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## Greek default necessary but Grexit is not



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Defaulting on the IMF and ECB is the only route to short-term relief but nobody has ever done it

Until last week, discussions with Greece did not go well. That changed when the circus of international financial diplomacy moved to Washington for the spring meetings of the [International Monetary Fund](#) and the World Bank. Then it became worse.

My hunch is that this show will go on for quite a while. The Greeks want to merge the talks on the extension of the current, second, loan programme with the talks on the new third one. For that to work they will require temporary bridging finance to get through the summer. This sounds like somebody has a plan. But this is not my impression. I have never seen European finance officials so much at a loss.

The big question — whether [Greece](#) will leave the eurozone or not — remains unanswerable. But I am now fairly certain it will default.

My understanding is that some eurozone officials are at least contemplating the possibility of a Greek default but without Grexit. The complexity is severe, and they may not have had the time to work it out. But it may be the only way to avert utter disaster.

On whom could, or should, Greece default? It could default on its citizens by not paying public-sector wages or pensions. That would be morally repugnant and politically suicidal for the Syriza-led government. In theory, it could default on the two loans it received from its EU partners, though it is not due to start repaying the first of those until 2020, and the second in 2023. It could also default on the remaining private-sector bondholders but that would not be a good idea. Greece might need private sector investors later.

It could also default on the IMF and the European Central Bank. The IMF is expecting a series of repayments. The ECB wants its money back in the next few months on debt it holds on its books. Defaulting on the IMF and ECB is the only option that would bring genuine financial relief in the short term. Nobody has ever done that. It might trigger Grexit.

Then again, it might not. Default is not synonymous with exit. There is no EU ruling that says you have to leave the eurozone when you default on your debt. The link between default and exit is indirect; if a country defaults, its defaulting securities are no longer eligible as IOUs for the country's banks to tender at ECB money auctions. The same applies to any other debt guaranteed by Athens. The Greek banks hold quite a bit of the latter category, and might find it hard to obtain liquidity if their government falters.

So to default “inside the eurozone” one only needs to devise another way to keep the banking system afloat. If someone could concoct a brilliant answer, there would be no need for Grexit.

On the substance, I tend to agree with finance minister Yanis Varoufakis: the eurozone's economic crisis management has been catastrophic

The economic case for a debt default is overwhelming. It is hard to see how Greece can ever service its debts as agreed. Even in the creditor countries few people are under illusions about Athens' long-term debt-servicing capacity. Full servicing would require huge primary surpluses — that is, surpluses before payment of interest on debt. It would leave Greece trapped in a debt depression for a long time. The scheduled primary surplus for 2016 is 4.5 per cent, which is bordering on the insane. Athens absolutely needs to default.

At the same time, there is a strong case for remaining in the eurozone. Grexit would bring incalculable economic risk to the country itself, and would harm the EU's geopolitical ambitions and its [global reputation](#).

What is worrying is that the talks are not going anywhere. This is why speculation about an agreement in the summer or the autumn is ultimately not reassuring. Particularly puzzling is the Greek negotiating strategy. On the substance, I tend to agree with finance minister [Yanis Varoufakis](#): the eurozone's economic crisis management has been catastrophic. Under present parameters, it is fundamentally unsustainable. But I do not understand why he spends so much time preaching to those who tend to agree with him at prestigious conferences in pleasant surroundings. Should he not be working on the hard negotiations with his European creditors, and on the two plan B scenarios?

Both Grexit and the option of a default inside the eurozone would stretch the resources of even the most organised government. It would require military-style preparation: exchange controls, temporary closure of land borders and airports, overnight bank recapitalisation, and logistical planning to convey money from A to B on D-Day. Is the Greek government really so smart it can just wait until the fateful moment arrives, and then manage this whole process in real time with no script?

I think I know the answer to that, and wonder whether one or more people on both sides of these discussions may simply be miscalculating. We may be on the verge of one of those sleepwalking moments in European history.

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