The inside story of the tortuous negotiations over Athens' debt

How Greece went bust

BY RENEE MALTEZOU, ELIZABETH PINEAU AND ANDREAS RINKE

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It was a small room with a plain wooden table a few feet wide. The Greek Prime Minister Alexis Tsipras sat on one side, along with a translator and Angela Merkel, the German chancellor. On the other sat President Francois Hollande of France; around were a handful of officials.

In this modest Brussels setting last Friday morning, key players in the great Greek debt drama tried to avert a meltdown that could threaten the future of the euro and even the European Union (EU). Merkel and Hollande made a final offer of billions of euros in aid for bankrupt Greece – if Tsipras would sign up to economic reforms demanded by his country's creditors.

The participants looked tired, their body language was stiff. The meeting did not last long. Tsipras, according to Greek officials close to the negotiations, had already decided to call an emergency meeting of his cabinet in Athens for that evening. Even as he spoke with Merkel and Hollande, he was preparing to hand the decision over Greece's fate to the nation's voters. The day before he had decided, after months of talks, that he and Greece's creditors were unable to agree a deal.

As he flew home to Athens later that day on a government plane, the young Greek leader settled on the idea of a referendum, according to the Greek officials. Staging a full-scale election would take too long, he had been advised. But a referendum could express the will of the Greek people.

He informed ministers of his plan, the cabinet approved it and he announced the referendum in a late night television broadcast. The abruptness of the move took some European leaders by surprise. Merkel and Hollande were told of it by telephone shortly before Tsipras announced it.

The bombshell said much about the long-running struggle between wayward Greece and the megalithic European Union, a struggle beset by blunders and serial brinkmanship. As this account details, all parties had their flaws and misjudgments.

HELPING HAND: Greek Prime Minister Alexis Tsipras is welcomed by European Commission President Jean-Claude Juncker ahead of a euro zone summit on Greece in Brussels on June 22. Cover, the flags of Greece and the European Union flutter under storm clouds in Athens in May. **REUTERS/YVES HERMAN, ALKIS KONSTANTINIDIS**

> “The whole planet would take a Greek 'No' ... to mean Greece wants to set itself apart from the euro zone.
>
> **Jean-Claude Juncker**
> President of the European Commission, urging Greeks to vote in favour of a debt deal in a July 5 referendum

At stake is far more than money. The Greek problem cuts to the heart of Europe's future. In Tsipras' eyes it is a crisis of democracy and sovereignty, of whether the wishes of a nation state outweigh the aims of the supra-national euro zone and EU.

For the euro zone – and Germany in particular – it is a test of unity, of whether countries within the 19-nation single currency bloc that fail to meet its economic standards and agreed rules can be brought into line, or not.

Tsipras' call for a referendum infuriated finance ministers from the euro zone, whose meetings are known as the Eurogroup. They and the International Monetary Fund (IMF) had previously rescued Greece from its mountainous debts with massive bailout programmes; the latest was due to end on June 30, when Greece also had to pay 1.6 billion euros to the IMF.

Patience exhausted, the Eurogroup decided last weekend to let the bailout programme expire as scheduled. The European Central Bank (ECB), which was keeping Greek banks afloat with 89 billion euros of emergency funding, also decided enough was enough: it said it would give no further emergency funding.

In Greece fearful citizens queued to take cash out of ATMs. Tsipras and his government ordered Greek banks to stay shut and imposed capital controls to stop funds leaving the country.

On Tuesday Greece failed to make its payment to the IMF. Though talks between the various parties continue and a deal may still be struck, Wednesday dawned with Greece adrift - with no recourse to further funding from the IMF or the bailout programme.

The referendum is due on July 5, though rumours circulated on Wednesday that it might be cancelled. If it does go ahead, Greek voters face a stark choice: Give in to their creditors and accept painful economic reforms, or go their own way. The latter course, some European leaders have made clear, will amount to a decision to quit the euro zone – though Tsipras disputes that view.

This account, based on interviews with people close to the negotiations, shows how the debt crisis became a political one. None of the main players would speak to Reuters on the record.

A CROSSROADS

From the moment he became Greek prime minister in January, Tsipras, 40, posed a novel challenge to the well-cut suits of Brussels. Bold and inexperienced, he had no fear of defying convention - not for him any necktie, no matter who he was meeting. His finance minister, Yanis Varoufakis, was inclined to leather jackets, blunt language and radical ideas.

Though Tsipras' style was casual, his resolve was steely. As talks on Greece's debts dragged on, he held firm to the core demands of his leftist Syriza party for debt relief – allowing Greece not to repay some of the billions it had borrowed - and an end to austerity.

Tsipras, who had flirted with communism in his youth, cast the debt crisis more as a political issue than a problem of number-crunching. Europe, he wrote in French newspaper Le Monde at the end of May, was "at a crossroads." Either it showed solidarity and granted Greece an easier ride, or it would face division and "the beginning of the end for the European unification project."

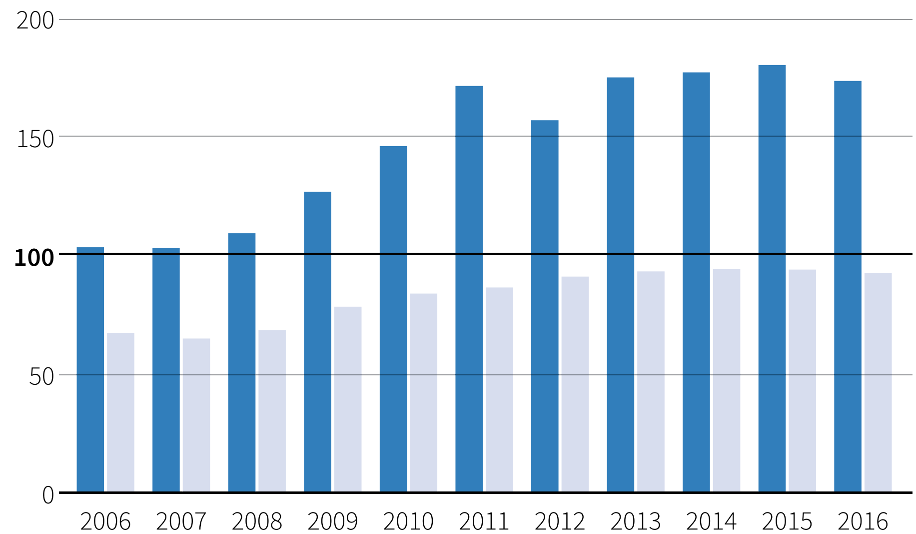
That was his bargaining chip: If the

Greece's mountain of debt

Greece   Euro zone

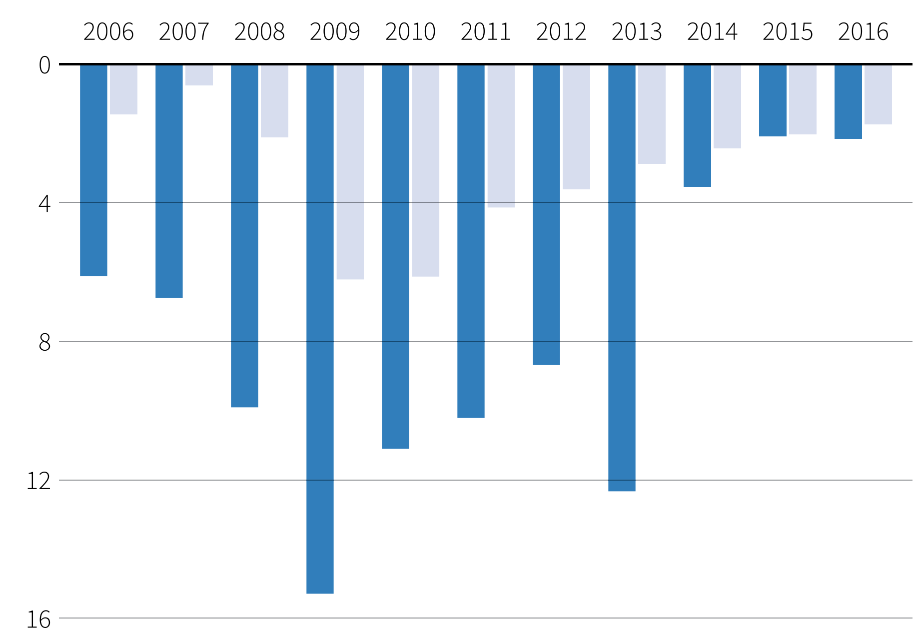
Gross government debt as percentage of GDP

Includes European Commission forecasts



Government surplus/deficit as percentage of GDP

Includes European Commission forecasts



Sources: Thomson Reuters Datastream; European Commission euro zone leaders did not cave in, Greece could cause chaos by defaulting on its loans. Greece owes its official lenders 243 billion euros ($271 billion), according to a Reuters calculation based on official data. Germany alone accounts for 57 billion euros in two bailout programmes. Germany is also the biggest shareholder in the European Central Bank (ECB), which has provided 118 billion euros in liquidity to Greek banks, the bank's head Mario Draghi recently said.

Tsipras' chief opponent was Merkel, long-standing leader of Germany, seen by some as a bastion of financial rectitude. Merkel and her combative finance minister, Wolfgang Schaeuble, did not believe Germany should pay any more for Greece's economic mistakes. Not all creditors agreed: Some were sympathetic to Tsipras' call for debt relief.

One of Merkel's main objectives, according to a senior German official, was to get creditors and other institutions to take a united position. Berlin suspected the EU Commission – the executive body running the EU – was willing to give too much ground to Greece to hold the euro zone together.

The Germans fretted that Jean-Claude Juncker, the Commission's president, might be too amenable to Tsipras. When Juncker had met the newly-elected Tsipras in February, he had greeted him with a kiss and led him off by the hand to a meeting. One senior German official joked: "If Juncker could decide for himself, we would have a pure financial transfer (of money from Germany and other countries) to Greece for the next 10 years."

The Germans and their northern creditor allies repeatedly pointed out that the Commission does not provide loans to Greece. It is the member states who lend the money and call the shots.

Merkel was also at odds with the IMF, which thought further debt relief for Greece should be considered. Merkel told Christine Lagarde, the IMF's managing director, that it was essential for Germany that the IMF remain engaged in the Greek bailout programme, according to two persons briefed on their discussion. But the German chancellor ruled out what many economists, and the Greek finance minister, saw as the most practical solution to Greece's immediate cash crunch. That idea was to allow the euro zone's bailout fund, the European Stability Mechanism (ESM), to pay off the loans from the IMF and to take over Greek government bonds held by the ECB. Both sets of debts could be replaced with lower-rate, longer-term loans from the ESM.

Merkel told Lagarde the idea would be unacceptable to Berlin and to others in the euro zone, according to a person familiar with the German position.

Whether Tsipras felt emboldened by divisions among Greece's creditors is unclear. He played his cards close to his chest. Compounding the difficulties on the Greek side was the fragmented nature of Tsipras' ruling party, Syriza, an assemblage of leftist factions, some passionately opposed to any deal involving austerity. Alexis Mitropoulos, a Syriza member and deputy parliamentary speaker, described one set of creditors' proposals as "the most vulgar, most murderous, toughest plan."

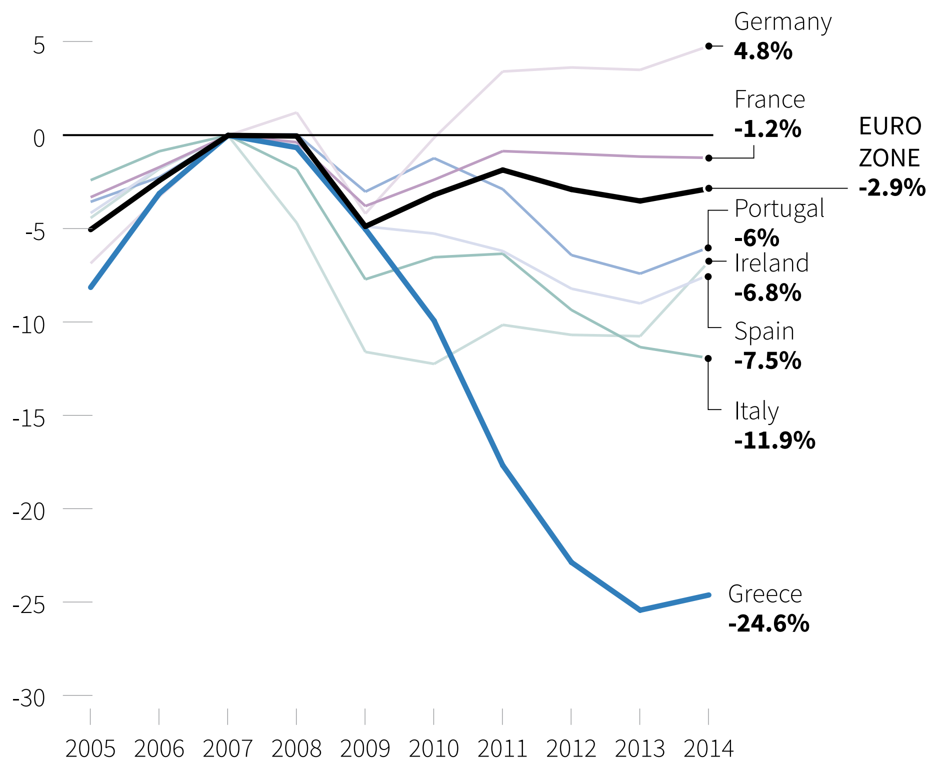
"LOOTING"

As endless meetings came and went, both

Greece's steep decline

GDP per capita since 2005

Rebased to zero at end-2007



Sources: Thomson Reuters Datastream; European Commission

POWER PLAYERS: International Monetary Fund Managing Director Christine Lagarde (here at a conference on inequalities in Brussels in June) and German Chancellor Angela Merkel (in Germany's parliament in March) had different approaches to solving the debt crisis. But they agreed on the central issue that Greece had to reform its economy. **REUTERS/ERIC VIDAL, FABRIZIO BENSCH**

sides refused to give much ground. Tsipras ratcheted up the rhetoric, accusing Greece's creditors of "five years of looting under the bailouts." Greece, he said, would wait until the creditors recognised the will of the Greek people to end austerity. "We do not have the right to bury European democracy at the place where it was born," he said.

On the other side, some EU officials wondered whether Tsipras wanted to reach a compromise at all. The Greek government repeatedly sent its proposals or responses too late to be analysed by experts of the EU, ECB and IMF before ministerial meetings, raising suspicions that it wanted to avoid scrutiny of fiscal measures that did not add up.

The creditors saw chaos looming. They hurriedly agreed to hold an emergency summit at which political leaders – not officials – would discuss the crisis. It was a goal Tsipras had been seeking.

Events, though, had a momentum of their own. Fearful Greeks were pulling their money from Greek banks. Between last October and April, about 30 billion euros had flowed out. Now the pace quickened: In just a week, depositors yanked some 4 billion euros out of Greek bank accounts.

The governor of Greece's central bank, Yannis Stournaras, summoned senior bankers to a special meeting. According to two of those present, Stournaras issued a dire warning. "If there is no deal, the Europeans will have decided to move on – (that) is what we were told," said one of the bankers. In other words, if there was no deal, Greece would default, go bust and maybe crash out of the euro. A spokesman for the central bank confirmed that the meeting took place but declined to comment on what was discussed.

A "TOMBSTONE"

Faced with time running out and the possibility of banks closing their doors, Tsipras began contemplating concessions to Greece's creditors, according to aides. One of the main sticking points was the pensions system. The IMF insisted that Greece overhaul its pension system to reduce the burden on the state, people familiar with the negotiations said.

> "We do not have the right to bury European democracy at the place where it was born.
>
> **Alexis Tsipras**
>
> Greece's prime minister, criticising the country's creditors for overriding the wishes of voters

Pensions gobbled up 17.5 percent of Greece's GDP in 2012, according to Eurostat, more than any other EU country. Despite subsequent cuts, the country still spends 16 percent of its GDP on pensions – though that's partly because Greece's GDP has fallen. Creditors say the system is fundamentally flawed, creating perverse incentives for Greeks to retire early, draw a pension and then work in the shadow economy, depriving the government of revenue.

The IMF wanted that to change. Tsipras resisted, saying that high unemployment meant that pensions were a vital source of income for many families.

On Sunday June 21 he met Syriza colleagues in Athens to thrash out a new deal to present to creditors. "Tsipras was in and out of the meeting room," said a deputy minister. "He spoke several times by phone to other EU leaders and some policy makers during the meeting. That's why it lasted so many hours."

Late that night Tsipras' team sent new proposals to euro zone officials in Brussels. But they arrived too late for proper consideration at a summit scheduled for the next day, according to EU officials.

Still, after months of wrangling there

was mood of optimism as European leaders gathered in Brussels on June 22. President Francois Hollande of France flew in on a Falcon jet and was upbeat, despite headlines such as "Europe on a knife-edge" and "Greece Bust." As a person on the plane familiar with the president's thinking told Reuters: "It's always at the last moment that people find solutions that seemed difficult to imagine at the start."

The same source added a note of caution. "This drama has a risk too, and that's that people may find themselves in a real Greek tragedy, with a death at the end. Possibly several."

True to the warning, talks did not go well. Tsipras gave some ground on pension reforms, but he focused on increasing pension contributions and taxes rather than cutting spending. Creditors wanted more cuts.

German finance minister Schaeuble remained unconvinced. "There is nothing new beyond many trying to create expectations which are not supported by substance," he told reporters. Once again discussions descended into disagreement and acrimony.

Ordinary Greeks also reacted angrily. As word of Tsipras' proposals reached Athens, impoverished pensioners protested in the streets. Leftist lawmaker Yannis Michelogiannakis decried the proposed reforms as a "tombstone" for Greece, asking: "How can you cut a deal that will increase suicides and make people poorer?"

With creditors insisting on tougher measures, Tsipras began considering putting the issue to voters. "We realised ... that there was no will to reach a deal on a viable solution," said a Greek official.

On June 26, Tsipras met Merkel and Hollande in the small room in the French delegation offices in Brussels. Merkel and Hollande dangled the prospect of more than 15 billion euros of loans in instalments over the next five months if Tsipras agreed to creditors' proposals. Almost all of that money, though, would simply go to meet Greece's debt repayments, and none of it was new cash not already committed under the bailout programme. Greeks would still face years of austerity and economic reform.

PRAYERS: A man prays before lunch in an Athens soup kitchen run by the Greek Orthodox church. Greece's economy has declined by 25 percent since 2007, and thousands of Greeks now depend on handouts. **REUTERS/YANNIS BEHRAKIS**

> "How can you cut a deal that will increase suicides and make people poorer?
>
> **Yannis Michelogiannakis**
> A Syriza lawmaker, commenting on Greek negotiators making concessions to creditors' demands

Tsipras spurned the offer and accused the creditors of "blackmail" in a press conference with reporters.

WEIGHTY DECISION

When he announced the referendum, Tsipras hoped the European institutions would grant some respite from financial pressures until the vote could be held. He asked for Greece's bailout programme to be extended beyond July 5.

France was willing to discuss the idea, euro zone officials said. But other finance ministers refused. "That (calling a referendum) is a sad decision for Greece," said Jeroen Dijsselbloem, president of the Eurogroup. "It has closed the door on further talks while the door was still open, in my mind."

Schaeuble was blunter: "The negotiations are clearly ended, if I understand Mr Tsipras correctly. We have no grounds for further discussions."

Early that evening Varoufakis, the Greek finance minister, left the EU Council building in Brussels. According to several participants in the Eurogroup, he went with a smile. "It was disturbing that someone who has just made a decision against his country, is not devastated, but grins," said an EU official.

The following day, Varoufakis posted a blog entry defending the referendum. "The very idea that a government would consult

MIDDLE WAY: Though some Greeks wanted their government to default, polls showed that most wanted to stay in the euro zone. This protestor joined a June 22 rally in Athens urging the government to sign up to a deal. **REUTERS/YANNIS BEHRAKIS**

its people on a problematic proposal put to it by the institutions was treated with incomprehension and often with disdain bordering on contempt," he wrote. "Can democracy and a monetary union coexist? Or must one give way?"

In Berlin, government officials noted that Schaeuble had suggested the idea of a Greek referendum back in May.

Greek officials close to the talks said negotiations could continue despite the expiry of the bailout programme and the referendum. For now, though, Greek banks remain closed. Efforts to find a compromise continued, though on Wednesday Merkel showed little sign of giving ground.

EU Commission president Juncker has made plain the stakes as he sees them in a referendum. On June 29 he told a news conference: "The whole planet would take a Greek 'No' ... to mean Greece wants to set itself apart from the euro zone and from Europe."

He said he would ask "the Greek people to vote 'Yes,'" advising that they should not "commit suicide."

Maltezou reported from Athens, Pineau from Paris and Rinke from Berlin.

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