

Looking after Greece

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To continue this morning's macroeconomic and foreign focus, I share here (with permission) the macroeconomic briefing written by James Meadway of the New Economics Foundation for NEON (the New Economics Organisers' Network) that was published yesterday. His focus was Greece, and the impact that the forthcoming general election may have there on financial stability within that country and beyond. The financial markets are terrified of instability resulting from election of a left wing government. The reality may be is that such a government could create the tipping point that breaks the Eurozone out of the paralysis that is gripping it.

MACROECONOMIC BRIEFING

SUMMARY: The sudden possibility of early elections in Greece has raised the prospect of an outright election victory by Syriza. Europe's financial markets have been thrown into turmoil at the result. The stakes have been raised massively: Syriza have repeatedly said they will not honour Greece's illegitimate debts and will end the harsh austerity measures, but Europe's leadership is still insisting they must be met.

* The announcement on Tuesday last week that Greek Prime Minister Samaras is to call early elections for the Greek Presidency has caused turmoil this week. Should Parliament fail to elect a new President, in three rounds of votes, Greece will go to the polls early in the New Year. Syriza, the "Coalition of the Radical Left", is currently ahead in the opinion polls and most likely to form the next government.

* The Greek stock market fell 12% on the news, the biggest single-day fall since the global market crash of late 1987. The interest rate on Greek government bonds, reflecting the fears of potential lenders, rose to its highest level in two years. Stock markets across Europe, including London, have been jittery all week partly as a result, with the biggest drop in London share prices for three years.

* Syriza, meanwhile, has been attempting a charm offensive on Europe's financiers. They were seemingly more offended than charmed, with an (alleged) email leaked from \$1tr investment fund Capital Group after meeting Syriza representatives in London describing their plans as "worse than communism".

* They may have a point - Communists tried to pay their debts. Poland introduced austerity measures in 1980 to meet the costs of its \$24bn external debt, leading to the formation of the Solidarnosc trade union, the 1981 imposition of martial law and, ultimately, the fall of the regime. Yugoslavia's \$21bn foreign debt was renegotiated through the International Monetary Fund (IMF) in 1982, who imposed austerity. Nationalists adroitly exploited the economic crisis that ensued, pushing the country towards eventual civil war.

* When Yugoslavia fell apart in the 1990s, Greek capital moved in swiftly. Greek investment (FDI) in the Balkans is now around \$10.9bn, or about 6% of all Balkan FDI, second only to Austria, but it is in banking that Greek capital has the most significant presence. Greek-owned banks are four of the ten largest in Bulgaria, three of the top ten in Serbia, and two of the top ten in Romania. Bulgaria already suffered a bank run over the summer on KTB bank, one of its largest, leading to the collapse of its government. Romania's banking system is currently under European Central Bank (ECB) supervision.

* The relationship between Greek and Balkan banks is like a mini-me version of the relationship French and German banks have to southern Europe - including Greece. Right up to the crash, and beyond, German and (especially) French banks were happy to lend money to the Greek government in the belief that no eurozone member would be allowed to default. When that became obviously untrue, following Greek elections in late 2009, the euro debt crisis erupted.

* Since then, Greece has undergone the most stringent austerity programme of any high-income country, totalling cuts of 41bn euros. Public healthcare spending has been cut by 40%. Unemployment is still over 25%, and as high as 58% for those under 25. The economy is 25% smaller than it was four years ago, and feeble growth this year doing little to reverse the decline. The real pay for those in work, after taxes and inflation, has fallen by around 50%.

* These drastic austerity measures were in return for loans totalling 245bn euros. These have ensured Greece's creditors kept on being paid, with Greek sovereign debt totalling 318bn euros, or 175% of GDP. Its creditors are mainly other institutions in Europe, the bailout package having transferred Greece's debt from private hands (principally French and German banks) to official, like the ECB. Around 85% of Greek

sovereign debt is now owed to the “official sector”. Substantial payments on this debt are due to the ECB over the next year, including on 38bn euros that was loaned to support the banking system.

* Syriza leader Alexis Tsipras has repeatedly said he will refuse to meet such demands for repayments. Syriza’s alternative plan for the debt is in three parts:

- o a European conference on debt, modelled on the 1953 London conference that cut Germany’s debt;
- o major cuts to debt owing to the official sector, reducing the total Greek sovereign debt to a sustainable level;
- o linking interest payments on the remaining debt to GDP growth (thus resurrecting an idea of Keynes’).

* Meanwhile, Syriza’s rescue plan for Greek society includes:

- o ending the “Memorandum of Understanding” between the Greek state and EU/ECB/IMF “Troika” under which draconian austerity has been imposed;
- o provision of free food, health care, shelter, electricity and water to all those in need;
- o plans to lift the minimum wage 750 euros/month (up from 450/euros), up from 551 euros/month;
- o same minimum income for pensioners;
- o income taxes will be cut for all but the wealthy, who will face a clampdown on avoidance expected to bring in 70bn euros;
- o the re-establishment of collective bargaining in the workplace - abolished in 2012;
- o a massive, publicly-funded, job creation programme.

* These measures will be expensive, but Syriza’s leadership appear to be pinning their hopes on a return to rapid growth, increased tax collection, massively reduced debt payments and finally direct assistance from the EU institutions. For this to work, it will be necessary persuade Europe’s leadership that the costs of a managed write-off of Greek debt, and possibly a “European New Deal” to reconstruct the country and others in southern Europe, will be less than an uncontrolled default and exit from the euro.

* There are some indications that Germany’s political leadership are inclined to reach a compromise, viewing the costs of (in effect) paying Greece to shut up as less than the

costs of the euro's disintegration. The ECB has softened its hard line, adopted under former President Trichet from 2009-12, in favour of easing monetary conditions — making it easier for banks to lend. This did not stop them threatening Cyprus with being pushed out of the eurozone in 2013, however.

* If Greece is granted any leeway, with anti-austerity Podemos also leading the polls in Spain the potential for such demands spreading across southern Europe is high. More likely, for now, will be a continuation of the pressure applied most recently by EU Commission chief Jean-Claude Juncker, describing Syriza as “extreme forces” and warning Greeks not to deliver “the wrong election result”. The EU and ECB believe that the threat of Greece being thrown out of the euro can be used, as it has in the past, to discipline any future government there to keep to the Memorandum.

* Economics is about choices, and developments in Greece further emphasise that there are real alternatives to business as usual. The wide-ranging, fundamental economic debates in Spain and Greece can only be a good thing for democracy in Europe.