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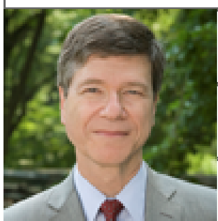

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English

A Way Out for Greece

QUITO – The Greek crisis is a tragedy for the country and a danger for the world economy. Germany is demanding that Greece continue to service its debts in full, even though Greece is clearly broke and the International Monetary Fund has noted the need for debt relief. The collision of reality (Greece's insolvency) with politics (Germany's demands) was bound to create a disaster. And, indeed, it has: the shocking collapse this week of the Greek banking system.

Yet there still is a way out of this mess. Greece's debt should be cut sharply, and the country should remain within the eurozone.

In negotiations with its creditors this spring, Greece recognized this, insisting that its debt be reduced. Germany refused. Though the United States and the IMF privately sided with

Greece, Germany prevailed, as creditors usually do.

Yet creditors sometimes prevail to their own detriment; by pushing the debtor to the breaking point, they end up bringing about a complete default. Germany's mistake this past week was to push the Greek economy – already in conditions rivaling those of the Great Depression – into a complete financial collapse.

German Finance Minister Wolfgang Schäuble has a clear negotiating strategy, aimed at getting Greece to agree to leave the eurozone. Unfortunately for him, Greece does not want to exit, and it cannot be forced to do so under the treaties governing the European Union. What Greece wants is to remain in the eurozone, with a lower debt burden – a position that is both economically astute and protected by treaty.

Indeed, a euro exit would be remarkably costly for Greece, and would almost certainly create political and social chaos – and perhaps even hyperinflation – in the heart of Europe. The value of Greek residents' savings would be slashed, as euros were suddenly converted into New Drachmas. The middle class would be eviscerated. And the currency conversion would not save the country one cent with regard to its external debt, which would, of course, remain denominated in euros.

Still, Greece's debt burden is unsustainable. This week, Greece defaulted on its payments to the IMF, rightly choosing pensions over debt service. The country's creditors should now negotiate a consensual debt reduction through some combination of lower (and fixed) interest rates, reduced face value of debt, and very long maturities.

There are plenty of precedents for such a course. Sovereign debts have been restructured hundreds, perhaps thousands, of times – including for Germany. In fact, hardline demands by the country's US government creditors after World War I contributed to deep financial instability in Germany and other parts of Europe, and indirectly to the rise of Adolf Hitler in 1933. After World War II, however, Germany was the recipient of vastly wiser concessions by the US government, culminating in consensual debt relief in 1953, an action that greatly benefitted Germany and the world. Yet Germany has failed to learn the lessons of its own history.

I propose a four-step path out of the Greek crisis. First, I recommend that the Greek people give a resounding "No" to the creditors in the referendum on their demands this weekend.

Second, Greece should continue to withhold service on its external debts to official creditors in advance of a consensual debt restructuring later this year. Given its great depression, Greece should use its savings to pay pensioners, provide food relief, make crucial infrastructure repairs, and direct liquidity toward the banking system.

Third, Prime Minister Alexis Tsipras must use his persuasive powers to convince the public, in the style of US President Franklin D. Roosevelt, that the only thing they have to fear is fear itself. Specifically, the government should make clear to all Greeks that their euro deposits are safe; that the country will remain within the eurozone (despite the false claims by some members of the Eurogroup that a no vote means a Greek exit); and that its banks will reopen immediately after the referendum.

Finally, Greece and Germany need to come to a rapprochement soon after the referendum and agree to a package of economic reforms and debt relief. No country – including Greece – should expect to be offered debt relief on a silver platter; relief must be earned and justified by real reforms that restore growth, to the benefit of both debtor and creditor. And yet, a corpse cannot carry out reforms. That is why debt relief and reforms must be offered together, not reforms "first" with some vague promises that debt relief will come in some unspecified amount at some unspecified time in the future (as some in Europe have said to Greece).

To be sure, in the Greek debacle, both sides have made countless mistakes, misjudgments, and misdeeds over the last decade, and even before. A country does not reach Greece's parlous state without a generation of egregious mismanagement. But nor does a country go bankrupt without serious mistakes by its creditors – first in lending too much money, and then in demanding excessive repayments to the point of the debtor's collapse. With both sides at fault, it is important for them not to lose the future by squabbling endlessly over the past.

Easing Greece's debt burden while keeping the country within the eurozone is the correct and achievable path out of the crisis, and it can be accomplished easily through a mutual accord between Germany and Greece, to which the rest of Europe will subscribe. The result would be a win not only for those countries, but also for the world economy.

Read more from *Greece and the Fate of the Euro*

Crunch time has come for Greece, and perhaps for the euro. If Greece defaults and exits the eurozone, how much collateral damage should Europe expect?

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