PANOECONOMICUS, 2016, Vol. 63, Issue 2 (Special Issue), pp. 175-194
Received: 14 September 2015; Accepted: 16 March 2016.
UDC 339.923:061.1 EU]:338.124.4 (495)
DOI: 10.2298/PAN1602175K
Original scientific paper

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The Conundrum of Greece and the Eurozone: Puzzles, Paradoxes and Contradictions

Summary: This paper examines three questions regarding the controversial relationship between Greece and the eurozone during the current crisis. First, why was Greece "bailed-out" in 2010? Second, why the Greek economy collapsed despite the largest "bail-out" in global financial history? Third, was the electoral mandate of the Syriza government for ending austerity while remaining in the eurozone contradictory? There are conflicting answers to all three questions and the paper compares the answers of the so called "dominant narrative" to those provided by the "counter-narrative" of the eurozone crisis. The paper reaches the following conclusions. First, the primary motivation for the "bail-out" of Greece was the maintenance of European and global financial stability. Second, although programme implementation was less successful in Greece than in other "programme" countries the catastrophic collapse of the Greek economy had more to do with the programme itself than its implementation. Third, the meaning of democratic decision-making in the Euro-group needs re-appraisal and must go beyond seeing the Greek demand of a policy reversal in the eurozone as simply a clash of democratic mandates in a 19 member monetary union. Political unity will not only improve efficiency but also democracy and accountability in eurozone policymaking.

Key words: "Bail-out", Expansionary austerity, Fiscal consolidation, Internal devaluation, Structural reforms, Programme implementation, Democratic dialogue.

JEL: B20, B25, E44, E52, F15, H30, H60.

The eurozone crisis erupted in 2009 when the newly elected Greek Prime Minister George Papandreou revealed that his country's public finances were a lot worse than what was stated in the official statistics. In fact both the budget deficit and total indebtedness as a proportion of GDP was well in excess of what was allowed by the rules of the monetary union. Greece had not only broken the rules but also lied about it. There were also rumors that Greece had gained entry to the eurozone in 2001 by allegedly "cooking the books". Moreover additional stories begun to circulate in the media about the Greek economy and society that painted a very sorry picture of a country that expected to be treated as an equal and respected member of a monetary union. These were stories about endemic tax evasion, overblown public sector, political corruption and cronyism, unsustainable pensions including over-generous early retirement schemes. Any fair minded person would have been astounded if told in 2009 that this saga concerning the crisis in Greece would still remain unresolved in 2015. In fact a fair minded person would have expected Greece to be have been ejected from the monetary union in 2009.

Why have events in a country that accounts for less than 2% of the eurozone GDP, which had violated the rules of the monetary union and lied about it, (a) sparked off a crisis in the eurozone and (b) continue to cause problems for the eurozone in 2015? This is one of the many puzzles, paradoxes and contradictions of the crisis that will be explored in this paper. In the course of the crisis a "dominant narrative" has emerged concerning the tangled relationship between Greece and the eurozone. In this paper the way the "dominant narrative" deals with these questions will be compared to that of an "alternative narrative" or "counter-narrative" of the eurozone crisis. Although a novel approach, the "story-telling" paradigm in economics is still in its infancy. (For the theoretical significance of stories and narratives in economics, see Donald N. McCloskey 1990; George A. Akerloff and Robert J. Shiller 2009; Shiller 2012 and for a discussion of the Greek and eurozone crises, from a story-telling perspective, see Yiannis Kitromilides 2013).

We proceed as follows after this short introduction. Section 1 examines the first puzzle, which is why the problem was not resolved in 2009. Section 2 considers the paradox of how the "rescue" of a country can result in its virtual destruction. In Section 3 the contradictions of democratic decision-making in the eurozone are explored and Section 4 summarizes and concludes.

1. Puzzles

Greece having repeatedly flouted the Maastricht rules and lied about it was "bailed-out" in May 2010 in a clear breach of the same rules. Why?

The fiscal rules of the Economic and Monetary Union (EMU) were put in place for a purpose: to prevent fiscal irresponsibility. Excessive deficit spending by a member country could eventually create "unsustainable" levels of total national indebtedness, which in turn could undermine the unity and cohesiveness of the monetary union. The eurozone was initially constructed as a monetary union without a fiscal union but always aiming ultimately at a political union, which will involve also a fiscal union. In the meantime sovereign member states agreed to use their fiscal autonomy responsibly, which meant adhering to the so called Maastricht rules of fiscal discipline: budget deficits should be kept below 3% of GDP and total sovereign indebtedness below 60% of GDP. To deal with the "moral hazard" element of this arrangement there was a second major rule, which was expected to re-enforce and cement the first rule about fiscal discipline. This second rule has come to be known as the "no bail-out" rule. The European Central Bank (ECB) was not allowed to act as "lender-of-last-resort" to governments. All member countries, therefore, were aware of the twin requirement of (i) not to over-borrow and (ii) not to ask for help from the ECB when they do over-borrow. Given this crucial "no bail-out" clause in the Maastricht treaty why was Greece "bailed-out" in 2010? Greece was "bailed-out" in 2010 in the sense that, although Greece was unable to meet its financial obligations through market borrowing at sustainable rates, default was prevented because of the loan provided by the "troika". The way this question is answered can have a pivotal influence in determining the tone and nature of the narrative of the crisis. Was the "bail-out" of Greece an act of altruism and an expression of genuine community solidarity or a decision based on naked self-interest and the desire for self-preservation by the eurozone policymakers? Given the lack of transparency during the relevant euro-group meetings there is no way of knowing the real motives for the actual decisions taken by the euro-group between February and July 2015. We can only speculate as to why 18 out of 19 members supported the "dominant narrative" and the "troika" prescriptions for Greece.

Without a "bail-out" in 2010 Greece would have been in very serious trouble. Its immediate financial needs which were estimated in 2010 to be 53 billion euros (Jill Treanor 2010) could not have been accommodated either by the ECB or the markets. Financial markets had finally woken up to the fact that lending to the Greek sovereign was not "like lending to the German government". There was indeed for the first time in the short life of the euro, a real and present danger of a sovereign default in the eurozone. The "bail-out" decision in May 2010 was an *ad hoc* institutional reform in the monetary union, agreed after several acrimonious meetings of the euro-group between April and May 2010, which prevented a Greek default and probable exit from the eurozone. According to one, often repeated, interpretation of this decision, the Greek "bail-out" was in fact an act of generosity and altruism and a demonstration of European solidarity towards Greece and the Greek people. Despite the rule violations and deceptions, Greece was given in 2010 a reprieve, saved from bankruptcy and default and given another chance to sort out its many social and economic problems.

An alternative and more plausible interpretation sees the Greek "bail-out" as a policy decision by the euro-group based not so much on altruism and generosity but fundamentally on self-interest and pragmatism. There is no doubt that without a "bail-out" the economic consequences for Greece would have been dire. Whether these consequences would have been more disastrous than the current situation in Greece, had Greece defaulted and exited the single currency in 2009, is a counterfactual question for which we can of course only speculate. What is not in dispute, however, is that in 2010 a Greek default would have had grave adverse repercussions on the rest of the eurozone. A "contagion" - the inability to confine the effects of Greek default only to Greece - was highly probable in 2010.

The architects of the EMU had failed to put in place an adequate crisis management mechanism. This was one of several so called "design faults" of the monetary union, which meant that in 2010 the eurozone had no adequate means of preventing the spreading of the crisis to other eurozone member countries. The fear of "contagion" from a Greek default was of two interconnected types: a "contagion" to the European banking system and a "contagion" to the bond markets. With regard to the effects of a Greek default on the European banking system it was estimated that most of the Greek government debt was held by non-domestic banks, notably French and German (based on data from the Bank of International Settlements - BIS; see Treanor 2010). This would have meant that the taxpayers of these countries would have had to foot the bill for the "bail-out" of their "systemic" banks in the event of a Greek default. This in itself would probably not have caused a serious "contagion" problem for these countries' banking system and the rest of the eurozone if the exposure of European banks was confined simply to the Greek sovereign.

The very real fear of "contagion", however, was based on estimates, again using BIS data, of a huge exposure of $2.9 trillion of the European banking system to the PIIGS (Portugal, Ireland, Italy, Spain and Greece) an exposure which was particularly concentrated among French and German banks (Treanor 2010). If there was a "contagion" of this magnitude it is difficult to envisage how the effects of a Greek default could have been contained under the arrangements prevailing at the time in the eurozone. Moreover, if there was "contagion" in the banking system following a Greek default there would almost certainly have been a "contagion" in the bond markets as investors would begin to fear that if one sovereign in the eurozone can default why not others? This was not a risk worth taking and therefore the Greek "bail-out" by preventing Greek default in effect prevented a possible collapse of the eurozone in 2010 with all its global repercussions. Brent Glover and Seth Richards-Shubik (2014) simulated the effects of a hypothetical Greek default on other sovereigns and found minimal risk of contagion in 2010. Similar empirical simulations were carried out by Pietro Bonaldi, Ali Hortacsu, and Jakub Kastl (2015) with similar conclusions with regard to contagion risks in the banking system in Europe. This of course was not the perception of policymakers in 2010. So soon after the Lehman Brothers meltdown (15 September, 2008), the fear of possible "contagion" was very real. Although Dan Davies (2015) dismisses the claim that the *sole* motivation for the Greek "bail-out" was to protect France and Germany from having to bail out their domestic banks, he nevertheless concludes that the *primary* motivation for the 2010 bailout was, indeed, preserving European financial stability. If that is the case it is fair to ask who should bear the burden for preventing contagion. The International Monetary Fund (IMF 2014a) suggested that under these circumstances some form of burden sharing is warranted. Greece should have been compensated for having to hold on to its unsustainable debt burden in the interest of preventing contagion, through some form of what the IMF (op. cit.) calls "concessional assistance" or grant instead of a loan. The Greek "bail-out" in 2010 contained no such "concessional assistance" and it was to act shortly afterwards and fundamentally for the same reasons, as a template for the "bail-out" of Ireland, Portugal, and the banking system of Spain and eventually in 2013 of Cyprus. The stated aim was the "rescue" of these economies individually; the unstated aim was the rescue of the whole of the eurozone. In 2010 the "no bail-out" rule had to give way.

The "bail-out" plan for Greece was proposed by Jean-Claude Trichet, the then president of the ECB and vigorously advocated by the then President Sarkosy of France who managed to convince the German government, allegedly by threatening to leave the euro (as Spain's former prime minister, José Luis Rodriguez Zapatero, later revealed to the newspaper El País); namely that this was an operation not simply to save Greece but to rescue the whole of the eurozone. It had the desired effect of preventing default and "contagion" in the eurozone. It had also the effect of transforming the nature of indebtedness in the eurozone and the relationship between borrower and lender. As Hans-Werner Sinn (2015) points out, a private dispute between creditors and debtors was transformed into a dispute between sovereign states with disastrous consequences for the cohesion and unity of the eurozone. Before the "bail-outs" of 2010 and 2011 Greece was a borrower and owed money to European banks who were the original lenders. After the "bail-outs" Greece was still a borrower but owed money to new lenders, the taxpayers of the eurozone and via the IMF to tax-payers in the rest of the world.

This development introduced a new ethical dimension to the relationship between borrower and lender. The following question is often asked by politicians and commentators in the media: is it fair that the (mainly) German tax-payers' hard-earned money be used to "bail-out" the irresponsible and profligate Greeks? This type of question, however, does not take into account the dual ethical dimension of the relationship between debtors and creditors.

For every foolish and irresponsible borrower there is usually a foolish and irresponsible lender. In fact irresponsible borrowers are usually only able to obtain credit from irresponsible lenders. There is of course "asymmetric information" between borrowers and lenders but this is typically dealt with by the lenders charging a higher interest rate for those borrowers that they suspect of being a "bad risk". In modern economies the punishment for irresponsible borrowing is bankruptcy; the punishment for irresponsible lending is that the lenders lose their money. In 2010 irresponsible Greek borrowing would have resulted in default and "Grexit" or exit of Greece from the euro, which would undoubtedly have been disastrous for Greece and certainly would have been sufficient punishment to satisfy the angry European (mainly German) taxpayers' sense of fairness and justice. It would also have resulted in the just and fair punishment for the irresponsible or foolish or both lenders (predominantly German, French, Greek and other European banks) who would have lost their money had Greece defaulted.

If the high moral standards of those who believe that irresponsibility must be punished are to be consistently applied then not only the irresponsible Greeks but also the bankers who foolishly lent to Greece (and to the other peripheral countries) must also be punished. The strict application of this ethical code, however, would have produced perverse outcomes: the punishment of irresponsible borrowers in Greece would have resulted in the punishment of irresponsible bankers which could have threatened financial stability in Europe and the global economy. Eventually in 2010 pragmatism prevailed over considerations of strict morality. This was indeed the case with most countries (with the exception of Iceland) that experienced a banking crisis in 2007-8: banks were "bailed-out" by the taxpayers of each country. In the eurozone this was done in a round-about way.

Greece was "rescued" by lending the Greek government billions of euros to pay back the money they owed to the "irresponsible" bankers - an arrangement that undoubtedly prevented Greek default but more significantly preserved the stability of the European and Global financial system. The Greek, Irish, Spanish, Portuguese and Cypriot tax payers now owe money to each other and to the tax-payers of all other member countries such as Malta, Slovenia, Slovakia, Finland and of course Germany. Naturally these taxpayers have no sympathy for the plight of Greece. If they were asked in a referendum whether they approve of debt relief for Greece they would, almost certainly, vote no. This question, however, as we argued in this section is only part of the story. It is equally legitimate and equally likely that a referendum would produce a "no" vote if the question was: do you approve of your money being spent on "bailing-out" irresponsible bankers, which is in effect what happened with the a significant proportion of the Greek "bail-out" funds?

There are, therefore, two answers to the question posed at the beginning of this section. First, the "no bail-out" rule was breached in order to save Greece from default and bankruptcy. Second, the "no bail-out" rule was breached in order to save the euro. There is some truth, of course, in both answers but the more plausible answer is the second one. Yet the first answer is the one most commonly provided by the "dominant narrative" of the crisis that Greece was "saved" by the Euro-group decision to bend the rules of the monetary union in 2010 and this was a generous altruistic act of community solidarity.

2. Paradoxes

Although, according to the "dominant narrative" of the crisis, Greece was "saved" from bankruptcy and economic catastrophe in 2010, the Greek economy experienced a 1930s style economic collapse since the "bail-out". What is the explanation for this apparent paradox? Despite receiving 240 billion euros in 2010 and 2011and a Private Sector Involvement (PSI) partial debt restructuring in 2012, at the beginning of 2015 the Greek economy shrank by 25% from its pre-crisis level, its debt to GDP ratio shot up to 175%, unemployment, long term unemployment and youth unemployment sky rocketed and the country was facing a serious humanitarian crisis. As with the previous question discussed in Section 1 above there are two conflicting answers. The "dominant narrative" of the crisis sees the collapse of the Greek economy as the inevitable consequence of the failure of successive Greek governments to implement appropriately the agreed "troika" economic adjustment programme; the "alternative narrative" claims that the opposite is the case: the collapse of the Greek economy was primarily due to the implementation of the "troika" programme. Is it the case that Greece did not take the prescribed medicine or was Greece prescribed by the "troika" the wrong medicine? As with the previous question there are elements of truth in both assertions. Unlike the previous question, however, the truth concerning this paradox is not so easy to disentangle. The main difficulty lies in finding an acceptable definition of what a successful implementation process consists of in all its quantitative and qualitative aspects. Clearly the implementation process in Greece was far slower and effective than in other peripheral economies under the "troika" economic adjustment programmes (Jean Pisani-Ferry, Andre Sapir, and Guntram B. Wolff 2013; Sapir et al. 2014). Equally however it would be wrong to claim that Greece did not implement fully a great deal of the "troika" imposed programme in particular fiscal consolidation (Organization for Economic Co-operation and Development - OECD 2013; IMF 2014b).

The troika economic adjustment programme was a condition for the "bail-out" of Greece but also of the other programme countries of Ireland, Portugal and Cyprus. It was designed by the "troika" and is generally known as the "austerity" strategy. It had three components: fiscal consolidation, internal devaluation and structural reforms. All three elements were expected to promote growth and ultimately result in a reduction in indebtedness although elements of the program differ in each country, depending on what the "troika" perceived as country specific problems.

Fiscal consolidation - the process of reducing the budget deficit by cutting government spending and raising taxes - is, of course, contractionary because it reduces total demand in the economy. At the same time, however, it can be expansionary because of the effect that the achievement of sound public finances can have on confidence in the economy. In the first place, rational consumers, seeing that the government is serious about reducing the deficit, will become more confident and increase their spending, in anticipation of lower taxes. The relevance of this factor in an economy that allegedly suffers from endemic tax evasion is not clear. Also *business* confidence will improve and investment will increase as a result of anticipated and actual lower interest rates resulting from lower government borrowing. Overall the theory predicts that the net effect of fiscal consolidation will be expansionary and growth inducing because improved confidence can stimulate business investment and growth. This is known as the theory of "expansionary fiscal contraction" or "expansionary austerity" (Freddy Heylen and Gerdie Everaert 2000; Maria Gabriella Briotti 2004; Alberto F. Alesina and Silvia Ardagna 2009).

Internal devaluation, which is necessary in the absence of exchange rate adjustments, can also promote growth by improving competitiveness. The effect of internal devaluation would also initially be contractionary but again it can be arrested and reversed by an increase in demand due to an increase in exports. The proponents of the austerity strategy insist that fiscal consolidation and internal devaluation although necessary conditions for the success of the strategy are by no means sufficient. They must be accompanied by "structural reforms" which by modernizing the economy can create the conditions necessary for a sustained private sector-led growth.

In Greece and other countries of the southern Eurozone periphery, the implementation of a wide range of measures of "structural reforms" were considered by the "troika" to be as important, if not more important, than fiscal consolidation and internal devaluation in promoting growth. The "reform agenda" therefore has become an integral part of the "troika" growth strategy. Structural reforms are vital in promoting private sector-led growth because by lowering the cost of doing business they encourage more investment, growth and job creation as well as improving competitiveness and encourage exports. In fact countries should vigorously pursue and implement these reforms irrespective of the requirements and dictates of the "troika" program. Acquiring "ownership" of the adjustment program and in particular the reform agenda is, according to the "troika", an essential prerequisite for its successful implementation (Kenneth Rogoff 2015).

In December 2013 Ireland that faithfully and "stoically" implemented the austerity strategy exited the "troika" program. Portugal also faithfully but less "stoically" did the same in May 2014. Greece was also preparing for exit from the program in 2014. In fact in June 2014, the IMF chief in Greece declared that he was "cautiously optimistic" about the progress the country was making in that direction (IMF 2014b). Earlier in April 2014, the Greek Finance Minister went a step further and claimed that after four years of fiscal consolidation, internal devaluation and structural reforms the Greek economy has been “turned around”; both fiscal and current account deficits had not only been eliminated but turned into surpluses - an economic adjustment success story unparallel in global financial history (Yiannis Stournaras 2014). For the first time after six years of deep recession (more accurately of a 1930s style depression) Greece was expected, according to the IMF (2014b) to return to positive economic growth in 2014. In July 2014 only 7.2 billion euros of the 240 billion of the Greek “bail-out” funds have not been disbursed. The rest of the funds have been disbursed following successful programme reviews. The final disbursement would have been effected on successful completion of the final programme review, which had been fixed for February 28, 2015, by which date Greece was expected to meet all its outstanding programme targets and like Ireland and Portugal exit the programme.

The claim, therefore, that the collapse of the Greek economy was due to the inadequate and insufficient implementation of the “troika” programme by successive Greek governments since 2010 must be evaluated against this background. Both the OECD (2013) and the IMF (2014b) were impressed with the progress of programme implementation in Greece. In terms of fiscal consolidation, the first element of the austerity strategy, Greece was by the end of 2013 above target and ahead of schedule. According to the IMF chief in Greece (IMF 2014b) this means that “the fiscal adjustment in Greece has been extraordinary by any international comparison. Having entered the crisis with a deficit in double digits, Greece has not only achieved a primary surplus in just four years and ahead of schedule, but also now has the highest ‘cyclically-adjusted primary balance’ in the euro area, that is, the highest underlying primary balance after accounting for the effect of the business cycle on revenues” (p. 1).

With regard to the second element of the austerity strategy, internal devaluation, private sector nominal wages have fallen by 16% since 2009, which put downward pressure on prices (IMF 2014b). This resulted in an improvement in competitiveness although due to price rigidities the price declines were not commensurate with those of wages. This indicated the need for further structural adjustment measures to deal with the problem of price rigidities. However, the structure and export specialization of the Greek economy was such as to cast serious doubts on the potential effects of internal devaluation as a means of promoting exports and growth. The kind of Greek exports that internal devaluation was expected to boost were simply absent. In this case, an active industrial policy in Greece would have been desirable in order to incentivize a change in the Greek productive structure and develop the kind of export industries with higher added value that could benefit from internal devaluation.

In terms of the third element of the austerity strategy, the implementation of a wide ranging programme of “structural reforms”, the verdict was that a great deal has been achieved but more needed to be done before exit from the “troika” programme. According to Angel Gurria of the OECD (2013), “Greece, which has been under an internationally coordinated adjustment programme since 2010, has made impressive headway in cutting its fiscal and external imbalances and implementing structural reforms to raise labour market flexibility and improve labour competitiveness” (p. 1).

In the words of the IMF chief in Greece: "Greece implemented path-breaking labor market reforms in 2012, which have helped wages to adjust in line with productivity" (IMF 2014b, p. 1). However "impressive" or "path-breaking" the various "structural reforms" implemented in Greece have been, the general consensus was that more needed to be done. The critical question, therefore, is whether these "residual" structural reforms in 2014, on the eve of the final programme review and the disbursement of the final tranche of the "bail-out" funds were so crucial that they were primarily responsible for the economic catastrophe that befell Greece since 2010.

The aim of the strategy of simultaneously implementing rapid fiscal consolidation, internal devaluation and "structural reforms" was to promote economic growth that could in turn enable a heavily indebted economy to achieve debt sustainability. That failed spectacularly in Greece. Austerity in Greece proved counterproductive and the Greek economy experienced a 1930s style economic depression. It has been argued in this section that the "non-implementation of the economic adjustment programme" explanation for the economic catastrophe in Greece is only partially correct because Greece did in fact implement the bulk of the economic adjustment programme demanded by the troika. It is also undoubtedly true that the implementation process with regard to many structural reforms was slow, half-hearted and lacking in "political ownership" of the programme. Moreover, several "residual" reforms which had they been implemented would have enabled Greece to exit the "troika" programme, remained unresolved and outstanding in 2014. How significant and crucial these remaining reforms were is not easy to ascertain. It is, however, highly unlikely that those were such key reforms that they were the sole reason why the Greek economy experienced such a catastrophic collapse since 2010. The economy seems to have collapsed *despite* implementing the bulk of the "troika" economic adjustment programme.

It is fair to point out that this conclusion ignores some important *qualitative* aspects of the issue. The cornerstone of the austerity strategy as a growth-inducing strategy is the re-establishment of both consumer and business confidence in the economy. Improved confidence, which comes about not only by restoring sound public finances but also through the credible implementation of "growth-inducing" structural reforms, can lead to increased domestic and foreign business investment which could in turn counter the severe deflationary effects of fiscal consolidation and internal devaluation. Restoring sound public finances, which Greece achieved remarkably well, was, according to the conventional narrative, a necessary but by no means a sufficient condition for preventing the economic collapse of the Greek economy. Although the bulk of the "troika" targets were met and nearly all but a small fraction of the "bail-out" funds have been disbursed, it may be argued that *due to the manner* in which the structural reform programme was implemented in Greece which was half-hearted, slow and totally unconvincing it had adverse effects on confidence and growth. According to this point of view, therefore, Greece failed to implement *credible* structural reforms and without *credible* reforms Greece was doomed. This might be termed the "holistic" approach to the problem of achieving growth in a heavily indebted economy: this is the "troika" philosophy that fiscal consolidation, internal devaluation and structural reforms must be implemented simultaneously, attaching paramount importance on the "credibility" of structural reforms. The "holistic" approach, of course, is not without its criticism.

The principal objection to what was called above as the "holistic" approach is that there is a very real possibility of creating a "vicious circle" of economic decline. Fiscal contraction is only expansionary if it is reasonably quickly accompanied by a return of confidence in the economy. Growth-enhancing structural reforms can contribute to this process by further boosting confidence and growth. The contractionary effects of fiscal consolidation, however, are immediate whereas the growth-enhancing effects of "structural reforms" take time to have an effect. Under these circumstances a deflationary spiral can be set in motion, which according to Irving Fisher (1933) makes the fall in output self-feeding and the attempt to reduce indebtedness self-defeating. Significantly according to Alessio Terzi (2015) it can also make the task of implementing growth enhancing structural reforms even harder. To make matters worse in the case of Greece, the initial under-estimation of the fiscal multipliers (Olivier J. Blanchard and Daniel Leigh 2013; IMF 2013) further aggravated the severity of the deflationary spiral and consequently the swift and credible implementation of much needed reforms.

Amartya Sen (2015) has used a medical analogy to illustrate the ineffectiveness and futility of the "holistic" approach. The insistence that an indebted economy must implement "structural reforms" at the same time as savage austerity is like a patient who has fever being forced to take a pill that contains both antibiotic and rat poisoning. He writes: "We were in effect being told that if you want economic reform then you must also have, along with it, economic austerity, although there is absolutely no reason whatsoever why the two must be put together as a chemical compound… The compounding of the two - not least in the demands made on Greece - has made it much harder to pursue institutional reforms. And the shrinking of the Greek economy under the influence mainly of austerity has created the most unfavourable circumstances possible for bold institutional reforms" (p. 4). Ashoka Mody (2015) uses another medical analogy, namely, in conditions of debt-deflation imposing fiscal austerity is like asking a trauma patient whose blood flow does not stop on its own "to run around the block to demonstrate good faith" (p. 3).

The linking at the policy level of the problem of structural reforms with that of indebtedness is a mistake. This is not to deny that there is a very clear link between the two problems in the case of Greece. Endemic tax evasion, overblown public sector and an unsustainable pension system are but a few of the "structural" problems that need to be addressed urgently and have a direct bearing on national indebtedness. These and a whole host of other problems commonly associated with the Greek "malaise" must be addressed. The problem with the "holistic" approach, however, is that it assumes that the confidence-boosting and growth-enhancing effects of combining severe and rapid fiscal consolidation with a swift implementation of "structural reforms" will eventually bring about growth and ultimately resolve the indebtedness problem. As noted above the negative effects of fiscal consolidation on growth are immediate while the growth-enhancing effects of reforms take more time to have an effect. Furthermore as Terzi (2015) points out the *sequencing* of reforms in the Greek adjustment programme was wrong. The reforms that could have produced quick positive effects on output were delayed until 2012. This combined with unnecessarily harsh fiscal consolidation imposed in 2010 set in motion a classic debt-deflation spiral that made the task of implementing further "structural reforms" more difficult. It is far easier to implement institutional reforms in an environment of growth than in an environment of stagnation and economic depression (Dani Rodrik 2009; Sen 2015). Terzi (2015) goes a step further and extrapolates, based on the empirical findings of Daron Acemoglu et al. (2001), that if the aim is a swift return to growth and debt sustainability, institutional reforms are neither a necessary nor sufficient condition for success. He concludes: "Once growth momentum is restored, however, improving the institutions will help to solidify and sustain it" (p. 14). This, of course, is easier said than done. How can the growth momentum be initiated and restored in a heavily indebted economy member of an imperfect monetary union?

According to Mody (2015) there is greater certainty about what is **not** needed in the midst of a debt - deflation cycle. A depressed economy burdened with an unsustainable debt mountain does not need austerity. Fisher (1933) reached the same conclusion with regard to the US economy during the Great Depression of the 1930s. What the economy needed was not austerity but "reflation" - a policy lesson that President Roosevelt had quickly learned. He abandoned his pre-election promise of balancing the budget, engaged in deficit-spending and ultimately ended the Great Depression. Such a policy option is precluded by the rules of the monetary union in Europe. "Rules are rules" but should not rules be changed when they clearly do not make sense?

Is the major claim of the "dominant narrative" that the successful exit from the "troika" programme of Ireland and Portugal, the return of growth in Spain and the prospect of a return to growth in Greece in 2014, a vindication of the austerity strategy in the eurozone periphery? A satisfactory answer to this question would require a separate paper. Suffice it to note at this point that each economy in the periphery, faced with specific challenges, none had to deal with the severity and inconsistencies of the Greek programme (see: Mody 2015; Sen 2015; Terzi 2015).

3. Contradictions

In December 2014 "pre-mature" elections were proclaimed in Greece for January 25, 2015. According to opinion polls it was widely projected that the anti-austerity Syriza party that in the 2009 elections was supported by only about 4% of Greek voters was going to form the next government in Greece. It appears that a democratic majority of the Greek people after five years of austerity, especially those who were at the receiving end of the worst economic depression since the 1930s, have come to believe in the Syriza promise that it was possible for Greece to re-negotiate the austerity strategy and still remain a member of the eurozone. On the 25th of January 2015 the Syriza government was democratically elected with a popular mandate to re-negotiate the austerity strategy while remaining in the eurozone. Was the democratically expressed wish of the Greek people to stay in the euro but with different policies a contradictory demand? Is continued membership of the monetary union incompatible with opposition to the austerity strategy? Many commentators seem to have concluded that these were indeed contradictory demands and that what the

Greek people voted was effectively to "have their cake and eat it" or to enjoy the benefits of the eurozone membership without any associated costs. Some commentators (The Economist 2015) went a step further and claimed that Syriza's resounding electoral success in January was based "on the contradictory promise both to end 'barbarous' austerity and to keep the euro" (p. 17).

In principle the demands are not necessarily incompatible. Austerity is a policy based on a particular economic philosophy and imposed on indebted eurozone economies primarily as a means of reducing indebtedness. Opposition to austerity would be incompatible with continued membership of the eurozone if this strategy is indisputably and unquestionably the only means of dealing with the crisis. Opposition to the *only* sound and sane policy for ending the debt crisis would indeed be tantamount to a refusal to accept "short-term pain for long-term gain" and as such incompatible with continued membership of the eurozone. The austerity strategy, however, is not without its critics. There are many powerful and cogent theoretical and empirical arguments against the austerity strategy. Indeed a credible and persuasive case can be made that the austerity strategy has failed in achieving its objectives, the principal objective being the reduction in indebtedness that caused the crisis in the first place. In principle, therefore, it is not self-evidently true that it is "contradictory" to want an end to austerity and remain within the eurozone if you believe that the strategy is wrong and has failed to deliver what it promised. A majority of the Greek people after five years of austerity have come to believe in two, not necessarily contradictory, ideas. First, that the austerity strategy was counter-productive and must end and second that the newly elected Greek politicians would be able to win hearts and minds in Europe not only about ending austerity in Greece but also about the need to reform a malfunctioning and dysfunctional monetary union.

Although Greece's democratic choice as expressed in the general election of 25th January 2015 and the referendum of 5th July is not inherently contradictory, is the *rejection* by the Euro-group of this democratically expressed demand itself undemocratic? There is no straightforward answer to this question although some of the justifications for the rejection, as Martin Sandbu (2015) points out, range from "disingenuous", "charitable" and "plane cynical".

An example of a "disingenuous" justification is provided by Jeffrey Frankel (2015) who writes: "The Greeks would have done better to admit that democracy does not mean that one country's people can vote to give themselves other countries' money" (p. 9).

This is of course correct, but as the author explained in the same article "other countries' money" went largely to pay off the banks, not to the Greek people! The argument that there are 19 sovereign governments with 19 different democratic mandates in the eurozone is genuine. It is true that voters in Germany or Finland would expect their governments to reject any suggestion that their hard earned money be used to pay for the mistakes of the profligate Greeks. Is this, however, the right question? If the question as noted in Section 1 above was: "why Eurozone taxpayers (mainly German) pay for the mistakes of bankers and the architects of a malfunctioning monetary union" a different democratic outcome is likely. As Rodrik (2015) points out: "Europe's political elite could have framed the Greek financial crisis as a tale of economic interdependence – you cannot have bad borrowers, after all, without careless lenders – instead of a morality tale pitting frugal, hard-working Germans against profligate, carefree Greeks. Doing so might have facilitated the sharing of the burden between debtors and creditors and prevented the emergence of the us-*versus*-them attitude that poisoned the relationship between Greece and the institutions of the eurozone" (p. 1). A better informed public makes for better democracy.

A second "charitable" interpretation according to Sandbu (2015) as to why the rejection of the Greek democratic mandate for the reversal of the austerity strategy is not undemocratic is this: there is no alternative policy to the one the Greek democratic mandate wants reversed. It is not, therefore, undemocratic to want to prevent the unraveling of the euro by resisting demands for a policy reversal that would adversely affect the other 18 member states of the monetary union. As discussed in Section 2 above, however, the claim that there is no alternative policy is at best questionable and at worse gravely mistaken.

The third "plane cynical" justification is based on the political reality and power politics in the Euro-group. The eurozone consists of 19 member states, in theory, of equal status. Some member states, however, are more equal than others. The austerity strategy is firmly and single-mindedly supported by Germany, the economically most powerful nation in the eurozone that exercises hegemonic influence over eurozone policymaking and the, usually *ad hoc*, crisis management process. Furthermore a number of other eurozone states have elected governments that are committed to the austerity strategy and are resisting similar and equally popular local opposition demands for a reversal of the austerity strategy. As Sandbu (2015) points out: "having tied their credibility to policies that can fairly be blamed for holding back Europe's economic growth, the established elites cannot afford to admit that they were wrong. The claim that there is no alternative cannot survive the demonstration of an alternative that works" (p. 1). All pleas by the elected representatives of the Greek people that the "counter-narrative" of the eurozone crisis be heard has fallen on deaf ears and met with the firm reply that what the Greek people want is contradictory. They must choose: if they want to end austerity they cannot stay in the eurozone and if they want to stay in the eurozone they must continue with more austerity.

A more general point regarding the general issue of democracy and sovereignty is raised by Marek Dabrowski (2015) who correctly states that Greece "must accept the unpleasant fact that the range of available economic choices for a bankrupt country is more limited in comparison with a solvent one" (p. 1). These limits on sovereignty and democratic choice imposed by capital markets on indebted economies apply to all countries whether they belong to a monetary union or not. In a monetary union, however, because of the various inter-dependencies the issue of the limits and responsibilities of sovereignty need to be more fully defined. This can only happen when there is full political union. In a federal Europe these decisions on economic policies will be taken at the European level with much greater scope for democratic decision making and accountability at that level. In the meantime the question of the exact meaning of national sovereignty and democratic decision-making in the eurozone will remain unresolved.

If we accept John Stuart Mill's idea that democracy is "government by discussion" (John Stuart Mill 1859) then Greece's electoral mandate does not provide the Greek government with the unilateral right to override other electoral mandates in the eurozone; but it gives the Greek government a *right to be heard* in a democratic dialogue in the Euro-group. For Mill (op. cit.) "government by discussion" is an attempt to avoid the "tyranny of the majority" and in this sense democracy failed in the eurozone. Instead of a dialogue Greece was told in no uncertain terms that first, the Euro-group does not very much care about lectures from "maverick" Greek finance ministers and second that in the eurozone compliance with the rules and commitment to the undertakings of previous governments has precedence over recent electoral mandates. There were four crucial elements in the "counter-narrative" presented to the euro-group by the newly elected Greek government (see Yanis Varoufakis 2015a).

First, the excessive borrowing in Greece was just one manifestation of a much more general malaise in a malfunctioning monetary union that had no mechanism of dealing with persistent "capital flow imbalances". These un-detected and un-corrected imbalances were largely responsible for the sovereign debt crises not only in Greece but also in countries that were otherwise fiscally prudent and faithfully abiding by the rules of the monetary union such as Ireland and Spain. (See, Eckhard Hein and Daniel Detzer 2015). Fiscal discipline although necessary was not sufficient for preserving financial stability in the eurozone (Pisani-Ferry 2013).

Second, in addition to the above, the moralizing about Greek indebtedness must take into account the following: the "bail-out" of Greece in 2010 was in effect: (1) a "bail-out" of European banks that lent to Greece and other peripheral economies having disastrously miss-calculated and miss-priced the exchange-rate risk of such lending; and (2) a means of preventing "contagion" in the eurozone. The architects of the monetary union in Europe have omitted putting in place an effective mechanism of preventing contagion in the event of a sovereign debt crisis. In 2010 therefore the effects of a Greek default would have been disastrous for Greece but possibly even more disastrous for the eurozone as a whole.

Third, the austerity strategy imposed on Greece without prior debt restructuring was exceptionally harsh and with hindsight (Blanchard and Leigh 2013) unnecessarily exceptionally harsh. It resulted in a desperate 1930s style depression and humanitarian crisis in a European country in the 21st century that must be stopped. The claim that Greece's predicament, unlike the experience of other counties under "troika" imposed programs, is *entirely* due to inadequate implementation of the program is simply wrong.

Fourth, the Greek debt was not sustainable in 2010 and is not sustainable now. This is not simply a Syriza view but a widely held view. This is not simply a Greek problem but a European problem that needs to be addressed by a Pan-European conference along the model of the London Debt Conference of 1953. Germany, the chief beneficiary from the 1953 conference and debt relief, is flatly refusing to discuss "debt forgiveness" because it is not in the treaty and that is the end of this discussion. Were the various "bail-outs" or the program of Outright Monetary Transactions and Quantitative Easing in the treaty?

Since Euro-group meetings take place behind closed doors and without minutes we will never know what was discussed or not discussed in these meetings. The general impression, however, was that no substantial debate of these issues in the Euro-group took place. Moreover very soon attention shifted away from the message towards the messenger. The vilification and scape-goating of Yanis Varoufakis, the Greek Finance minister, was not unexpected but totally unjustified (Mohamed A. El-Erian 2015; Phillipe Legrain 2015). The only concession that was afforded to the new government was a five month period during which an alternative means of achieving the targets agreed by the previous government were to be worked out and presented. There would be no "debt forgiveness", no reversal of austerity and no "governance by discussion"! Significantly there was no serious fear of economic "contagion" in 2015. Unlike 2010, the European Stability Mechanism (ESM), the programme of asset purchases or Quantitative Easing (QE) by the ECB and serious steps towards banking union were in place. Above all, the markets found Draghi's commitment in 2012 to "do whatever it takes to save the euro" credible.

On July 12^{th} 2015 the Syriza government capitulated, the party split and ironically if not surrealistically new elections have been declared. A bemused Greek population having been told by its partners that it made contradictory and conflicting choices on the last two occasions it voted in 2015, it is was asked in September 2015 to make more meaningless choices.

4. Summary and Conclusions

In this paper we focused on three important questions concerning the troubled relationship between Greece and the eurozone: first, why instead of "Grexit" Greece was "baled-out" in 2010; second, why despite the biggest "bail-out" in global financial history the Greek economy collapsed and third what is the meaning of democratic choice in a monetary union?

There is a "dominant narrative" of the crises, which provides the following answers to the above questions:

1. Greece having broken the rules of the eurozone and lied about it was nevertheless shown leniency and solidarity through a generous multi-billion euro "rescue" package. In 2010 the "no-bailout" rule of the EMU was circumvented on condition that an economic "adjustment program" would be implemented with the expresses aim of promoting growth and reducing indebtedness thus lifting the country out of the crisis.

2. Greece, unlike Ireland, Portugal and Cyprus, failed to implement the agreed strategy and as a direct consequence of this failure its economy experienced a catastrophic collapse.

3. Adding insult to injury Greece elected in January 2015 a radical left government of inexperienced amateurs who believed they had a democratic mandate to unilaterally reverse the austerity strategy and demand debt-forgiveness. If Greece wants to stay in the eurozone it must be prepared to accept the democratic decision of other 18 member states to *reject* the Greek plea for a reversal of the austerity strategy and debt re-structuring.

According to the "dominant narrative" the Greek people have been given a final chance on July 12^{th} 2015 to decide what they *really* want. If they wish to remain in the eurozone they must fully implement the new agreement, regain their lost credibility, acquire "political ownership" of the reform agenda and come to terms with the "reality" of eurozone membership: it is austerity or bankruptcy and exit. Moreover the "amputation" option is still available.

The following are the main elements of the "counter-narrative":

1. It is undoubtedly true that in 2010 the multi-billion euro "bail-out" saved Greece from a disastrous bankruptcy. Whether Greek default and exit from the euro in 2010 would have been considerably worse than the current economic catastrophe in Greece is debatable. It is, however, disingenuous not to acknowledge the following two factors. First, the Greek "bail-out" had significant beneficial effects on the whole of the eurozone and the global economy by limiting the, as perceived at the time, elevated risk of "contagion". European tax-payers money was not simply used to "bail-out" irresponsible "borrowers" but also irresponsible "lenders". As Mody (2015) points out: "The argument is that contagion is a global problem and the global community should share the cost of preventing contagion. Absent such burden-sharing, it is an arithmetical matter that the austerity required on Greece was much greater than it would otherwise have been. And before the terms of the official loans were finally eased, the wind was knocked out of the Greek economy" (p. 1). Second, "bailing-out" an illiquid but solvent economy makes sense. "Bailing-out" a bankrupt country makes no sense, as the IMF rules that have been ignored clearly stipulate.

2. Presenting the 1930s style collapse of the Greek economy as *solely* the result of failure to implement reforms is also disingenuous and misleading. First, the economic adjustment programme had serious flaws. It was based as noted above on the assumption that the country was solvent when it was (and still is) insolvent. Fiscal multipliers were seriously under-estimated (Blanchard and Leigh 2013) and the sequencing of structural reforms was inappropriate (Terzi 2015). Second, it is simply not true that Greece failed to implement important parts of the "troika" programme, parts of which, like fiscal consolidation, was above target and ahead of schedule (IMF 2014b).

It is true that Greece massively violated the fiscal rules of the monetary union and lied about it. Greece, however, was not the first country to violate these rules. The first country was Germany, followed by France and Italy. Furthermore although Greece violated the rules of monetary union, Germany also has been violating rules: these are the "unwritten" rules of the monetary union. The "neo-mercantilist" German policy of fiscal austerity, while maintaining massive current account surpluses, makes no sense outside a monetary union and even less within a monetary union: and it is a great deal more harmful for its partners in the monetary union.

3. If we accept John Stuart Mill's notion of democracy as "government by discussion", the recent negotiation between Greece and its partners in the eurozone was a democratic failure. It was also, as Sandbu (2015) reminds us, a betrayal of one of Europe's most significant values articulated by Voltaire: to defend someone's right to express a view even if it is one that one deeply disagrees with. Not only was there no debate in the Euro-group about the "counter-narrative" (see, Varoufakis 2015b), but many who debated the issue in the social media have come to the conclusion that the Euro-group's policy on Greece amounted to a *coup d'état:* the removal of a legitimate government not through the force of guns but through the equally powerful force of financial strangulation.

According to the alternative narrative of the eurozone crisis, Greece not only got a raw deal in terms of the policies imposed on the country by the "troika" but also in terms of its efforts to win hearts and minds among the northern European electorate. As Rodrik (2015) points out: "One might argue that Europeans are not well informed about the plight of the Greeks and the damage that austerity has done to the country. And, indeed, it is possible that with better information, many among them would change their position" (p. 1). Most of them, however, have been told a substantially different "morality tale" which as we argued in this paper it is at best only partially correct and at worst a serious distortion of the nature of the eurozone crisis.

There was momentarily a glimmer of hope that the "counter-narrative" of the eurozone crisis so brutally dismissed and ridiculed by the policymaking elite of the eurozone was beginning to have resonance among many anti-austerity citizens of Europe. Whether the humiliating crashing of Syriza in Greece for daring to challenge the dominant narrative of the crisis would help or hinder the emergence of a European movement for the long awaited political reform of Europe remains to be seen. The Greek people and voters in other eurozone countries contemplating voting for parties opposed to austerity are now been told that this choice is not available. We argued in this paper that this contradiction is primarily the result of a particular political reality in the eurozone, dominated by a hegemonic German view of a monetary union. The policymaking elite in the Euro-group is unrepentant and unprepared to acknowledge its policy mistakes or accept what Plato taught us in the *Republic* 2,500 years ago that "might is not right"! There is a great deal of difference between the command "you must do as you're told because I am stronger than you" and the demand that "you must do as you're told because it is the right and correct thing to do"! In the former case debate and democracy is not possible, in the latter case it is.

It seems that the only real "contradiction" that remains in the eurozone is the utopian expectation that a monetary union, which has been imperfectly designed, will work under German hegemony without political union. The European Project is that of an "ever closer union". A dysfunctional and malfunctioning monetary union is a barrier to an ever closer union and therefore, as the recent experience in the USA shows, a barrier to the establishment of a rational crisis management mechanism in Europe. "Muddling-through" like the Euro-group, "a-Greek-ment" of July 12th, is no substitute for rational policymaking in the eurozone, the second largest economy in the world. A politically united federal Europe seems the only way forward.

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