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Europe debt crisis forces nations to make tough calls

Greece on verge of defaulting



Protesters clash with police outside the [Greek parliament](#) during a demonstration by the [Panhellenic Federation of Workers Association](#) on Wednesday. The union is protesting the decision to increase working hours from 37.5 to 40 per week. (Associated Press)

By [Patrice Hill](#)

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The United States is just beginning to wrestle with its massive debt problem, but in Europe the debt crisis is advancing rapidly with worries about defaults and turmoil re-emerging in global markets.

Efforts to revive Greece, the first nation to get a bailout from the European Union and International Monetary Fund a year ago, appear to be failing as the country's austerity program has sent its economy into a tailspin and worsened its budget deficits rather than cured them.

Analysts say the kind of a "debt trap" Greece has fallen into could also emerge in other debt-burdened states such as Ireland and Portugal, which was the latest to get a bailout this month.

With social and political resistance already intense to the deep budget cuts Greece has carried out in the last year, Greece is faced with two stark options: Either defaulting — that is, restructuring its debts and offering creditors partial payments to lower burdensome debt payments — or getting more loans from the IMF and EU, adding further to its huge and already unsustainable debt load.

"Greece has reached the point where, under realistic scenarios, debt dynamics are unsustainable. The countdown to restructuring has started, in our view," said Piero Ghezzi, an analyst at Barclays Capital.

Under its own efforts, and with help from the EU and IMF, Barclays estimates that Greece could achieve only about half the deficit cuts needed to become solvent again, he said.

As in the United States, debt payments constitute a large and fast-growing part of the budget in Greece, crowding out spending on other programs and making it even harder to curb the debt.

"Fiscal consolidation will need to be helped by an effective debt reduction" to get Greece out of this debt trap, Mr. Ghezzi said.

Expecting the worst

Barclays is not alone in believing that Greece is essentially bankrupt and has little alternative to reneging on its debts. Global financial markets have been bracing for the possibility for weeks, creating a major distraction that has helped take investors' focus off the United States' own big debt problems.

A survey by Bloomberg News found that 85 percent of investors worldwide expect Greece, Portugal and Ireland to default. Many even view that as the best alternative since further draconian budget cuts would only worsen such debt-strapped countries' recessions and zap the revival of tax revenues needed to close gaping budget gaps.

But debt restructuring in Greece presents many risks. It could trigger a renewed crisis in global financial markets by forcing Portugal, Ireland and larger countries like Spain into the same kind of debt trap.

It also threatens the solvency of European banks that hold the majority of the outstanding debt of Greece, Portugal and Ireland and would be forced to take big losses on those holdings.

Because of the threat of contagion to the banks, European countries and global financial markets, Mr. Ghezzi expects European authorities and the IMF to try to postpone default by offering more loans and softening the terms on their existing \$156 billion loan package for Greece.

"We expect contagion fears to continue to dominate EU decisions," he said. But by early next year, "the status of Ireland and Portugal should be clearer" and the EU and IMF will probably bow to the inevitable and agree to a debt restructuring in Greece, he said.

Srinivas Thiruvadhanthai, an analyst at the Jerome Levy Forecasting Center, agreed that European authorities will continue to strenuously intervene to try to stave off default and help Greece and other insolvent nations, if only to avoid having to bail out the banks that lent to those nations.

"In bailing out Greece and then Ireland, the stronger eurozone countries were effectively bailing out their own banks," he said. But there's a danger that the toxic combination of deep budget cuts

and rising interest rates they're prescribing will overwhelm efforts to cut the debt and jeopardize the economic recovery in Europe, he said.

With difficult and delicate decisions facing Greece, Portugal and other European countries, markets grew anxious this week when turmoil engulfed the IMF and its managing director, Dominique Strauss-Kahn, who was arrested on sexual assault charges in New York. Mr. Strauss-Kahn was a key architect of the rescue plans for Greece, Ireland and Portugal, and was expected to lead efforts to keep those plans in place and work to make them succeed.

"The IMF together with its partner-in-arms, the European Central Bank, have most strongly resisted any talk of restructuring debts," said Alex Jurshevski of Recovery Partners, a crisis management firm, noting that the international institutions mostly represent the interests of big banks and creditors.

The IMF wants to remedy Greece's predicament by adding to its loan package. The problem is, Mr. Jurshevski said, "there is no way out of a debt problem by adding more debt to the mix."

Recovery Partners was instrumental in talking Iceland — another faltering debt-strapped state — out of accepting bailout loans from the EU in 2009, he said. Instead, the country forced its creditors to sacrifice along with its taxpayers, in a move that triggered a big financial collapse and recession.

But today, "Iceland is recovering albeit slowly, and without the millstone of additional debt," Mr. Jurshevski said.

Tough consequences

Lenders everywhere should be forced to reckon with the consequences of making bad loans just as borrowers are being forced to contend with their excesses, he said.

"EU banks are going to have to take a chop and likely be restructured themselves," he said. "The people of the EU have no desire to effectively become permanent tax slaves of the banks."

Wall Street credit agencies have been sounding warnings about the increasing likelihood that Greece will seek to restructure its debts. That, along with widespread speculation about default in global markets, has helped to drive the yield on Greek bonds to as high as 25 percent.

With such prohibitively high lending rates, few expect the country will be able to return to the markets for financing next year, as originally planned under the terms of its EU bailout.

Sarah Carlson, vice president at Moody's Investors Service, noted that the country is increasingly boxed in with few appetizing choices. While borrowing is getting increasingly difficult, further budget austerity measures threaten to "deepen and prolong the recession and further undermine domestic political support" for economic and budget reforms.