

Denying reality in Greece



John Kolesidis/Reuters

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To fix Greece, a modern country built on the ruins of past civilizations, is to impose a modern financial blueprint on the ruins of its failed economy.

Greece is insolvent. That's due, in part, to ingrained deficiencies that have long kept the country deeply uncompetitive.

Prevailing over those forces will prove an historic challenge, but one that should, in theory, not differ essentially from that facing any failed enterprise, including other countries that have fought back from default.

Yet after billions in bailout money and more than one year into its crisis, Greece has made roughly no progress. In fact, its problems have worsened. The debt burden has increased, the country's relationship with the rest of Europe is being poisoned by every bailout dollar thrown down the well, and the government has lost all credibility with the Greek people, making austerity and shared sacrifice politically impossible.

Greece has become a casualty of an economic and currency union that lacks political unity. The reduction in principal the country requires is a non-starter for European officials, who seem primarily concerned with protecting Greece's major creditors. Meanwhile, the Greeks themselves seem unable or unwilling to face up to their own fiscal realities.

A glance at Greece's books is enough to convince any objective observer that a restructuring of its debt is crucial to the country's recovery, said Alex Jurshevski, founder of Toronto-based Recovery Partners and an expert in sovereign restructurings.

The Greek debt load sits at about €330-billion (\$450-billion), or almost 150% of its GDP.

"If Greece has to refinance its entire debt at today's coupons, it would be immediately bankrupt," Mr. Jurshevski said. "It couldn't pay those coupons, it would crowd out all other government expenditure, the government would fall, there would be riots on the streets, and their paper would be worthless."

But what must be done and what has been done are worlds apart, he said. Europe's political powers instead advocate "bailouts" to fund short-term debt payments and austerity to improve fiscal conditions.

"The whole game from the get-go has been to preserve the bank's capital in this whole equation. There hasn't been a bailout of the countries under financial pressure, it's been to preserve the banks' financial solvency that have lent to these places. Nothing more," he said.

For their part, European officials guiding the bailouts expound the risks of restructuring Greek debt, warning it could trigger a series of bank failures, leading to an all out financial crisis and imperil the euro.

"They're worried about systemic risk," said Marc Chandler, global head of currency strategy with Brown Brothers Harriman. "They're worried about a Lehman event."

It's difficult to say those fears are baseless, particularly given the enormous levels of cross-border debt linking the fate of Greece to its neighbours.

Pre-bailout, Greece owed about US\$135-billion to Europe's "Big Three": Britain, France and Germany. "It could open the banks to real threat of default," Mr. Jurshevski said. "But in the end, it's going to happen anyway. Would you rather manage that process or be managed by it?"

Additionally, the ECB itself holds a big chunk of Greek debt, making the central bank vulnerable to a restructuring. If Greece were to pay 50¢ on the euro to its debt holders, for example, the ECB would see virtually all of its capital wiped out.

"It would probably end up being bankrupt," said Steve Hanke, professor of applied economics at Johns Hopkins University. "That would be a huge embarrassment for the European Central Bank."

Also, considering the precedent a Greek restructuring might set for Europe's other PIIGS, which collectively owed about US\$2-trillion to the Big Three, a severe, systemic reaction is conceivable, he explained.

But to insist that Greece's insolvency should not result in any loss for the country's creditors is unrealistic and unfair, said James W. Dean, economics professor emeritus at Simon Fraser University. "Greece is greatly at fault," Mr. Dean said. "But also, the lenders are at fault, starting from the institutions in Brussels and in Frankfurt, ranging all the way to the big German and Austrian banks that lent them the money. "They need to be given one big haircut," he said. To advocate otherwise promotes the moral hazard of further irresponsible lending.

Of course, the Greeks themselves need to bear responsibility for their own irresponsible finances and debt accumulation, fed, in part, by an oversized public service, exorbitant wage scale, early retirement and an overly generous entitlement regime.

However, as IMF officials visited Greece last week to further negotiate its bailout, the country's largest unions staged a general strike, further contributing to the perception that the Greek worker does not grasp the severity of the situation and the sacrifice required to even begin the mammoth task of building a competitive economy.

And therein lies a key failure of the attempted bailout of Greece. The Greek government has failed to properly communicate to its constituents what is truly at stake, Mr. Jurshevski said. In turn, the country has been unable to conjure anything resembling a unified effort.

For instruction on how to properly orchestrate a bailout, one might look to the U.S. government's rescue of General Motors and Chrysler.

While sovereign bailouts differ from corporate ones, there are some telling commonalities between the automakers' collapse and Greece's debt crisis.

Both entities had entrenched problems that, for years, were understood and acknowledged, yet ignored. At GM/Chrysler, decades of collective bargaining produced a bloated salary and benefit structure, compounded by the costs of funding the entitlements of retired workers.

Union concessions were made a condition of the federal government's loan package, and the auto workers quickly got on board with the necessary restructuring.

"Essentially GM stopped being a health care company and got the union in alignment," said Sheldon Stone, a turnaround expert at restructuring firm Amherst Partners. "The union wanted to survive and they realized what was at stake was the viability of those two companies."

No such recognition of the required shared pain has been arrived at in Greece. The current financial course in Greece will produce an estimated deficit this year of 9.5%, well off the target of 7.6% set as a term of its €110-billion, EU/IMF bailout.

Resistance to austerity in Greece is in turn feeding resentment in Europe over the bailouts. "The bad blood the Greeks have generated between themselves and the rest of the Europeans, is enormous," Mr. Jurshevski said. "You've got hausfraus in Germany saying, 'We've got potholes on our street but the Greeks are retiring at 49.'"

It's hard to argue with the futility of the bailouts themselves, which amount to little more than temporary injections of liquidity. "You're not facing a liquidity problem but a solvency problem," Mr. Hanke said.

There is little indication, however, that Europe's governing forces are willing to consider much beyond the current bailout scheme.

The "soft" restructuring currently being mulled, involving an extension of maturities and/or a reduction of coupon rates on Greek debt, will be insufficient to reduce Greece's principal, Mr. Chandler said.

"People aren't thinking about that. The banks are thinking, 'How can we get our money back?' The ECB is thinking, 'How can we avoid a systemic problem.' No one's thinking about what Greece needs to do."