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Holding out for a better deal: Brinkmanship in the Greek bailout negotiations

Athanassios Pitsoulis^{a,*}, Soeren C. Schwuchow^b

^a University of Hildesheim, Institute of Economics and Information Science, Samelsonplatz 1, 31141 Hildesheim, Germany

^b Brandenburg University of Technology, Germany

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ABSTRACT

Greece and its creditors concluded negotiations over a third bailout by signing a Memorandum of Understanding on 19 August 2015. The dominant view among most economic policy analysts and commentators seems to be that the actions of the Greek government in the months before the deal had been erratic and lacked coordination. In this paper we argue instead that the decisions of the Greek leaders, including asking the voters to reject the earlier terms demanded by the creditors in a referendum, can be rationally explained by the logic of brinkmanship. We develop a game-theoretic model to show that the actions of the Greek government are consistent with a strategy aimed at getting a better bailout deal.

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1. Introduction

How to make sense of a process in which Greek voters loudly spurn a euro-zone bail-out offer in a referendum, only to watch Alexis Tsipras, their prime minister, immediately seek a worse deal that is flatly rejected by the euro zone, which in turn presses a yet more stringent proposal to which Mr Tsipras humbly assents? Better, perhaps, not to try (The dark clouds of peace, 2015).

What to make of the third Greek bailout deal? To the Economist, an advertent observer of the Greek crisis, and many other commentators the answer is clear: “[R]ational actors would never have got this far” (The way ahead, 2015). We beg to disagree; the decisions of the key actors in the Greek bailout drama can in fact be consistently and rationally explained. Doing so just requires to understand how brinkmanship really works. In our view this is precisely where many observers of and commentators on the Greek bailout drama failed.

We argue that the key to understand the actions of the first SYRIZA/ANEL government, led by Prime Minister Alexis Tsipras from January until August 2015, may lie in daring to assume it had a rational game plan. To put a finer point on this, we argue that the actions of the Greek government can be consistently explained as those of an actor who “is playing an escalating game of brinkmanship, trying to force Europe to give ground” (Evans-Pritchard, 2015). In doing so, we clearly

* Corresponding author.

E-mail address: athanassios.pitsoulis@uni-hildesheim.de (A. Pitsoulis).

URL: <http://www.uni-hildesheim.de/wiwiid/> (A. Pitsoulis).

challenge the dominant view that the Greek government behaved in an erratic and uncoordinated fashion.

We claim that the departure of the radical new Greek leadership from the strategy of its moderate predecessors towards a more confrontational approach was probably well thought out. In the previous bailout negotiations Greece was “able to combine the threat of default (which would create an unknown and potentially massive risk for the EU), a promised commitment to economic reforms that would put it on the road to self-sufficiency, and its ‘too small to fail’ status to gain extraordinary financial support” (Bulow and Rogoff, 2015; cf. Crivelli and Staal, 2012). But once the threat of default was not credible anymore the new Greek leadership adopted a different grand strategy: Instead of relying on the outright threat of default it employed the *indirect* threat of a ‘Graccident’, viz., an accidental exit from the eurozone under the worst possible circumstances, to gain concessions that otherwise would not have been achievable. In this paper, which combines reporting on recent developments with game-theoretic analysis, we offer a political-economy perspective on this.¹ Our analysis produces some counterintuitive results that even readers who may disagree with our conclusion could find interesting.

We emphasise several themes. The first is that many observers of and commentators on the Greek bailout negotiations either had difficulties to make sense of how brinkmanship works or concluded a little too quickly that a Greek “madman at the wheel gambit” (Cook, 2015) would not make sense (cf. Finkelstein, 2015). As we see it, letting things develop towards the brink made a lot of sense once the explicit threat of default was not credible any more. The very logic of brinkmanship is indeed to *avoid* having to actually prove that one is prepared to do something irrational. Instead brinkmanship revolves around convincing the other side that one is prepared to take higher and higher risks of *accidentally* pulling everyone over the brink: “If two climbers are tied together, and one wants to intimidate the other by seeming about to fall over the edge, there has to be some uncertainty or anticipated irrationality or it won’t work” (Schelling, 2008, 99).² As we show in Section 3, by engaging in brinkmanship, the Greek government was probably able to induce the creditors to make a bailout offer that would otherwise not have been made.

Second, choosing a brinkmanship strategy was not an irrational choice of the Tsipras government; it could work as long as Greece was, on the one hand, apparently totally unprepared to leave the eurozone in an orderly manner and also, on the other hand, committed not to give in to the demands of the creditors for as long as possible. By holding out for a better deal and committing ever more strongly to not step back from the approaching brink, the Greek government tried to build up counter-pressure in the negotiations and thus to improve its initially very weak bargaining position. In our interpretation the creditors responded rationally to this by themselves allowing things to let go somewhat out of hand, hoping the Greeks would give in first. Yet in this case, as we show in Section 3.5, high costs are being caused by both sides’ attempts to hold out for a better deal.

Third, by holding a referendum the embattled Greek government did a perfectly rational thing from a game-theoretic perspective. This, too, seems not to have been grasped completely by many observers, who asked what sense it made to vote on a proposal that was already off the table. For instance, the president of the German Institute for Economic Research (DIW), Marcel Fratzscher, lambasted the referendum as a political and economic catastrophe for Greece (Fratzscher, 2015). In our view, the referendum was instead a bold tactical move, serving two purposes: It mobilized voters, further delayed the negotiations and worked as a commitment device, ensuring that the creditors would need to accommodate the fact that the terms of their proposal were unacceptable by improving its terms. Put differently, the referendum was a stratagem to hold out for a better deal. Indeed, Tsipras kept telling the voters precisely that the rejection of earlier-offered terms should not be seen as “a mandate for rupture with Europe, but a mandate that bolsters our negotiating strength to achieve a viable deal” (Marsden, 2015, *emphasis added*). Paraphrasing Karl Whelan, the decisive ‘no’ vote was supposed to leave Europe with two options: Give us concessions (forgive some debt) or, worse, face the risk of a Grexit (cf. Whelan, 2015).

Fourth, the third Greek bailout should be seen as what it is: The outcome of a bargaining process between actors with great differences in bargaining power. But is it true that “Mr. Tsipras’s eight-month standoff delivered next to nothing that he couldn’t have achieved on his first day” (Nixon, 2015, cf. Finkelstein, 2015)? Our analysis suggests that such a verdict may be too one-sided. The already stricken Greek citizens certainly paid a heavy price for their leaders’ brinkmanship. But did the Greek negotiators achieve something better with brinkmanship than they could have achieved without? Looking at the pros and cons of the third bailout agreement, our answer is most probably yes. Certainly, the terms of the new deal were harsher than those offered by the creditors earlier. But that should surprise no-one, as the final agreement was about an entirely new and huge bailout. What is certain is that the third Greek bailout presents a mixed bag of results; apart from many unpopular measures it contains several points which can be seen as concessions to the Greeks (see Section 2). The fact that the creditors have been more flexible with the radical SYRIZA/ANEL government of Greece than with previous more moderate ones has not escaped even critical commentators (cf. Papachelas, 2016).

In this paper we offer background information as well as some degree of formalism in support of our themes.³ In doing

¹ This paper reflects the state of affairs at late September 2015. Some additions were made when we revised the paper in May 2016.

² Whether such a strategy was actually the idea of the Greek prime minister or that of the leader of the Greek negotiating team, Yanis Varoufakis, is impossible to say. Varoufakis himself always denied he was “busily devising bluffs, stratagems and outside options, struggling to improve upon a weak hand” (Varoufakis, 2015). Yet the fact that he constantly confronted and provoked his interlocutors certainly reinforced the impression that the danger of an accidental but permanent rift between Greece and the creditors was there. Throughout the negotiations Varoufakis played this role remarkably well. We conjecture that, while Tsipras and Varoufakis agreed that they should use brinkmanship, Varoufakis was willing to bid up to strength to avoid further austerity whereas Tsipras was willing from the start to settle for a ‘honourable surrender’ that would secure his re-election.

³ For more background information and analyses of various aspects of the Greek debt crisis see e.g. Baltas (2013), Kasimati and Veraros (2013), Katsimi and Moutos (2010), Gibson et al. (2012), Hodson (2015), Mink and de Haan (2013), Oltheten et al. (2013), Potrafke and Reischmann (2016), Provopoulos (2014), and Samitas and Tsakalos (2013).

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