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Why Varoufakis Couldn't Fix the Debt Crisis

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Adults in the Room: My Battle With the European and American Deep Establishment BY YANIS VAROUFAKIS. Farrar, Straus and Giroux, 2017, 560 pp.

The Abrahamic religions take a radical view of debt. Charging excess interest is the sin of usury, and outstanding obligations are supposed to be periodically canceled during jubilee years. The old moralists understood the dangers of insisting on the repayment of unpayable debts. But the global financial crisis has revealed that we badly need to relearn this wisdom.

A debt crisis occurs when the credit that has sustained spending suddenly dries up, making it difficult or impossible for debtors to service their debts. This is what happened to both U.S. investment banks and eurozone governments from 2008 on (as well as to many homeowners on both sides of the Atlantic): without the easy lending that had been available before the crash, they ran out of cash when their obligations fell due.

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Policymakers have two options in such a crisis: they can either bail out debtors so their debts are honored, but restrict new borrowing until the debt shrinks, or suspend or write down debtors' past obligations, so that new creditors need not fear throwing good money after bad. Religious wisdom counsels the latter. The eurozone, fatally, chose the former.

When investors abandoned governments and banks in the eurozone in 2010, EU leaders, including Jean-Claude Trichet, the president of the European Central Bank, insisted that Greece, Ireland, and Portugal would have to pay their debts in full and back the debts of their banks to boot. Bailout loans made this possible, and in return, debtor governments agreed to slash spending, raise taxes, and pass economic reforms ordered by the "troika" of creditors—the ECB, the European Commission, and the International Monetary Fund (IMF).

Such policies were not confined to the crisis countries. Scared by the debt-market panic, all the eurozone governments tightened their belts. Although there was no sign of inflation on the horizon, the ECB raised interest rates. And instead of restructuring their own debts (giving bondholders a "haircut," in financial parlance), struggling banks received taxpayer-funded bailouts, large enough to prevent formal bankruptcy but too small to heal the banking system.

Ultimately, this effort to protect investors from losses caused much greater pain for everyone else. Instead of resolving the problem, these decisions created a second eurozone recession and outright depressions in the hardest-hit countries. Perversely, this worsened the

debt problem. Experts disagree about whether the crisis was avoidable. But there is no question that bad policy made things worse than they had to be—and nowhere more so than in Greece.

Athens was the first to get locked out of financial markets in 2010, after the global recession pushed its already weak public finances into a yawning deficit of 15 percent of GDP. In 2010, and again in 2012, it was also the first to be bailed out, to the tune of hundreds of billions of euros, in return for compliance with harsh austerity measures and structural reforms drawn up by the troika. These terms devastated the economy. By 2013, the unemployment rate had reached 25 percent, and the average Greek was 40 percent poorer. A bailout policy designed to avoid default—almost 90 percent of the money went toward repaying existing creditors and propping up Greek banks—had left Athens' debt burden greater than ever.

When desperate Greeks elected a radical left-wing party, Syriza, in January 2015, it was the first time a eurozone government had come to power that earnestly intended to oppose the troika's policies. The Syriza experiment put two big questions to the test: Was there a viable alternative to bailouts, austerity, and structural reform imposed from the outside? And would the eurozone allow people to democratically choose a radically different economic model?

The answer to both questions would appear to be no. After six months of negotiations with the troika, Greece's new prime minister, Alexis Tsipras, capitulated, accepting a new loan on terms that were even harsher than those he had been elected to reject. But the truth may be more complicated.

At the center of these events was Yanis Varoufakis, a firebrand academic economist who had long decried the eurozone's failure to more radically restructure Greek debt (the 2012 bailout had featured a substantial but insufficient restructuring). As Greece's finance minister in the Syriza government, he should have been well positioned to negotiate a better agreement with the troika, but by his own admission, he failed. *Adults in the Room*, his memoir from this period, offers an insight into why—but perhaps not the one Varoufakis believes.

AN UPHILL BATTLE

Although Varoufakis entered office armed with largely correct convictions about what ailed Greece's economy, he held a weak hand from the beginning. The outgoing center-right government had set a trap for its successors by allowing the previous bailout program to expire just a month into Syriza's term in power. An expiration with no new deal gave the ECB a pretext to force the closure of Greek banks (which eventually happened in June 2015). The prospect of citizens unable to access their cash forced Syriza's inexperienced radicals into high-stakes negotiations with the clock ticking against them.

It quickly got worse. According to Varoufakis, the troika cared more about forcing Athens to comply with its policy demands than about whether those policies would help Greece's recovery, or even allow it to return the bailout money. Varoufakis claims that many of his counterparts ignored his analysis and proposals, complaining, "I might as well have been singing the Swedish national anthem." And in his telling, it

was worse when they did listen. Varoufakis says that in his first meeting with Christine Lagarde, the IMF's managing director, she admitted that the bailout program would fail but then explained "with calm and gentle honesty" that it was too late to change course—too much political capital had already gone into the program.

Varoufakis spreads the blame widely. In his account, the Germans had ideological blinders that made them axiomatically opposed to debt relief on Greece's rescue loans. Their allies were sycophantic, and their natural opponents—especially the French—were submissive. ("France is not what it used to be," Varoufakis quotes Michel Sapin, then France's finance minister, as lamenting. In contrast, he depicts Emmanuel Macron, who was then France's economy minister, as a trustworthy ally who did what he could to help.) European Commission and IMF staffers suffered from rigid minds, big egos, and flawed economic models. Most of his Greek colleagues were duplicitous and covertly aligned with the troika or Greek oligarchs. Tsipras comes across as fatally indecisive and, ultimately, a coward.

This finger-pointing makes for exciting reading, and Varoufakis enthusiastically spills the beans on his many closed-door, race-against-the-clock meetings. But the book should be read with caution. It will be hard to verify many of these anecdotes until more participants publish memoirs—and some of the quotes are implausibly detailed and eloquent. Nevertheless, most of what Varoufakis says rings true, and many who have been close to these events will share his low opinion of some of the key players.

Yet the book also reveals Varoufakis' own weaknesses. Above all, it shows that embracing several roles at once—left-wing activist, academic analyst, and public servant—may have boosted his popular image, but it undermined his ability to master politics.

DAVID AND GOLIATH

His messianic zeal for debt relief helped Varoufakis make an immediate international impression. On his first trip as finance minister, to the United Kingdom, he became an overnight star, befriending past and present Tory chancellors and quoting the poet Dylan Thomas on the BBC: "Do not go gentle into that good night, . . . Rage, rage against the dying of the light." With hindsight, one can see that those lines, with their promise of temporary dignity before an inevitable demise, encapsulate Varoufakis' six-month tenure as finance minister, which ended in his resignation and Greece's capitulation to further austerity measures.

Always the showman, Varoufakis fills his memoir with literary allusions and excerpts from his own grandiloquent speeches. He presents himself as David fighting the Goliath of a neoliberal system; consider the book's subtitle: *My Battle With the European and American Deep Establishment*. Few members of that establishment come out looking good in Varoufakis' telling. For example, Jeroen Dijsselbloem, the Dutch politician who is president of the Eurogroup of the eurozone's finance ministers, is "abrupt and aggressive," "his voice dripping with condescension," "seemingly apoplectic."

It is hard not to sense a degree of condescension in Varoufakis himself when he dishes it out. His style, however popular with his voters, must have chipped away at the goodwill of those

he needed to win over—not least because he regularly told them that what they had done before he arrived on the scene was all wrong.

Why would a politician who needed a deal delight in rubbing his opponents the wrong way? Presumably, he sincerely believed that the force of his ideas alone would sway the wills of the powerful. But while confidence can get you far in politics, overconfidence can lead you astray.

PROFESSOR VAROUFAKIS

In his memoir, Varoufakis employs formal game theory to justify his political decisions, mapping out a "game tree" that would not be out of place in an economics classroom (indeed, he says he used it in one of his university courses).

This game has three stages. In the first stage, the troika decides whether it will play hardball or respond to Syriza's election by moderating its demands. If the troika backs down, an agreement is reached. If not, the game progresses to the second stage, where Syriza can either capitulate or hold out for a better deal. If Syriza honors its campaign pledge to stand firm, the game enters the final stage, in which the troika must either compromise with Athens or push Greece out of the eurozone.

The logic of this game guided Varoufakis' actions. He believed that the troika would compromise only if he could make Greece's creditors believe that Syriza would rather see Greece forced out of the eurozone than bow to their demands. This would call the troika's bluff: if the creditors considered a Greek exit ("Grexit") sufficiently costly, they would renegotiate. To sustain this strategy, Varoufakis says that he tried to impress on his own prime minister the need for a twofold deterrent. To make Grexit look maximally painful for the troika, Varoufakis wanted the government to signal its willingness to unilaterally default on Greek bonds held by the ECB, which would inflict politically toxic losses on the central bank. And to make Grexit easier to carry out if necessary, he began to develop a parallel payment system based on tax credits, which could be quickly turned into new currency if Greece had to leave the eurozone.

But Varoufakis never triggered his deterrents. In his own assessment, this was a mistake, because it became increasingly clear (as he tells it) that Tsipras would bow to the creditors' demands. But the opposite may be true. By signaling that he would rather Greece leave the eurozone than give in, Varoufakis may have convinced the other side that he actually wanted Grexit. In that case, there was little reason for the creditors to compromise, since they could not keep Greece in the eurozone against its will.

His strategy also played into the hands of those across the table who may have preferred Grexit (Wolfgang Schäuble, Germany's finance minister, notoriously proposed a "timeout" for Greece) by allowing them to pin the blame on him. Varoufakis relates a conversation with Schäuble in which he asked his German counterpart what he would do in Varoufakis' position. Schäuble reportedly answered that "a patriot" would reject the troika's terms, even if doing so would lead to Grexit.

Varoufakis quotes his own words from a *New York Times* op-ed in February 2015, in which he wrote, "It would be pure folly to think of the current deliberations between Greece and our partners as a bargaining game to be won or lost via bluffs and tactical subterfuge." But there is little evidence that he followed his own advice. Any negotiator worth his salt must understand the game he faces, but the best negotiators aim to change the game itself and create common ground where none existed before. That is where the analyst's work ends and the politician's begins.

FAILURE TO LAUNCH

Varoufakis vividly describes the plots, ambushes, duplicity, and even ostracism he faced during his six-month tenure. But the book also reveals something that its author does not dwell on: a willingness of the other side to compromise. Early on, both the European Commission and the IMF come across as ready to make something like a fresh start with Greece. As late as April 2015, two and a half months into the negotiations, Varoufakis depicts Lagarde as genuinely open to a revised program that would accommodate Greece's priorities, such as being the author of its own structural reforms. So why didn't such an agreement happen? To say that Schäuble sabotaged it all, as Varoufakis very nearly does, raises the question of how Schäuble was able to do so. Ultimately, the book cannot paper over the fact that Varoufakis could not hold up his side of a new bargain.

Varoufakis' Finance Ministry never came up with policies substantial enough to compete with those laid down by the troika. Negotiators representing the creditors rightly dismissed early Greek proposals as frivolous. Varoufakis occasionally mentions sensible initiatives, such as an algorithmic search system to identify tax cheats, but he then says very little about what happened to them. Of course, implementing programs takes time, but if these and other reforms were well under way or already producing good effects, why couldn't the creditors be convinced to support them? If Varoufakis pays so little attention to them in the book, perhaps he also paid little attention to them while in office.

Even many of Varoufakis' best ideas seem like afterthoughts. For example, he overlooked the potential of the parallel payment system, which would have created a means of monetary transaction alongside the euro. Varoufakis saw this tool solely as a way to pave a smoother exit out of the eurozone. But even within the single currency, a parallel payment system could have helped mitigate the lack of credit that resulted from a banking system that was bleeding deposits. Had this plan been implemented, Varoufakis might have been able to boost growth a little and reduce the harm caused by bank closures and capital control. Both outcomes would have strengthened the Greek government's bargaining power by giving it more breathing space.

Varoufakis also supported restructuring Greece's failing banks, which were full of bad loans after years of economic crisis. Separating good from bad assets would have created new, healthier banks, which would have supported the economy and mitigated the ECB's threat to force bank closures. So why was this not done? Varoufakis claims that when he assumed office, Syriza immediately transferred power over the banks from the Finance Ministry to the deputy prime minister's office (he intimates that this move was to protect powerful oligarchs), but he says nothing about trying to reassert control. Whoever is to blame, the failure to act early on the banks made the Greek negotiating position much more desperate.

The book also reveals that Varoufakis' personal authority was weaker than he lets on. He describes senior staff members undermining him from the outset, but he did not fight to have them removed. This was a symptom

of a deeper challenge: Varoufakis had little support inside Syriza (he was not a member), and he relied entirely on his relationship with Tsipras for his authority. At his very first Eurogroup meeting, facing strong pressure from the rest of the eurozone members, he wobbled on his no-capitulation strategy and referred the decision not to compromise up to Tsipras. None of this suggests a fully empowered negotiator. Indeed, Tsipras later sidelined Varoufakis by opening a parallel channel of communication to negotiate with the creditors.

THE ESTABLISHMENT HAS NO CLOTHES

Varoufakis faced enormous challenges from the start. Still, his memoir suggests that failure was not preordained. The image that emerges of him—a picture of moral overbearance coupled with strategic miscalculation and negligent policymaking—is not especially flattering. A more adept politician could have played the game better and perhaps nudged the eurozone to distance itself from past mistakes.

Then again, maybe diplomatic success is not the metric by which Varoufakis should be judged. He is, first and foremost, an activist, who is more comfortable protesting outside a government building than making decisions inside it. In the book's first chapter, Varoufakis recounts a late-night meeting with former U.S. Treasury Secretary Lawrence Summers, who taught him the omerta of establishment politics over drinks in a hotel bar: "Never turn against other insiders and never talk to outsiders about what insiders say or do."

With this book, Varoufakis loudly reclaims his outsider status by telling the story of Greece's negotiations as he experienced them: the pettiness of individual players, the incompetence of much of the creditors' technical analysis, and the bullying of a small bankrupt state at the hands of larger powers. Such revelations constitute a genuine service. By stripping the establishment of any remaining mystique, Varoufakis shows ordinary citizens that much better leadership is possible, and he encourages outsiders to demand that insiders raise their game. But for that to happen, those leaders will just have to be better politicians than Varoufakis.