II. The Greek Default and Subsequent Bailout Deal

A. Introduction

After six years and well over €200 billion in bailouts, Greece continues to perennially teeter on the edge of default.[1] Its narrative reached a climax in the summer of 2015, when Greece missed a key debt payment to the International Monetary Fund (IMF), held a national referendum to reject an initial bailout offer, and registered another €86 billion in bailout funds from its European neighbors.[2]

Greece's financial woes stretch beyond the IMF's usual purview.[3] Its government does not merely lack liquidity, it is outright insolvent.[4] The IMF and European creditors grapple with prolonged recession, record public debt, and a strongly ingrained political prejudice against fiscal reforms in Greece.[5] Their responding policy array must focus on minimizing moral hazard and demand austerity policies that go beyond tax increases. It could also reevaluate the cost of continental monetary policy that limits the efficacy of central banks.

B. Background on Previous Bailouts

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[1] Jack Ewing & Liz Alderman, *Bailout Money Goes to Greece, Only to Flow Out Again*, N.Y. TIMES, July 30, 2015, at B1.

[2] Jack Ewing, *Greece Makes Payment to European Central Bank, Avoiding Default*, N.Y. TIMES (Aug. 20, 2015), http://www.nytimes.com/2015/08/21/business/international/greece-bailout-debt.html [http://perma.cc/R3D9-LQ7E]. *See also* Netkaria Stamouli & Stelios Bouras, *In Rebuke to Europe, Greeks Vote Resounding 'No' to Bailout Terms*, Wall St. J. (July 6, 2015, 12:03 AM), http://www.wsj.com/articles/polls-close-in-greek-referendum-1436113280 [http://perma.cc/XL9P-GXHZ].

[3] Carlos Eduardo Goncalves & Bernardo Guimaraes, *Sovereign Default Risk and Commitment for Fiscal Adjustment*, 95 J. OF INT'L ECON., no. 1, 2015, at 68.

[4] *Id.*

[5] *See, e.g.*, Ewing, *supra* note 2 (discussing recession and political prejudice); *see also Economic Crisis: The Global Impact of a Greek Default: Hearing before the Subcomm. on Nat'l Sec. and Int'l Trade and Fin. of the S. Comm. of Banking, Hous., and Urban Affairs*, 114th Cong. (2015), (statement of Desmond Lachman, Resident Fellow, American Enterprise Institute) [hereinafter Economic Crisis].

Greece's latest sovereign debt crisis captured international headlines in the summer of 2015.[6] Its subsequent international aid package came on the heels of a five-year saga, featuring recurring bailouts from Greece's Eurozone neighbors.[7] During that period, creditor states funneled nearly €360 billion into Greece's ailing public treasury through the International Monetary Fund, the European Central Bank (ECB), and the European Stability Mechanism.[8]

Perpetual bailouts inevitably taxed the patience of Eurozone powers and stoked resentment from their voters.[9] The tenuous relationship between Greece and the IMF began with a €110 billion bailout in 2010.[10] At its nadir of insolvency, in June 2015, Greece defaulted on a €1.55 billion debt payment owed to the IMF.[11] By the end of the 2015 summer, however, Greece secured another €86 billion in aid.[12] Of that sum, the government used nearly a third to prop up commercial banks in Greece—an industry struggling to maintain liquidity and stifle the cash outflow of spooked depositors.[13] Leaders then applied the balance toward payments to creditors like the ECB and IMF.[14]

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[6] *Id.* ("The latest aid, some 13 billion euros, or nearly $14.4 billion, arrived just in time for Greece to repay €3.2 billion that was due Thursday on government bonds held by the European Central Bank. Failure to pay would have put Greece into default and provoked another crisis.").

[7] *See* Ewing & Alderman, *supra* note 1.

[8] *Id.*

[9] *See generally id.* ("Greeks understandably feel that the latest bailout package is not likely to benefit them very much. . . . In Germany and other northern European countries, the opposite sentiment prevails. The wealthier countries lent huge sums to Greece, the thinking goes, and the Greeks wasted it.").

[10] *Europe and IMF Agree €110 Billion Financing Plan with Greece*, IMF SURVEY MAG., (May 2, 2010), http://www.imf.org/external/pubs/ft/survey/so/2010/car050210a.htm [http://perma.cc/A6G6-W6UL].

[11] Gabriele Steinhauser et al., *Greece Defaults on IMF Loan Despite New Push for Bailout Aid*, WALL ST. J., (July 1, 2015, 12:12 AM), http://www.wsj.com/articles/some-greek-banks-to-open-for-pensioners-1435653433 [http://perma.cc/6427-Y7UT].

[12] Ewing & Alderman, *supra* note 1.

[13] *Id.*

[14] *Id.*

From the Greeks' perspective, each bailout and subsequent austerity measure only adds to their despondency.[15] Rather than finding new capital to fund domestic infrastructure investment or growth-oriented tax reforms, new debt and bailouts are used to service old debt.[16] Meanwhile, public deficits since 2010 coincided with a full-scale economic depression in the private sector.[17] In that period, economic output fell by a quarter and the unemployment rate passed 25%, even as Greece's public debt-to-GDP ratio continued to climb, reaching 180%.[18] Prime Minister Alexis Tsipras capitalized on the malaise by ostracizing the very lenders keeping Greek banks solvent and the nation's government afloat, accusing them of "pillaging" the Greeks.[19] In June 2015, Tsipras held a public referendum to reject bailout packages that mandated domestic fiscal reform.[20]

Critics accuse the Tsipras-led government of failing to reform public finances, crack down on tax evasion, or trim expensive government largesse.[21] They label Tsipras a proponent of "Rumpelstiltskin economics," making delusional promises to Greek voters while obligating "other European taxpayers to fund them."[22] Skeptics buttress their critique of Greek fiscal irresponsibility by highlighting the rise of taxpayer obligations: real public sector wages nearly doubled in the late 1990s and 2000s, with the average

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[15] *See generally id.*
[16] *Id.*
[17] *Economic Crisis, supra* note 5.
[18] *Id.*
[19] Peter Spiegel & Kerin Hope, *Defiant Alexis Tsipras Accuses Creditors of 'Pillaging' Greece*, FIN. TIMES (June 16, 2015), http://www.ft.com/intl/cms/s/0/1707f542-1337-11e5-ad26-00144feabdc0.html#axzz3dXgS9BDm [http://perma.cc/4XHS-V2SC].
[20] Steinhauser, *supra* note 11.
[21] *See generally* Ewing & Alderman, *supra* note 1.
[22] George F. Will, *So What if Greece Leaves the European Union?*, WASH. POST (June 19, 2015), https://www.washingtonpost.com/opinions/the-greek-monetary-melodrama/2015/06/19/4ae915de-15ea-11e5-9518-f9e0a8959f32_story.html [https://perma.cc/4AC9-2CPR] ("How could one humiliate a nation that chooses governments committed to Rumpelstiltskin economics, the belief that the straw of government largesse can be spun into the gold of national wealth? . . . He thinks Greek voters, by making delusional promises to themselves, obligate other European taxpayers to fund them.").

government job paying nearly triple the private-sector average.[23] These public workers wield tremendous political power. They organize thousands of supporters for demonstrations and protests opposing public pension reform, an increased retirement age, and other fiscal restraints.[24] On the revenue side of the ledger, infamously high rates of Greek tax evasion leave mammoth swaths of the economy untaxed.[25]

C. Challenges facing the Eurozone in New Bailout Deals.

Few European leaders are optimistic about Greece's financial future, seeing it more as a trap than a problem solved by bailouts.[26] With looming discussions of whether Greece will eventually be forced out of the Eurozone, several challenges face the IMF and European powers.

1. Greek Default Threatens IMF Credibility

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[23] MICHAEL LEWIS, BOOMERANG 44 (2011) ("In just the past twelve years the wage bill of the Greek public sector has doubled, in real terms—and that number doesn't take into account the bribes collected by public officials. The average government job pays almost three times the average private-sector job.").

[24] *Id*. at 79 ("The day before I left Greece the Greek parliament debated and voted on a bill to raise the retirement age, reduce government pensions, and otherwise reduce the spoils of public-sector life. . . . Thousands upon thousands of government employees take to the streets to protest the bill. Here is Greece's version of the Tea Party: tax collectors on the take, public-school teachers who don't really teach, well-paid employees of bankrupt state railroads whose trains never run on time, state hospital workers bribed to buy overpriced supplies. Here they are, and here we are: a nation of people looking for anyone to blame but themselves.").

[25] *See, e.g., id.* at 51 ("The scale of Greek tax cheating was at least as incredible as its scope: an estimated two-thirds of Greek doctors reported incomes under 12,000 euros a year—which meant, because incomes below that amount weren't taxable, that even plastic surgeons making millions a year paid no tax at all.").

[26] *See generally* Ewing and Alderman, *supra* note 1.

Greece and just two other countries "account for around two-thirds of the total IMF loans presently outstanding."[27] IMF funding from the United States, along with others, is subject to political pressures.[28] Accordingly, the IMF must justify its risk to taxpayers while using their funds, an even more daunting prospect under a Greek default or Eurozone exit.[29] Further complicating Europe's position, Greek troubles fall outside the ordinary scope of IMF intervention.[30] National bailouts generally address short-term losses of liquidity.[31] But problems in Greece, beginning in 2011, ran far deeper—it was wholly insolvent.[32]

While creditor states dealt with the political fallout of bailouts, the IMF loosened its own rules to allow for the new payments to Greece.[33] Under its old regime, the IMF followed an "'exceptional access' rule" barring loans to countries with unsustainable debt.[34] It pivoted to aid Greece, however, by writing an open-ended exemption to the rule.[35] Now it permits loans to unsustainable borrowers when they pose a "high risk of international systemic spillover."[36] Eurozone leaders want to insulate their economies from a crisis that could spread across the continent, but

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[27] *Economic Crisis*, *supra* note 5 ("A Greek exit is also likely to involve Greece defaulting on the US$24 billion that the IMF has loaned to it. This would be of considerable concern considering that Greece together with Portugal and Ukraine account for around two-thirds of the total IMF loans presently outstanding.").
[28] *See generally id.*
[29] *See generally id.*
[30] Goncalves & Guimaraes, *supra* note 3.
[31] *Id.*
[32] *Id.*
[33] John B. Taylor, *The Lesson Greece's Lenders Forgot*, THE HOOVER INST. (July 20, 2015), http://www.hoover.org/research/lesson-greeces-lenders-forgot-0 [http://perma.cc/5UVH-X7AB] ("Rather than follow its 'exceptional access' rule—no loans to a country with unsustainable debt—the IMF wrote in an open-ended exemption. New loans, it said, could be made in unsustainable situations so long as there was a 'high risk of international systemic spillover.' The IMF claimed, with very little evidence, that this was true in Greece's case and approved an exceptionally large loan of €30 billion."), *see also* Ewing & Alderman, *supra* note 1 (discussing political fallout in Germany).
[34] *Id.*
[35] *Id.*
[36] *Id.*

their insulation comes at a social and economic cost.[37] Analysts warn that continued outside support without debt restructuring "facilitated the exit of private sector creditors from [Greece] by placing the global taxpayer very much on the hook in the event of a Greek default."[38]

2. Greek Domestic Depression Perpetuates Crises

Greece's flailing economy perpetuates its inability to make debt payments and restore confidence in the market.[39] Prime Minister Tsipras campaigned against the austerity measures embedded in bailouts, which he believes bind his ability to stimulate growth through public spending.[40] Even after five years of austerity measures, Greek government spending still accounts for a crippling 49.3% of its entire economy.[41] Budget control efforts thus far have been lopsided, ratcheting up tax rates rather than reforming public sector pensions or labor markets.[42] Under the weight of a weak economy, price deflation, and lack of structural reform, Greece's debt as a share of its GDP edged even higher over the past three years.[43] Absent economic growth, Greece seems poised to continue using most of its liquidity to service ongoing debt obligations.[44]

3. Each Bailout Creates New Moral Hazard

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[37] *See generally id.* ("Following the loan, most private creditors started getting out of Greek debt, leaving the IMF, European governments and the European Central Bank holding the bag. The Greek economy continued to deteriorate, and by early 2012 the inevitable debt-restructuring began. But with no serious pro-growth reforms, the economy continued to sink, the debt problem grew, and Greece finally defaulted on its IMF loan on June 30.").

[38] *Economic Crisis,* supra note 5.

[39] *See, e.g.*, *id.*

[40] *See generally* Spiegel & Hope, *supra* note 19.

[41] Bill Below, *The Facts About Greece*, OECD INSIGHTS (July 2, 2015), http://oecdinsights.org/2015/07/02/the-facts-about-greece/ [http://perma.cc/6X3T-86AT].

[42] *Economic Crisis,* supra note 5.

[43] *Id.* ("At the same time, despite five years of budget austerity and a major write-down of its privately owned sovereign debt, Greece's public debt to GDP ratio has risen to 180 percent.").

[44] *See generally* Ewing & Alderman, *supra* note 1.

Bailouts insulate the Greek financial system, and its voters, from the cost of its public deficits. Financial bailouts create moral hazard. In the poker analogy of economist Paul Romer, they allow policymakers to play with other people's money.[45] As a general economic rule, agents who lack sufficient oversight from principals have incentive to shirk responsibility for their decisions.[46] We see meaningful changes in risk-taking behavior from policies less drastic than bailouts, including how bank customers behave when deposit insurance insulates them from risk.[47] Enjoying its public support while subsidized by European largesse, voters in Greece reelected Prime Minister Tsipras and his Syriza party to power in September 2015.[48] While Tsipras agreed to some austerity measures in exchange for the latest bailout funds, Syriza lacks detailed commitment to structural fiscal reform.[49]

4. Continent-Wide Monetary Policy is a Heavy-Handed Tool

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[45] *See, e.g.*, Russell Roberts, *Gambling With Other People's Money*, THE GEORGE MASON UNIV. MERCATUS CTR. (Apr. 28, 2010), http://mercatus.org/publication/gambling-other-peoples-money [http://perma.cc/DT8F-2EAZ] ("But the greater the chance that Uncle Sam will cover the debts of the poker player if he goes bust, the less likely you are to try to restrain your friend's behavior at the table. . . . Capitalism is a profit and loss system. The profits encourage risk taking. The losses encourage prudence. Eliminate losses or even raise the chance that there will be no losses and you get less prudence. So when public decisions reduce losses, it isn't surprising that people are more reckless.").

[46] N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS, 462 (7th ed. 2015).

[47] Hofiz Hoque et al., *Bank Regulation, Risk and Return: Evidence from the Credit and Sovereign Debt Crises*, 50 J. OF BANKING & FIN. 455, 455 (2015).

[48] *Syriza Defies the Polls with Comfortable Re-Election Win*, THE ECONOMIST (Sept. 20, 2015), http://www.economist.com/news/europe/21665370-despite-u-turn-accepting-austerity-alexis-tsipras-remains-charge-syriza-defies-polls [http://perma.cc/6P9Y-ZS6U].

[49] *See e.g.*, Nektaria Stamouli & Stelios Bouras, *Alexis Tsipras's Syriza Set to Return to Power After Resounding Greek Election Victory*, THE WALL ST. J. (Sept. 21, 2015), http://www.wsj.com/articles/syriza-ahead-in-greek-election-according-to-exit-polls-1442767118 [http://perma.cc/F3GQ-996P].

Europe's unified continental currency, the Euro, promotes free trade through a unified European market, but it also limits the policy options for central banks.[50] Member states can no longer monetize debt or devalue currency to stave off default.[51] Nor can the ECB easily address asymmetric shocks in particular Eurozone regions, because different economies within the Eurozone have such different needs.[52] The ECB lacks the precision policy tools necessary to address these regional needs.[53]

D. Goals for Future Lenders

Continental Europe and the IMF continue to subsidize an economy that fails to produce levels of output sufficient to enable its public sector consumption.[54] Lenders should demand specific structural changes in pensions and outstanding public liabilities instead of general deficit targets. In the long term, both creditors and Greeks have the same goal: economic growth. Only growth paired with fiscal discipline can return Greek to fiscal solvency, and only a solvent Greece can honor outstanding liabilities without further

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[50] *One Market Without Borders*, EUROPEAN UNION, http://europa.eu/pol/singl/index_en.htm (last visited Oct. 30, 2015) [http://perma.cc/7KMG-RMH8].

[51] Karl Whelan, *Sovereign Default and the Euro 23, in* WORKING PAPER SERIES (U. C. DUBLIN CTR. FOR ECON. RES., Working Paper No. 13/09, 2013), http://www.econstor.eu/bitstream/10419/96272/1/756522900.pdf [http://perma.cc/ARJ7-VPER] ("While countries could no longer devalue once they joined the euro, the absence of devaluation greatly raised the prospects of sovereign default.").

[52] *See id.* ("Unfortunately, the introduction of new monetary arrangements did not turn out to be sufficient to eliminate the consequences of the economic differences across the participating member states. Indeed, the concern about asymmetric shocks that was widely discussed in the pre-EMU academic debates failed to anticipate two huge asymmetric shocks that would hit the euro area: The near-harmonisation of sovereign and private borrowing rates during the early years of the euro and the subsequent reversal of this pattern. The asymmetric shocks that critics predicted would afflict the euro have occurred in a deadlier form than most people anticipated.").

[53] *See id.* ("As of yet, Europe's leaders have failed to arrive at the appropriate set of institutions and compromises that will allow so many countries to share a common currency while avoiding chronic instability.").

[54] *See* Taylor, *supra* note 33.

international aid.[55] The IMF could begin to safeguard against prolonged moral hazard by reinstating its "exceptional access" rule limiting its lending to individual countries, though it would come at the price of potential exits from the Eurozone after future sovereign defaults.

E. Conclusions

Euro-skeptics continue to ask whether a monetary union is as valuable as a union limited to free trade and open travel. While remaining in the Eurozone is valuable for Greece, and may serve America's economic trade interest, it may not serve the needs of its creditors. Within the current political arrangement, voters and politicians in Greece should face increasing pressure to break with the Tspiras administration's blame-shifting and adopt more comprehensive domestic reforms. Without them, Greece will continue its infinite loop of insolvency. Voters in the West's original democracy cannot abide in that loop forever.

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[55] *See generally Economic Crisis,* supra note 5.
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