

“Managing” Greek Debts: Catastrophe Masquerading as “Rescue”

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Greece’s so-called “rescue” packages, most notably the “voluntary” haircut by the private sector, are inflicting severe damages on nearly everyone: private creditors, the Greek, other EU-countries and their taxpayers, on future capital market access for all euro-countries, and they threaten to roll back democracy. Briefly put, with their public “rescue” mission politicians have created the greatest possible catastrophe.

A quick look at numbers should puzzle us: if everything worked out as planned (which is by no means totally assured) about €100 Billion of Greek debts will be cut; as a reward Greece gets another official credit of €130 billion. Debts increase further from a level officially declared unsustainable. Initially it was hoped that – everything going well – Greece would be again at not more than 120% in 2020, or where she was when the crisis started. In its Fifth Review of December 2011 the IMF called 120% “the maximum level considered sustainable for a market access Country“. Soon, official sources mentioned 120.5% in 2020, with a precision unusual in econometrics. Apparently, one started admitting that the 120% target will not hold. But even if it did: why should the same debt burden become sustainable at which trouble started? When Argentina stopped payments in 2001, she had a debt-GDP ratio of some 63%. When her ratio was above 50%, IMF-staff thought a haircut of 15-40% necessary. Nevertheless, the IMF went on lending there as well. Bloomberg recently reported that 129% are now expected in 2020, indisputably higher than when the crisis took off. Taking recent reality into account, a “strictly confidential” paper by the Troika on Greece’s Debt Sustainability of 21 October 2011 painted an even worse scenario: “Debt (net of collateral required for PSI) would peak at 186 percent of GDP in 2013 and decline only to 152 percent of GDP by end-2020 and to 130 percent of GDP by end 2030”. The baseline scenario of the IMF’s Country Report of March 2012 even expects external debt to peak at 203% in 2013, attempting to allay fears by mentioning a net ratio (minus around 90% of GDP of residents’ assets abroad) of 113%. But there is little reason to suppose flight capital to be repatriated soon, considering the policies forced on Greece. The fact that “rescue” operations have drastically increased debts shows the quality of debt management in no unclear terms. Bungling on, politicians and EU-bureaucrats have inflicted damage on virtually everyone.

How such increases can be explained seems interesting. If only debts due were substituted by new public money, total debts must remain constant. As GDP has fallen due to “rescue” operations, Greece’s debt-GDP ratio must increase somewhat. But where precisely did the rest go? Taxpayers should demand proper information on where their money went.

Private creditors have lost more than necessary because the EU and the IMF delayed the haircut. Early on, haircuts were proposed and considered unavoidable, inter alia by El-Erian, who saw Greece in a “debt trap”, drawing attention to the increase in debts by the “rescue”. Gros & Mayer [1] (the latter chief economist of the Deutsche Bank) proposed a 50% haircut in exchange for EU-guarantees for remaining debts in February 2010. With Maastricht-conform debts (60% of GDP) Greece would have been afloat again. Legally more correct and economically preferable, I proposed a sovereign insolvency procedure, basically the adaptation of US Chapter 9, Title 11 (municipal bankruptcy) [2]. Arguably, this would have resulted in a necessary haircut below 50%, also less than present losses. “Rescue” activities dramatically increased

private sector losses. While bondholders were misguidedly bailed out first, they paid dearly for this in the end. Adding insult to injury the forced haircut is officially “voluntary” even though CACs were imposed and official money aggravating the crisis is now preferred. This is all the more unjust as regulators and governments pushed private investors into euro-member-country bonds. To use Soros’ words in the FT, banks “obliged to hold riskless assets to meet their liquidity requirements were induced to load up on the sovereign debt of the weaker countries to earn a few extra basis points”. A capital weight of zero pursuant to Basle I for “OECD-countries”, modified to countries with ratings from AAA to AA- by Basel II- the chairman of the : IASB is said to have gone so far as to call this the “biggest accounting scam in history” or the EU-exemption from the large exposure regime for highly rated sovereigns from the 25% of equity limit have all induced bona fide private creditors to invest in now dubious bonds of euro-members. Now they are told by the very same regulators that these zero risk investments were high risk exposure after all. Minds more critical than I might think of a con trick.

The damage to Greece is obvious. Austerity and reforms cannot be avoided if a sovereign goes bankrupt, but too high a dose ruins a country and triggers large scale capital flight. Measures in Greece are sterner than in Latin America after 1982. The now apparently abandoned expectation that Greece might be back in 2020 to where the crisis started means nearly a decade of strong austerity resulting in being back to square one. Without the help of exchange rate policies, adjustment has to be brought about uniquely by internal adjustment. Argentina had tried to do this before finally abandoning the currency board and defaulting. Privatisations forced though under duress and time pressure mean selling for a song. Lower privatisation proceeds are one reason for the revisions by the Troika’s leaked, strictly confidential paper. Not unlike privatisations elsewhere on the globe there will be winners, but not the Greek people whose asset share being squandered.

The damages to euro-members and their citizens are also obvious. A sizeable chunk of official credits flooding Greece in blatant violation of Art. 125 of the Lisbon Treaty (the no-bail-out rule) will be lost. This money has created or exacerbated budget problems and triggered austerity policies and tax increases all over the EU, especially so as the self-imposed Maastricht limits are nevertheless to be obeyed. EU-wide austerity was one major reason for the recent downgrading of EU-countries (the new preference ladder in favour of EU-money was another), which often results in higher interest rates for future government borrowing. Official guarantees loom over EU-taxpayers. The European Central Bank (ECB) has violated its ironclad taboo by buying up the bonds of countries in distress. It is now sitting on assets of doubtful quality, becoming an EBB (European Bad Bank), as some

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cynics joke. On top of these bond purchases so-called Target-credits (hidden claims within the euro-system) amount to hundreds of billions too. All this risk and all future costs are the taxpayers'. Politicians causing these damages remain economically unaccountable.

The undue preference the EU granted its EMS and other states lending bilaterally in coordination with the EMS can only make future capital market access for all euro-countries much more difficult. Bonafide creditors must expect preferred IMF, EMS and other EU-money flooding a country in distress or whose market financing is at risk of being impaired, resulting in larger private haircuts. If the amount of money flooding Greece is any guideline, these EU-caused, technically avoidable losses will be enormous. As in Greece now, bonafide investors will have to suffer haircuts, while the IMF (by its on Articles of Agreement not a preferred creditor, but customarily treated so in breach of the law) and EU-money are preferred, a premium on transforming a crisis into catastrophe. It is difficult to see why any euro-country, except "blue chips" such as Germany, should ever be able to raise money without an appropriate risk premium added, if at all. Especially other euro-countries presently under duress are likely to suffer from this economically, legally and ethically absurd self-preference. One should not forget that the "policies" presently increasing catastrophe in Greece are outlawed by most municipal laws, in quite a few delaying insolvency is a statutory offense.

Finally, democracy is being rolled back by the EU. The idea of a European Finance Ministry or an EU authority to veto national budget laws would take away their most important right from democratically elected parliaments, voting on the budget, in favour of unelected and virtually unaccountable bureaucrats, in favour of those who turned crisis into catastrophe in Greece. A euro-commissioner for Greece and other debtors is already demanded. The only right remaining to taxpayers/voters would thus be picking up the bills for the damages of "rescue" actions and the salaries of their new leaders.

In the end everyone except bureaucrats and possibly risk loving professional hold-outs loses, credit markets and European economies will be severely damaged. It unfavourably compares with the act of Herostratus, who burned down the temple of Artemis. Economics and plain common sense request this to be stopped.

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