THE GREEK EURO TRAGEDY

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On 4 February 2015, the European Central Bank (ECB) unexpectedly and suddenly cancelled acceptance of Greek bonds as collateral for liquidity funding unless Greece obeyed the Troika agreement.

The ECB's irresponsible and incompetent actions call into question their respect for the Greek government's attempts to resolve its debt crisis in a sustainable way. The ECB may or may not have good reasons to cut off Greece, depending on your point of view, but it is clear that such a move would be political. A central bank that is supposed to be the lender of last resort and guardian of financial stability would be taking a deliberate and calculated decision to undermine the Greek banking system. The ECB is now seen in some quarters as arrogant, unaccountable and authoritarian.[1]

This Strategic Update discusses the most recent problems for the Eurozone, namely the Greek crisis and the European Central Bank's (ECB) lack of democratic accountability which has contributed to considerable difficulties for the stability of the Eurozone.

The policy designed for the rescue of the Greek economy, was in fact intended to punish the country for its alleged "profligacy," rather than serve as a way out of the crisis. If the Eurozone and the EU cannot resolve a relatively small problem the size of Greece, what is the point of Europe as a political and economic concept? It is worth asking again at this critical stage who is most to blame, because that question is so often asked in the wrong way.

Greece's Syriza party was composed of inexperienced politicians who would in normal circumstances have been a minority party on the opposition benches without the responsibility of government. It is therefore not surprising that members of the party made unrealistic decisions, and that they lacked judgment due to their limited experience. So the question therefore really is who was on the other side of the negotiations? There were many experienced prime ministers, finance ministers, and high level technocrats with years of experience at domestic, European and international politics. In fact, a highly talented group with skill and expertise, which has produced what? The unresolved Greek crisis in the Eurozone.

The Euro, although ‘a currency without a state’, is backed by significant political and even state-like commitments. That the Euro must be saved at all costs is an imperative suggested not only by ECB president Mario Draghi, the technocrat, but German chancellor Angela Merkel, the statesman. Political elites, particularly in Germany, have staked their legacy on its success.[2]

But there is a growing mismatch between the monetary and fiscal sides of the Eurozone governance system and this has led to a number of problems. The main problem is that, while we may not find it easy to live with the ECB, we cannot live without it. Yet, when we look at the Greek bailout programmes, it is easy to conclude that they have failed. The Troika has imposed austerity, which has led to a severe contraction of output and highly adverse welfare effects. This was intended, in a way, to punish Greece for its profligacy rather than serve as a way out of the crisis.[3]

The ECB is far more independent than the US Federal Reserve, whose legal status is far weaker and which is directly accountable to Congress and the government. The ECB was supposed to be like the German central bank, the Bundesbank. It has, however, failed to emulate the distinctive attributes that made the Bundesbank successful, such as accountability and interdependence with other democratic institutions. The Maastricht Treaty, which defines the role of the ECB, says that the ECB has a primary mandate to maintain stable prices. It also says that, “where it is possible without compromising the mandate to maintain price stability”, the ECB will also support the “general economic policy of the EU” which includes, among others, “steady, non-inflationary and environmentally friendly growth” and “a high level of employment”. However, the emphasis is explicitly on price stability. The ECB can justly claim to have held together a poorly designed system in difficult circumstances. But the mission creep is its own responsibility.

The ECB, in fact, is the least accountable central bank among advanced nations.[4] There is no democratic accountability when the ECB strong-arms governments into policy actions that go well beyond any reasonable interpretation of its mandate. Not only is the ECB shielded from politicians, ECB statutes have also placed it beyond the reach of democratic rules on bad behaviour. The ultimate control politicians have over a central bank is the power to change its statutes and the power to appoint governors. For example, in the case of Germany, a simple majority in the Bundestag can change Bundesbank law. This procedure is absent in the Eurozone. The statutes of the ECB can only be changed by revising the Maastricht Treaty, which requires unanimity of all member states. The ECB today argues that the only institution that has the right to limit its power is the European Court of Justice, which has an activist Europhile interpretation of European treaties. The crisis has given the ECB governing council such an increased power that no national government or national institution can match it.

The project of European integration was not designed democratically, or at least not in the way democracy is traditionally conceived in terms of placing ultimate law-making authority in the hands of the people or their elected representatives. It is not even meant to be democratically responsive in the way that term is usually understood. Any democratic deficit that the EU suffers seems to many observers a deliberately constructed one. So how could we control the ECB in the future? It needs to be placed under a stricter and more direct supervision by democratically elected politicians. One of the institutions the president of the ECB puts himself in front of, the European Parliament, does not inspire anyone to believe that the ECB is being held accountable. This very independence means that democratic governments now have no way to keep the ECB accountable if it starts to violate its mandate.[5]

With almost prophetic insight German economist and former president of the Bundesbank Karl Otto Pöhl wrote in 1988:

> *In a monetary union with irreversibly fixed exchange rates the weak would become ever weaker and the strong ever stronger. We would thus experience great tensions in the real economy of Europe ...*
> *In order to create a European currency, the governments and parliaments of Europe would have to be prepared to transfer sovereign rights to a supranational institution.*[6]

The ECB's new policy focus arguably makes sense, up to a point. However, the change in its mission introduced by Outright Monetary Transactions has profound political consequences. The ECB has become more powerful than the Fed, but with even less democratic oversight. In the early stages of the crisis, the ECB exercised its influence through secret letters to troubled member states such as Ireland and Italy, laying down conditions and implicitly threatening to withdraw support if they were not met. Now, the bank exercises its power directly and in public.[7]

DEMOCRACY PLAYS SECOND FIDDLE TO TECHNOCRACY

At the moment, the ECB is both politicized and free from external political control. In principle, it is hard to see how this is sustainable over the long term. Politicians and bureaucrats are already crafting proposals to introduce greater democratic controls over economic policy. But it is equally hard to see how things can change, given Germany's principled attachment to central bank independence, and its entirely practical attraction to an arrangement under which the EU's more troublesome states will be disciplined without Germany getting all the blame. If the history of Europe is any guide, then such apparently irrational arrangements can persist for a very long time indeed.[8] What it means, rather, is more of the same sub-optimal performance that has plagued Europe since the crisis began, including sluggish growth, persistent unemployment and financial instability. The Eurozone will endure, but it will not prosper.[9]

In November 2010, in a letter to the Irish Finance Minister, the ECB threatened to cut off liquidity support for Irish banks unless the government agreed to a financial assistance programme with the EU and the IMF.[10] The letter also made demands in the areas of fiscal austerity and structural reform that were not only beyond the ECB's remit but were also wrong for Ireland's circumstances.

The ECB threatened to decline its responsibility in seeking to force the Irish Government into the Troika programme in November 2010, and threatened again (this time under Draghi's leadership) in the case of Cyprus in 2013. It is unclear whether the ECB's role in designing and monitoring programme conditionality relating to fiscal policy and structural reforms is consistent with its legal mandate.

The ECB should explain why it was necessary for it to be a formal member of the Troika group. The history of ECB involvement in Ireland and in the 2015 Greek crisis shows that as long as its lender of last resort role remains as confused as it currently is, questions about whether the ECB is acting beyond its legal mandate and becoming overly involved in political and economic policy will provoke questions about its legitimacy and unaccountability.[11]

On 28 June 2015, the ECB capped the availability of liquidity support to Greek banks deemed solvent by its supervisory arm as they faced a depositor run. They had to close, and the Greek government had to impose exchange controls.

While the ECB's hard-money mandate is immutable and the Bank is far more 'independent' than was even the Bundesbank, this very independence means Germany now has no way to keep the ECB accountable if it starts to violate its mandate. The Governing Council can at any time, with a majority vote, decide the fate of at least half a dozen governments, supporting them or bringing them down – and that number is increasing. The ECB has to be placed under a stricter and more direct supervision by democratically elected politicians. The independence of central banks had initially been granted in order to enable them to provide their core product – monetary stability.[12]

The ECB is the least accountable central bank among advanced nations. Its degree of independence has only one precedence: the Reichsbank, a central bank with one of history's most disastrous records. This sounds a strong note of caution, as a number of important issues require further research, before a hasty decision is made by any country about handing over monetary policy control to the ECB.

Now the European project is in real trouble with out-of- touch domestic and European political elites and an establishment unable to address the concerns of public opinion. Many people no longer trust mainstream politicians, EU technocrats and elites in general. They seem captured by vested interests and incapable of improving the life of ordinary people, let alone setting out a compelling vision of a brighter future. Politics is turning nasty, fractious and inward-looking – with unpredictable consequences.[13]

The ECB's deep involvement in the fiscal affairs of distressed European Monetary Union (EMU) member states raises serious questions about its policy independence, despite the protections of the Maastricht Treaty. As a member (along with the European Commission and the IMF) of the Troika assessing the Greek, Irish and Portuguese fiscal programmes, the ECB's credibility depends at least partly on the evolution of those programmes.

Concerns about a sovereign default and ensuing contagion have led ECB officials to favour restructuring schemes that effectively undermine the risk-mitigation role of credit default swaps.[14] And the ECB has agreed – partly in response to pressure from EMU member states – to forgo profits on its Greek debt holdings in order to lower the costs to EMU countries of the second Greek bailout. The fig leaf of not accepting losses on the Greek debt – and thereby not engaging in monetary finance of a distressed government – is unlikely to persuade sceptics of ECB independence. Finally, the ECB's unlimited supply of *long-term* liquidity to Eurozone banks, beginning in December 2011, was only a modest step from the more direct acquisition of government debts. In various ways, the ECB lowered the bar for future interventions in the debt of fiscally distressed member states. The ECB's policy of quantitative easing (QE) has been buying government bonds of the Eurozone countries since March 2015.

The ECB has bought about €645 billion in government bonds. And it has announced that it will continue to do so, at an accelerated monthly rate, until at least March 2017. Greece is excluded from the QE programme, and thus from the debt relief that arises as a result of this programme. It would be wise to allow the QE programme to include Greece which is struggling under the burden of high levels of unstainable debt in the same way as the other Eurozone countries that have been enjoying stealth debt relief organised by the ECB.[15]

THE GREXIT CONUNDRUM

When German finance minister Wolfgang Schäuble placed the possibility of 'Grexit' on the table, the nature of the game change fundamentally. He dispelled the illusion that the Euro is irreversible for each and every country.[16] Even though it is too early to say precisely where this will end, it will be suggested in conclusion that this signposts a fundamental but as yet uncharted mutation in the constitution of EMU: The Euro is irreversible not in its composition, but in its ideology. In other words, in the final battle, austerity wins.

The governor of the Central Bank of Greece, Yiannis Stournaras wrote his annual report and forwarded it to the Greek Parliament and Tsipras' cabinet. Never before has such a "monetary policy" report been published by the central bank of a developed country, or indeed any country. It is a political assault on its own elected government.[17] Zoe Konstantopoulou, the speaker of the Greek parliament, rejected the document as "unacceptable". Furious Syriza MPs called it an attempt to strike terror. Yannis Stournaras, the central bank's governor, is not a neutral figure. He was finance minister in the previous conservative government.[18]

In the power struggle between Greece and its creditors, the ECB was stoking the bank run as a means of applying pressure to the Greek government. The ECB seemed to make the same sort of 'offer you can't refuse' that it made to bring Ireland and Cyprus to heel: that bank support in the form of the ELA would be withdrawn (leading to a collapse of the banking system, and in Greece's case, a disorderly 'Grexit' of capital controls, nationalization of banks, and issuance of drachma to fill the banks' balance sheet hole) unless the government took specific actions set forth by the ECB. Given the much greater size and visibility of the Greek crisis, it is unlikely for the ECB to engage in this type of pressure unless (or perhaps more accurately, until) it has plenty of political cover. Nevertheless, the Greek central bank report seemed to be an effort to pour gas on the ongoing fire of the bank run, particularly since Greek citizens were losing confidence in the Syriza negotiating strategy.[19]

Discussions of 'Grexit' were given credibility by the fact that an extended period of capital controls would possibly lead the Greek government to decide to introduce its own currency. Members of the ECB Governing Council, including Executive Board member Benoit Coeure, encouraged the perception that this process could end with Greece leaving the Euro by freely admitting this was a possibility. ECB officials insisted that they were being forced by their own rules to cut off liquidity support for Greek banks. This is simply untrue.[20]

With a focus on the solvency of the Greek banks and the need to encourage financial stability, the ECB and European governments could have handled the situation in Greece in a very different manner. As long as the ECB's lender of last resort role remains as confused as it currently is, questions about whether the ECB is acting beyond its legal mandate and becoming overly involved in political developments will continue to be aired.

Germany is clearly opposed to any significant debt relief measures. Furthermore, if these were to be considered at all, it would be after the programme ended and only if seriously required. On the other, the IMF made its continued participation conditional on guaranteeing the sustainability of Greek debt. Given the dire economic prospects of Greece, explained in detail in the preliminary Debt Sustainability Analysis (DSA) published by the IMF before the Eurogroup meeting, the scale of measures on debt relief it envisioned was clearly incompatible with the German position.[21]

According to economics professor Costas Lapavitsas, Syriza failed not because austerity is invincible, nor because radical change is impossible, but because, disastrously, it was unwilling and unprepared to put up a direct challenge to the Euro. Radical change and the abandonment of austerity in Europe require direct confrontation with the monetary union itself. For smaller countries this means preparing to exit, for core countries it means accepting decisive changes to dysfunctional monetary arrangements.[22]

The IMF has articulated a view to Eurozone governments during 2016 that they need to take action to alleviate Greece's debt burden. The IMF's participation in Greece's international bailout – a decision that is causing anxiety among EU nations such as Germany, which see the fund's participation as vital to the rescue programme's legitimacy has still to be resolved.

CONCLUSION

The Eurozone, in its relatively short time of existence, has successfully overcome a number of crisis periods. As the political landscape is changing, it will be difficult to develop more constructive and proactive solutions for the Eurozone crisis, such as debt restructuring, than was the case with the 'muddling-through' approach that has characterised the Eurozone crisis strategy in the last few years, especially in Greece. The ECB epitomizes that perceived 'democratic deficit' run by an unaccountable bureaucracy that poses serious problems for the future of the Eurozone.[23]

If mutualisation of at least a part of member states' debt issuance were to happen, the Eurozone would be taking a big stride towards a large, liquid, integrated bond market like that of the United States, which makes the dollar such an attractive key currency. As such, it would partly address the complaint that the Euro is a currency without a state and so by definition lacks the independent fiscal capacity that is a fundamental characteristic of a reserve currency. [24]

There is an urgent need for the Eurozone to address their problems such as the Greek debt restructuring process as a matter of urgency or it could be a destabilising factor in the international currency system. The Eurogroup failed to implement a definitive solution to the Greek debt problem. This is yet more evidence that the current institutional structure of the Eurozone/EU is unable to deal with the scale of economic problems caused by an incomplete monetary union: an ill omen for the future of Greece and, indeed, the Eurozone/EU. ■

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