

# Greece and Europe: What Now?

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## Manuela Saragosa

Good evening, welcome to Chatham House, this discussion is about the eurozone and what next for Greece and what next for the eurozone. Whither Greece? The 'h' is optional in whither.

A quick introduction; my name is Manuela Saragosa. I'm a journalist with the BBC World Service where I present business programmes. A bit of housekeeping before we kick off the discussion; feel free to comment throughout the discussion this evening and if you do, on Twitter, then remember to use the hashtag #CHEvents and also please, could you put your phones on silent mode. That would be good; we don't want any interruptions during any questions.

We've got an hour set aside for this evening's discussion so I think it's best if we just crack on and if I introduce our speakers. Anatole Kaletsky is our other speaker, who is not here yet, stuck in traffic because of the Tube strike but he is on his way. I've been assured that he is only about five or 10 minutes away. So, hopefully, he'll turn up very soon.

So let me just introduce our guests. Gene Frieda is a senior global strategist at the American hedge fund, Moore Capital and he focuses there on global macro policy issues. And also here is Dr Angelos Chrysosgelos, who is Academy senior fellow on the Europe Programme here at Chatham House.

What I'll do now is I'll hand the stage to our guests and let them kick off with their own views for the next five or six minutes each so I'll let you speak for five or six minutes each and then, hopefully, Anatole will turn up and then we'll open it up to the floor for comments and questions from the audience. So Gene, please go ahead.

## Gene Frieda

Thank you. I'm going to try to set the stage a little bit. I just came back from Brussels this morning so I've been talking to a lot of people who are involved in the negotiations and then also just talking about a couple of key conclusions in terms of what a yes or what a no means at the end of this process on a deal.

So my odds, just to cut to the chase, of a deal being signed over the weekend, are around 25 per cent. Now, inevitably, when you get close to the end of a process, people start to get more excited and optimistic as I think many of us were on the 25 and the 26 of June. But what you realize from talking to the people who are involved in this is just how complex the process is and how, in many respects, the process went over a cliff on June 27 when Greece walked away from the discussions. So I want to put that in context.

I mean, where we are today, you effectively have a process whereby the programme being designed is really being designed in Brussels at this stage and so the risk that, let's say, there's a design mistake is probably less. The question is about political buy-in and I think the issues about technical competence, which have plagued the process and political buy-in haven't really been resolved by the departure of Varoufakis, even though the mood music in the discussions has improved quite a bit. The only thing that really changes this

issue of political buy in is a change in government, which, I think, Angelos will talk about later.

So, what we've seen repeatedly in this process is the two sides get very close to an agreement in Brussels, then there is a discussion back in Athens and, suddenly, the conditions that have been agreed change and the deal falls apart. And really, that's where we were today. The discussions were happening in Athens; we're waiting for a plan to be agreed and put back to the institutions tonight. That should happen probably around 10:00 our time and assuming that that programme is deemed somewhat viable, you know, there'll be a back and forth over about 24 hours and then on Saturday morning, there'll be a Euro working group, which is the body that prepares for the Eurogroup meeting of finance ministers and if they believe it's technically viable, then it will go to the Eurogroup.

And I think this really will be kind of the pinnacle of the negotiation and the finance ministers are really in charge in this case. Every time Tsipras has tried to turn this into a discussion between political leaders, it's been kicked back down to the ministers, saying, 'You have to have a technically viable agreement in order to take this forward.'

So where you will see all of the knives come out, the knives between member states that are fed up with the Greeks, that will all come out on Saturday and the central question mark is probably around the German response to a programme. One thing that is clear... or let me put it this way, I think there are two pressure points between now and Sunday, Sunday being the day when we actually have a leaders' meeting. The first is the design and the cost of a Greek programme; the design has always been difficult but the cost has gone up dramatically, whereas, they were talking a programme of 15 to 20 billion prior to the imposition of capital controls, they're now talking a programme of 50 to 60 billion. And most importantly, a lot of that money will need to be disbursed immediately.

So this question of trust becomes central; how do we member states convince our people that we just put another 30 billion up front into Greece and they haven't really done anything to show that they're trustworthy partners? So that's one big issue.

The second issue and the related issue is basically resolving the banks. Now, the banks have come under extreme pressure, liquidity pressure, solvency pressure. There's a sense that the recapitalization needs of the banks under, let's say, the current scenario, before things get worse is probably going to be in the area of €25 to 30 billion. And so again, when you get back to the discussion of how to cost the programme or what kind of money member states have to put forward, you get into this tricky issue of whether or not to bail in depositors.

Now, there are some legal issues, some sort of technical and legal issues. Greece hasn't actually passed the legislation yet that it would need to have in place to resolve the banks but nonetheless, the point is that there aren't many private creditors to bail in before you actually get down to depositors and so there will be this extreme tension between the creditor countries who say, 'We don't want to put up more money. You should bail in the depositors,' and the depositors who, if anything, one can only say have been quite loyal if their money is still in the bank at this stage. And so that also plays into the political process.

Tsipras is already spinning the referendum result as having been a rejection because there was no debt relief on offer, whereas it's been very difficult to understand how would he do a 180? The perception now is the way he will do it is to say, 'Okay, well, the referendum really was a rejection of the fact that there was no debt relief included but now there will be debt relief.' So immediately, that becomes a huge point of tension. How do you design an offer of debt relief to satisfy the Greek side, to satisfy the IMF side that the debt is actually sustainable and to satisfy the member states that they're not going to give all this debt relief and not get anything back from the Greeks? So there will be a cost to it.

And the last point on the design and cost is we need a bridge. This whole process is going to take quite a bit of time to design a third programme and if you look at the numbers that are needed now, the numbers are adding up. You've got over seven billion for the ECB in July and August, a billion and a half from the IMF, another half to a billion to pay for some other debt coming due and there's no money available. So basically, the leaders will have to actually come up with some kind of new source of funding. So that's an important question as well and it's a question that relates back to the ECB because the member states like to go to the ECB and say, 'Give us some money.' So the question of whether or not the ECB allows Greece to issue more T-bills in order to get this funding is an open question.

The second pressure point is really member state political approval and the point I was trying to make earlier was that for the first time in this European crisis, it's really not up to Angela Merkel on whether or not to put a solution forward. At this point, Schäuble is the most popular politician in Germany. He really owns the Greek issue and Merkel is legendary for never going against her people and there's now a majority of the people who are in favour of Greece leaving the Eurozone. So what this means is that there is a very high bar for Germany to sign off on any deal that's put forward.

The second point is most... sorry, I mentioned the part about most of the funding being up front. The third point is that this also a unique situation where unanimity is required. Normally, countries will follow the Germans; in this case, it's actually possible that some of the smaller countries block the process, most notably the Slovaks but there are a couple of other hardline countries.

So this is why... I mean, there are numerous other complexities but this is why I think the odds of a deal are reasonably low at this stage in spite of the better of efforts of Tsipras at this stage to kind of reorient the political leadership of the country and try to get some form of unity behind a deal. What you have to recognize and here I think there is an analogue, not in the sense of a blow up but in a sense of why something that shouldn't fail fails. There is an analogue to Lehman Brothers, which is one of the key principals in the process is convinced that there shouldn't be a deal. In the case of Lehman Brothers, I think, debatable, that the US Treasury secretary had decided that Lehman should be made an example of and I think in this case, a number of the principal member states have decided that that should be the case with Greece as well.

In terms of the implications, I think the most important and this I think is definitely a good issue to debate is that regardless of what happens on Sunday night, we have had the precedent of an exit. We haven't had the physical exit, we haven't had the legal exit but we have had political acceptance by the key countries in the eurozone and the ECB that a

country can leave. And that means something in terms of reversibility risk. It means something when a government is elected in a country that has a high debt level where the market might start to move and actually price in a risk premium of exit.

The second point is that the precedent around debt relief risks being rendered somewhat perverse. I don't think it will happen in the current governments in Ireland and Portugal but it's bound to happen that some of the highly indebted governments like Ireland, Portugal do come back asking for relief in the future. I personally can't find any example outside of Africa where you have a situation where official creditors are lending to a country and at the same time, taking write downs on their existing debt. So that's an interesting precedent.

The third point is really on contagion. We've been reasonably sanguine on financial contagion risks. I think it's right to say that the links have mostly been severed and the tools that have been put in place by the ECB and by European member states in order to backstop other countries are reasonably robust but there is a real question about what it means for growth and investment in the future and I think that's where you can actually bring in the discussion of Brexit as well. How much are you going to be willing to invest in the Eurozone knowing it's possible that the whole thing breaks up? And I think that at some level, that applies to the EU as well.

And finally and just to transition this over to Angelos, I think the referendum was really striking in a broader context, which was who actually represents the yeses? There is no real face of Europe. We had a face of no; that face was Alexis Tsipras. Who was the yes? Who is the yes in Europe? It doesn't really exist anymore. And I think what we found with Greece is that in asserting its right as a nation to determine its own economic, social and political path, it's done so to the detriment of other members states and what that means, I think, is that... or what it signifies is that Europe doesn't really sell as an issue politically and assertions of national sovereignty make crises extremely costly. Thank you.

### Manuela Saragosa

That's a pretty downbeat view of the politics of it all and the political fallout. Angelos, I don't know if you agree or are as downbeat as that?

### Dr Angelos Chryssogelos

Yes, I would be very downbeat, actually. There is a face of yes in Greece and that's Alexis Tsipras himself. Tsipras basically became the face of 'no but maybe yes' from Monday onwards, virtually after the results came in.

What I would like to talk about and I think this actually is part of my argument is kind of trying to understand what has led the Greek government to the point where it is today. And the main argument is that Tsipras himself, as a person, has tried to reconcile what turns out to be fundamentally different issues, fundamentally different attitudes in Greek society and he has tried to reconcile them hoping that Europe will cave in eventually and help him escape these contradictions. And now it really boils down to him.

I understand the role that Schäuble plays but even if Europe was willing to have an agreement with Greece, based on what we have seen until now, I think I would find it very hard to imagine Tsipras taking the final step and signing up to the things that right now are being put on the table.

So, the main thing that we have to understand, first of all, is what led Tsipras and Syriza to their success initially and that was the fact that they managed to reconcile in the eyes and the minds of the Greek people two things. One thing was that after five years of austerity, Greek people had enough, alright? So austerity had to go. At the same time, the majority of Greek public opinion is adamant that they want Greece to stay in the eurozone. And Tsipras, basically and Syriza promised that this thing is possible, that the whole pre-electoral campaign that led to their victory in January was that, 'We can have fundamental changes but Greece's place in the eurozone would not be jeopardized.'

When Tsipras was asked, 'What if they say no?' Tsipras famously said, 'They won't say no.' And the idea behind it turned out that the implementation, if you will, the technical implementation of this was Yanis Varoufakis himself. One should not underestimate, I think, in my view, Varoufakis' role in all of this because it was his confidence that eventually Europe will cave in that basically led the process all the way to here. I wouldn't be surprised if the referendum decision was really his ultimate idea. And the idea was that if we just up the stakes just a bit, on Monday, something will happen. The markets will go down, other political parties around Europe will rally to us, national governments are going to be afraid and so on and so forth.

So Tsipras basically found himself from the beginning in this dilemma and he was told that the only way to break this dilemma was if he just upped the stakes just a bit and just a bit as he was going forward, which led, ultimately, to the referendum decision. Now, I have spoken to people who are close, who are in Syriza, who are close to Syriza and they have told me that the referendum decision completely backfired because Tsipras really did not expect that kind of outcome. He sincerely did not expect the 60 per cent no.

### Manuela Saragosa

He expected less or more?

### Dr Angelos Chryssogelos

He expected actually much less. He expected to be capable to go to Europe and say, 'Listen, Greek society is fundamentally split. Do something for me,' or something like that.

So, basically, Tsipras right now finds himself in a position where he has to spin the no into a yes and this is extremely difficult for him. Another thing that probably most of the people in this room probably are familiar with by now are the intricacies of far left politics in Greece and the whole notion of Syriza. I have to admit, I stand accused, I am guilty, in the beginning, I thought that Tsipras would lead Syriza towards a compromise. It turns out that while Tsipras was trying to reconcile this basic dilemma, yes to the euro, no to austerity and as time was going on, there was this convergence between Varoufakis' strategy, which was up the stakes, up the stakes, up the stakes all the time and the far left

of Syriza slowly taking over the agenda in Greece. And that turned out in the referendum. The no campaign of the referendum was essentially taken over by the hard core of Syriza, which while before January, before the elections, it did not talk about exiting the euro, now it barely conceals the fact that we might be better off outside the eurozone.

Which leads me to the day after; supposing there is an agreement, who will implement it? As things stand now in the Greek parliament – the Greek parliament had 300 seats. A hundred of those seats are occupied by the pro European opposition, New Democracy, which was the government beforehand and two small central left parties. Supposedly, we can count on those parties to support an agreement but that still leaves us short of a majority. Syriza would have to support anything, or the vast majority of Syriza. And I'm not sure whether the dynamics unleashed by the opposition can allow Tsipras to deliver Syriza to that and even more, I'm not sure whether Tsipras has reached the point where he's willing to impose heavy austerity with the cost of seeing his party split.

So I think that the domestic dynamics in Greece – while I understand the role of Wolfgang Schäuble because at the end of the day, he signs the cheques – but I think that the domestic dynamics of Greece and the internal dynamics of Syriza, while they were quite positive initially, back in January, for Tsipras to deliver an agreement, right now are becoming almost prohibitive for that.

## Manuela Saragosa

Angelos, thank you very much. I think we'll introduce Anatole Kaletsky who has managed to brave the traffic. He's a journalist and financial economist, now a columnist at Reuters as well. I thought if you could briefly say what – because we've already spent quite a lot of time introducing and hearing from our guests – if you could briefly say what your points are to be and then we can open up to the floor.

## Anatole Kaletsky

I'm very sorry if I repeat what others have already said but perhaps that will reinforce their credibility and on the other hand, if I contradict you, not having heard it, it will make the discussion more interesting.

Well, looking forward for a minute to next weekend and looking back to last weekend, which I think were the critical points. What happened six months ago is water under the bridge. I think there were huge mistakes made, primarily by the Greek side and Varoufakis' ridiculous game theory, idea that he could push the others into backing off and all that.

But I think that the crucial events were last Sunday with the referendum and this coming Sunday with the European Summit. Now, my impression, talking partly as a journalist but mostly as a consultant to a lot of financial institutions like Moore Capital and so on, so having talked to the investors and some of the people on the ground in Greece as well, is that I would say there's now about an 80 per cent chance that there will be a deal done on Sunday.

## Manuela Saragosa

We had Gene saying 25 per cent. It's a good thing you're sitting that far apart.

## Anatole Kaletsky

So obviously, I've been talking to people who are on the other side. I think the main obstacle to a deal now is probably, actually, Germany and Schäuble rather than Greece and Tsipras and that is a 180 degree reversal of the situation a week ago or two weeks ago before the referendum was called.

Before the referendum was called, I think the Europeans, including the Germans, were willing to do a deal on almost any terms with Greece, provided the Greek government accepted at least a few highly symbolic and political concessions rather than anything to do with economic numbers in order to show that this was not a give away to a Greek government that had blackmailed Europe into submission but, in fact, was a deal that was very reluctantly accepted by the Greek radicals.

So two weeks ago, if Tsipras had signed up to the really very modest pension reforms and the small increase in indirect taxes that were required, I think everybody in Europe, including the Germans, were willing to give him that deal. I think now it's less certain because he's antagonized so many people, the German government in particular and also because a number of the so-called periphery, the debtor governments and Spain in particular has a very strong interest in showing that this kind of behaviour does not get you a better deal; it gets you a worse deal because – probably, this has been mentioned already – you know, the concern in Spain is that Podemos will do the same to Rajoy that Syriza managed to do to Samaras.

So the situation now is that there are some people in the EU and in Germany in particular who are resisting. On the other hand, I think Tsipras is now, paradoxically, much more ready to sign up than he was before he won the referendum. And this is, at least, the story that I'm getting from I think fairly well informed contacts that I've spoken to in Greece in the last couple of days.

Why is Tsipras more ready now to sign up to things that he actually rejected two weeks ago? Because the referendum was really not about, 'Do we want to stay in the euro or not,' it was not about, 'Do we want to accept these conditions or not,' it was about whether Tsipras was going to get a huge vote of confidence personally from the Greek public or whether he was going to be sidelined or paralyzed as a weak leader in the same way that the Greeks had had up till now. He made a big gamble. From what I understand, the whole campaign, especially in the last few days, was a very, very personalized campaign about Tsipras personally going out to the public and saying, 'Trust me. Vote with me and I will save you.' And he made this gamble and he won.

As a result of this, again from what I've heard but maybe there's disagreement on this, he is now totally dominant on the Greek political scene, he has completely crushed the opposition on the left within his own party and more importantly, even, he's completely devastated all the other parties so that Syriza is now the only party that really mattered. We say yesterday, the leader of the centre-right party resigned. All the other parties are



totally in disarray. So he really has more power now to run Greece, at least for the next year or so, than any politician has had in the past.

So the question is does he want to use that power to pull Greece out of the euro or does he want to use that power to do a deal on the sort of terms that might have been available two weeks ago, maybe with a few bells and whistles? And the 80 per cent is that I think... well, put it this way, I think that there is a 90 per cent chance that he actually wants to do a deal and be the man who saved Greece and continues to dominate Greek politics for the next two, three, four years.

But then there's a small percentage chance, say 10 per cent chance that despite that, the Germans will reject it on Sunday. The other 10 per cent is that maybe, actually, Tsipras all along didn't want to do a deal; maybe he actually wants to be the guy who pulls Greece out of the euro and sets it on a much more radical path of defiance, not just to the Eurozone but the EU and the whole sort of globalized capitalist system. That's possible but what people who know Tsipras or claim to know him quite well tell me is that they don't think that that's the case. So I'll leave it at that.