provided further that the credit institution may request justifying documents if it is deemed necessary.

c) Cashless payment and or transfer of deposits/funds to accounts held abroad are prohibited, with the exception of:

(i) transaction that falls within the normal business activity of the customer upon presentation of justifying documents as follows:

(aa) payment and or transfer of deposits/funds of up to €1.000.000 per transaction, is not subject to the Committee's approval:
Provided that each credit institution shall ensure that the justifying documents presented in each case, justify the execution of the payment and or of the transfer of deposits/funds.

(bb) payment and or transfer of deposits/funds above €1.000.000 per transaction, is subject to the Committee's approval. The relevant credit institution shall submit to the Committee a request for each such payment and or transfer of deposits/funds as well as the necessary justifying documents. The relevant payment institution may submit to the Committee a request for each such payment and or transfer of deposits/funds and the necessary justifying documents and the name of the credit institution involved. The Committee in taking its decision takes into account the justifying documents and the liquidity buffer situation of the credit institution. The Commit-

tee's decision is communicated to the credit institution in every case and to any relevant payment institution.
Provided that the Committee may request information for payment and or transfer falling within the category of section (bb).

(ii) payments for salaries of employees upon presentation of supporting documents.

(iii) living expenses up to €5.000 per quarter as well as tuition fees, of a person who is studying abroad and is a first degree relative of a Cyprus resident, on the basis of supporting documents:

Provided that payment and or transfer for living expenses shall be allowed only upon submission to the relevant credit institution of documents establishing that the person receiving the payment and or transfer of deposits/funds is studying abroad and is a first degree relative of a Cyprus resident:

Provided further that tuition fees shall be paid only to the beneficiary educational institution, upon submission of the relevant justifying documents:

Provided still further that the credit institution maintains a catalogue in which it records and monitors all payments:
Provided still still further that the Committee may require the submission, to its attention, of the catalogue mentioned in the above proviso and or information on any payment and or transfer which falls under case (iii).

(iv) transfers of deposits/funds outside the Republic up to €5.000 per month, per person for each credit institution and or payment institution regardless of the purpose.

d) Sums transferred from a fixed term deposit to a sight/current account shall be subject to the restrictive measures applicable to sight/current accounts.

e) Exports of Euro notes and/or foreign currency notes are prohibited in excess of €3.000, or the equivalent in foreign currency, per natural person per journey abroad.
The Director of Customs and Excise Department shall ensure the implementation of this measure.

f) Every financial transaction, payment and or transfer which has not been completed prior to the entry into force of the Enforcement of Temporary Restrictive Measures on Transactions in case of Emergency First Decree, of 2013 shall be subject to the restrictive measures provided in this Decree:
Provided that any financial transaction, payment and or transfer, which has not been processed by the credit institution prior to the entry into force of the Enforcement of Temporary Restrictive Measures on Transactions in case of Emergency First Decree,
of 2013 shall be cancelled and will have to be submitted anew.

g) Credit institutions shall not facilitate the circumvention of the restrictive measures.

h) The restrictive measures apply to all accounts, payments and transfers regardless of the currency denomination.

i) It is prohibited to transfer Euro notes and/or foreign currency notes, in areas of the Republic, where the Republic does not exercise effective control, in excess of the amount of –

(i) €300 daily or its equivalent in foreign currency, per natural person who has its permanent residence in the Republic:
Provided that, in the case a natural person resides in areas of the Republic where the Republic does not exercise effective control, the transfer of Euro notes in excess of €300 is permitted, if the Euro notes originate from a salary payment, in the areas where the Republic exercises effective control, upon presentation of justifying documents,
(ii) €500 daily or its equivalent in foreign currency, per natural person who has its permanent residence abroad.
The Director of Customs and Excise Department shall ensure the implementation of this measure.

j) The opening of a new account for any person who is not an existing customer of a credit institution on the date of entry into force of the Enforcement of Temporary Restrictive Measures on Transactions in case of Emergency Sixth Decree of 2013, is prohibited unless-

(i) the account will only be credited with funds transferred from abroad to the Republic, or

(ii) the prior approval of the Committee is obtained or.

(iii) The account is a new fixed term deposit created with funds from cash provided that

(aa) the amount to be deposited exceeds €5.000 and
(bb) the new fixed term deposit cannot be terminated prior to its maturity.
Provided that upon the first maturity of the fixed term deposit the funds from the fixed term deposit will not be subject to the restrictive measures imposed by sub-paragraph (b) of the Decree:
Provided further that the opening of a current account for the beneficiary/beneficiaries of the fixed term deposit is prohibited, or

(iv) The account relates to a new loan granted after the entry into force of the Enforcement of Temporary Restrictive Measures on Transactions in case of Emergency Nineteenth Decree of 2013:
Provided that the opening of a current/sight account related to the new loan is permitted and the funds in the current/sight account can only be used for the servicing of the loan and for the regular activity of the customer and not for depositing purposes:
Provided further that the credit balance of the current/sight account, cannot at any time exceed the amount of the loan balance:
Provided even further that the loan proceeds must be disbursed into a current/sight account, within the same credit institution, within the Republic and shall be subject to the prevailing restrictive measures. The funds in the current/sight account can be deposited in cash or be transferred from an account abroad or from other accounts within the Republic, subject to the prevailing restrictive measures.

k) It is prohibited to add new beneficiaries in a current/sight account unless the prior approval of the Committee is obtained.

Exceptions:

A. All money transferred from abroad to the Republic.
B. Withdrawal of cash using credit and or debit and or prepaid card issued by foreign institutions on accounts abroad.
C. The cashing of cheques issued on accounts held with foreign institutions abroad.
D. Cash withdrawals from accounts of credit institutions with the Central Bank.
E. Payments and receipts of the Republic.
F. Payments and receipts of the Central Bank.
G. The foreign diplomatic missions and the UN missions in the Republic based on the exemptions specified in the Vienna Convention for Diplomatic Relations and the Agreements between the Republic and the United Nations and other international Agreements which have precedence over national legislations.
H. The payments via a debit and or credit and or prepaid card.
I. Transactions or payments that have been authorised by the Committee.

APPENDIX C

The risk of inflation following devaluation of the new currency

Would the nominal devaluation of the new Drachma lead to inflation rather than to an output boost? The concept that is important in this connection is “pass through” which generally captures the impact of devaluation on inflation. The pass-through includes:

1) transmission from higher price of foreign currency to the price of imports;

2) transmission from the price of imported materials and goods to consumer prices;

3) transmission from the price of imports to the price of output, and hence of consumption goods and exported goods;

But it is important to note that, in fact:

1) import prices are only one component of the Consumer Price Index, raw materials are only one among many input classes, and so on;

2) the short-run elasticities of demand are always lower than the long-run ones. Moreover, the adjustment may take years, owing to price sluggishness.

In historical experience – particularly in large-scale devaluation episodes – the pass-through has typically been less than one, and the nominal realignment of prices has not cancelled the effect of devaluation by causing inflation. Nominal devaluations typically lead to real devaluations, and thus have positive effects on trade and output. Needless to say, this only holds when the Marshal-Lerner conditions on demand elasticities also also satisfied. There have been exceptions to this experience, such as Mexico, where the real effects were transitory, and Latin American countries, where the pass-through was greater than one, thus the benefits of nominal devaluation were quickly eroded by inflation. But the historical record is clear: devaluations generally work.

In the case of the Greek economy the empirical literature indicates that a nominal devaluation is likely to lead to a real devaluation, and thus have a positive effect on output, instead of leading to major inflation. The following points on the Greek economy support this claim:

1) in most studies the Marshall-Lerner conditions are satisfied;

2) the long-run pass through of a nominal devaluation to import prices appears to be relatively high in aggregate studies;

3) the Keynesian multiplier is rather large standing at around 1.5.

In the aggregate it is true that the long-run pass-through of nominal exchange rate to import price for the Greek economy approaches unity. However, this does not imply that a nominal devaluation would traslate one-to-one into inflation (thus canceling the benefits of the nominal exchange rate adjustment). On the contrary, it could be expected that the short-run effect will positive for output, and thus employment. The reason is that there is significant differential price-stickiness, which creates a lag between currency devaluation and inflation. This stickiness evidently depends on the structure of the branches of production and on the production process itself, since relative prices would change greatly after the devaluation. Basically, branches of production where inputs are Greek-produced, and branches that work under strong competition would raise their prices by less than others. Note also that some areas of the service sector are known to adjust very vast, mostly in the tourist sector, which is very important to Greece.

Mariolis and Katsinos, who have produced the only significant study of devaluation for Greece that is disaggregated at industry level, indicate that the pass-through is not equal among the different industries, with energy products being obviously the most affected. They estimate that it takes five years for a 50% nominal devaluation to produce a 45% increase in the energy sector prices. Even in that case it would be possible for the Greek government to manage the price increase by reducing excise taxes, particularly if the economy resumes growth. Mariolis and Katsinos generally conclude that a devaluation would have a strongly positive effect on Greek output. According to their analysis the effects on inflation are likely to be very modest: in the worst possible case, annual inflation would be expected at just above 9%, declining to just over 2% five years later.

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