

## THE BIG READ

# A look at the submarine deals that helped to sink Greece

*Military transactions illustrate how Germany and other creditors have benefited from nation's profligacy*

BY CHRISTOPHER RHODES  
Athens

As Greece slashes spending to avoid default, it hasn't moved to skimp on one area: defense. The deeply indebted Mediterranean nation, whose financial crisis roiled the global financial system this year, is spending more than €1 billion (\$1.3 billion) on two submarines from Germany.

It's also looking to spend big on six frigates and 15 search-and-rescue helicopters from France. In recent years, Greece has bought more than two dozen F16 fighter jets from the U.S. at a cost of more than €1.5 billion.

Much of the equipment comes from Germany, the country that has had to shoulder most of the burden of bailing out Greece and has been loudest in condemning Athens for living beyond its means. German Chancellor Angela Merkel has admonished the Greek government "to do its homework" on debt reduction.

The military deals illustrate how Germany and other creditors have in some ways benefited from Greece's profligacy, and how that is coming back to haunt them.

Greece, with a population of just 11 million, is the largest importer of conventional weapons in Europe—and ranks fifth in the world behind China, India, the United Arab Emirates and South Korea. Its military spending is the highest in the European Union as a percentage of gross domestic product. That spending was one of the factors behind Greece's stratospheric national debt.

The German submarine deal in particular, announced in March as the country

lurched toward bankruptcy, has cast a spotlight on the Greek military budget and on the foreign vendors supplying the hardware. The deal includes a total of six subs in a complicated transaction that began a decade ago with German firms.

The arms sales are drawing heat from Turkey, Greece's neighbor and arch-rival. "Even those countries trying to help Greece at this time of difficulty are offering to sell them new military equipment," said Ege-men Bagis, Turkey's top European Union negotiator, shortly after the sub deal was announced. "Greece doesn't need new tanks or missiles or submarines or fighter planes, neither does Turkey."

Greece's deputy prime minister, Theodoros Pangalos, said during an Athens visit in May by Turkish Prime Minister Recep Tayyip Erdogan that he felt "forced to buy weapons we do not need," and that the deals made him feel "national shame."

Other European officials have charged France and Germany with making their military dealings with Greece a condition of their participation in the country's huge financial rescue. French and German officials deny the accusations.

A spokesman for German Chancellor Merkel says the submarine transaction was the culmination of an old contract signed long before Greece's debt crisis. In May, France's defense ministry said Greek authorities have confirmed their willingness to pursue talks on several arm-procurement deals.

In May, Greece's economic crimes unit began investigating all weapons deals of the past decade—totaling about €16 billion—to determine if Greece overpaid or bought unnecessary hardware.

German prosecutors are investigating

whether millions of euros in bribes were paid to Greek officials in connection with the sub deal. In May, the chief executive of one of the German companies helping to build the submarines, called Ferrostaal AG, resigned amid the probe.

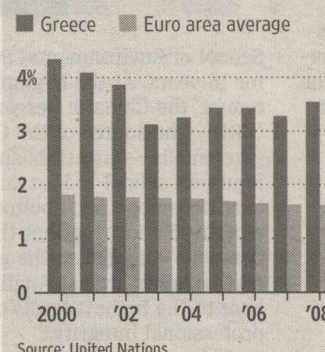
For some prominent Greeks, the latest submarine deal was the last straw. In late April, Stelios Fenekos, a 52-year-old vice admiral of the 22,000-person strong Greek Navy, resigned his position, bringing a three-decade Navy career to an end. He says he did so to protest the Greek defense minister's decision to purchase the subs, as well as other decisions taken in recent months that Mr. Fenekos considers "politically motivated."

"How can you say to people we are buying more subs at the same time we want you to cut your salaries and pensions?" says Adm. Fenekos, in his first interview with a reporter. He was referring to the government's 5% cut in most pensions and even deeper slashes to public-sector wages enacted in response to the crisis. The Greek Navy, he says, cannot afford to maintain the additional submarines. It currently has eight subs.

A spokesman for the Greek Ministry of Defense said Mr. Fenekos' resignation was accepted. In stepping down, "Mr. Fenekos did not refer to the submarine deal," he said.

## Aggressive spending

Military expenditures as a percentage of GDP



Greece became the first battleground in the Cold War, with the U.S. backing anti-Communists in the Greek civil war in the late-1940s against Communist insurgents. The conflict led U.S. President Harry Truman, in 1947, to pledge unlimited military support for nations under Communist threat, known as the Truman Doctrine.

While the rest of Western Europe used U.S. aid to rebuild its economy from the war, in Greece, the emphasis was on building up the military.

"Greece became the front line in the Cold War, and that began, right then and there, the Greek economic crisis of today," says Andre Gerolymatos, a professor of Hellenic studies at Simon Fraser University in Vancouver.

By the mid-1950s, the U.S. pulled back aid, much of which had been in the form of military hardware, shifting much of the burden for Greek military spending to Athens.

By this time, Greece's worsening relations with Turkey led to yet more arms spending. Despite being fellow members of the North Atlantic Treaty Organization, the two nations are bitter rivals. The discovery of oil in the northern Aegean Sea and disagreements over territorial waters and airspace became the source of numerous—and expensive—altercations between the two countries.

An incident in 1996, involving a Turkish ship running aground on a rocky, uninhabited Greek islet, almost led to war. Greece later that year announced a 10-year modernization program of its armed services, costing nearly \$17 billion.

The U.S. over the years catered to the two NATO members under a 7:10 ratio, meaning for every \$7 million dollars of equipment it sold to Greece it sold \$10 million to the more populous Turkey.

It was in that environment that Greece in 1998 went shopping for submarines. It decided on three German-built class-214 submarines, a state-of-the-art diesel-electric powered vessel, with the option of buying a fourth—for a total of €1.8 billion. The first was to be built at the Kiel headquarters of Howaldtswerke-Deutsche Werft GmbH, with the others built at the affiliated Hellenic Shipyards SA, in Skaramangas, Greece.

The arrangement, called the Archimedes Program, would preserve thousands of jobs at the Greek shipyard.

Greek officials in 2002 expanded it to include the modernization of three older class-209 submarines—work to be done at the Skaramangas shipyard using materials and help from the Germans. The increase would cost another €985 million.

The German side consisted of a company owned by German truckmaker MAN SE, called Ferrostaal, and Howaldtswerke-Deutsche Werft, now owned by Thyssen-Krupp Marine Systems AG. (MAN has since reduced its stake in Ferrostaal to 30%.)

The total cost of the new and renovated subs: €2.84 billion.

As the military expenditures rose, Greece's two main political parties used them as a political football, each trying to

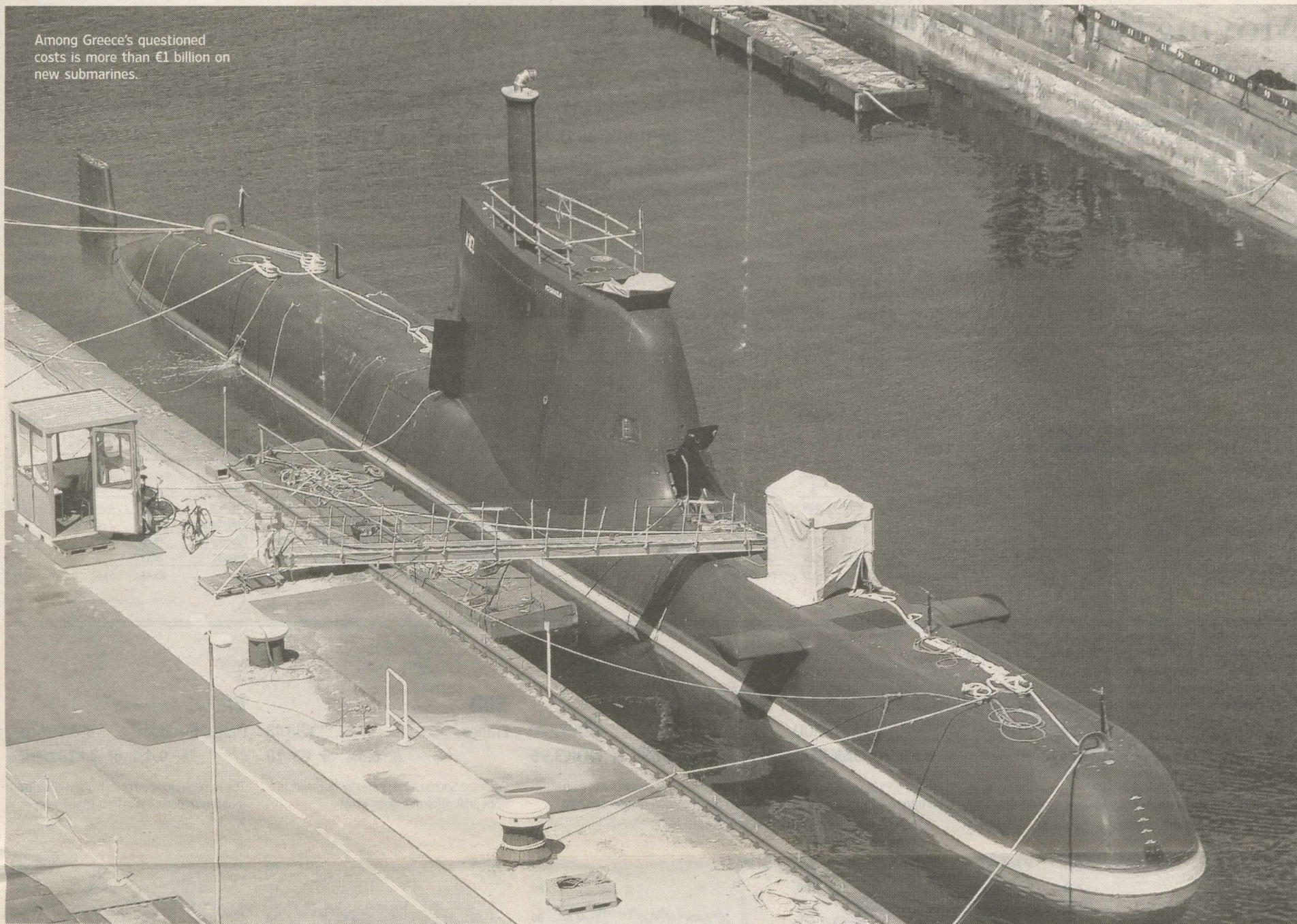


Prime Minister George Papandreou, left, and his government have been chided over spending by Germany's Angela Merkel.



## THE BIG READ

Among Greece's questioned costs is more than €1 billion on new submarines.



Arne Lutkenhorst

make the budget deficit figures look worse when the other was in charge.

When the Socialist government first bought the submarines, it post-dated the accounting for them to the day when the vessels were to be delivered, rather than when they were purchased.

The government at the time was struggling to meet budget criteria for entry into the euro zone, which it joined a year behind other members in 2001. Pushing back the expenses saddled the bill with the Socialists' successors, the conservative New Democracy party, which came to power in March 2004.

The New Democracy government that year then used a similar tactic, by retroactively accounting for the expenditures on the date of purchase. That inflated the budget deficits of the previous government—while making it easier for the New Democracy government to meet its own deficit goals.

Both accounting methods at the time were allowed by the European Union. The resulting massive deficit revisions made in 2004 for the previous years—4.6% of gross domestic product versus 1.7% for 2003—triggered an investigation in 2004 by Eurostat, the European Union's statistics agency, to understand what caused the revisions. The findings did not result in any sanctions.

Military spending accounted for nearly a quarter of the difference in the 2003 figures, and even more in revisions made on the deficits for preceding years.

After the Socialist party, PASOK, returned to power in October 2009, it made a similar maneuver: It announced the federal deficit was much worse than the outgoing government had let on, mainly due to public hospital debts, setting in motion the financial crisis.

Meanwhile, not one of the subs had been delivered. When Greek officials traveled to Kiel to test the first sub, called the Papan-

ikolis, they said that they found that in certain sea conditions the submarine listed to the right. "The Navy said we cannot accept this sub," said Mr. Fenekos, the admiral who recently resigned. "But the politicians did not want to stop it because they needed the production for the workers in the shipyard here."

ThyssenKrupp Marine Systems said the criticism was baseless and was made to delay payment.

By last fall, Greece had paid €2.032 billion, about 70% of the total owed. With the deal at an impasse, the German companies cancelled the contract.

Finally, in March, the two sides announced they had begun negotiating a new deal. Instead of having three older subs modernized, just one would be modernized, and Greece would buy two additional new ones, bringing the total to six new submarines—costing a total of €1.3 billion.

Abu Dhabi MAR LLC, a shipbuilding company in Abu Dhabi, would buy 75.1% of the Greek shipyard, with the expanded submarine deal a condition of the sale. The Greek government finally accepted the sub, with the understanding it would immediately resell it. No deal has been finalized.

Greece's defense minister, Evangelos Venizelos, speaking to the Greek parliament in March, explained that the deal was an attempt to end the mess, to "sever the Gordian knot" that the new government had inherited.

With 1,200 shipyard jobs at stake, Germany demanding concessions on the complex deal, and Greece having already paid two billion euros without receiving a single sub, the new arrangement was necessary, he said. But in February, just as a solution appeared to be at hand, German prosecutors in Munich began turning up evidence of unsavory dealings, according to records of their investigation.

Ferrosaal executives authorized payments worth millions of euros to politicians

to win the initial deal in 2000, through a Greek company called Marine Industrial Enterprises, according to the Munich prosecutor's records.

To do this, Ferrosaal used sham consulting contracts, according to the records. That company then distributed payments to "officials and decision-makers" in Greece, according to the records. The investigation is ongoing. No charges have been filed.

Adamos Seraphides, chairman of MIE Group Limited, a successor company to a division of Marine Industrial Enterprises, said he doesn't believe that the company's prior leadership was involved in bribery.

In March, police searched Ferrosaal offices in Essen, seeking evidence of bribe payments. In May, several executives stepped down.

"Ferrosaal will continue to pursue the intensive dialogue with the state prosecutor's office in Munich and has pledged full and comprehensive support and cooperation," says a Ferrosaal spokesman.

A ThyssenKrupp spokesperson says the company got into the business only in 2005, when it bought Howaldtswerke-Deutsche Werft.

Despite the tortuous, decade-long journey of the submarine deal—and Greece's precarious financial standing—Germany stands ready for more business.

Guido Westerwelle, the German foreign minister, in February told a Greek newspaper that Germany doesn't want to force Greece to buy anything.

But "whenever it comes to the point when it's ready to buy fighter planes," a European fighter-plane consortium, which Germany represents Greece, "wants to be considered in the decision."

A spokesman for Mr. Westerwelle says the minister didn't discuss fighter sales with the Greek government during the visit. —Alkman Granitsas, David Crawford and David Gauthier-Villars contributed to this article.

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