Athenian arrangers

The eurozone Amid anxiety about the finances of nations such as Greece, the role of big investment banks in massaging debt data is under scrutiny, write **Kerin Hope, Megan Murphy** and **Gillian Tett**

A few weeks ago, a distinctive delegation was spotted in the financial quarter of Athens: bankers from Goldman Sachs were escorting a high-powered team from the investment group run by John Paulson, the American hedge fund guru, around meetings with Greek officials and analysts.

Investment banks such as Goldman frequently accompany asset management clients on fact-finding trips – and hedge funds such as the Paulson group, which has made huge profits betting on troubled assets in the past two years, are considered an important catch. But in the febrile climate that currently surrounds Athens, the meetings generated wild rumours in several European capitals.

"A lot of people are wondering what they were doing there – the timing, perception of this was unfortunate," says the chairman of a large European bank.

As the crisis around Greece's public finances has deepened in recent weeks, Greek and other European officials have been expressing growing unease – if not outright anger – about the role played by western investment banks and hedge funds.

That is partly because of the manner in which hedge funds and others are perceived to be betting against the euro in general, and the debt of economically "peripheral" countries such as Greece in particular, by using derivative instruments such as credit default swaps. But it also stems from the role that Wall Street titans such as Goldman have played in helping Greece and other eurozone countries to massage their debt data over the past decade to meet European limits – and thus to mask some of the fiscal woes that have now come back to haunt international markets.

€1bn

Credit risk taken on by Goldman Sachs in 2002 Greek currency swap

€200m

Estimated fees and charges paid to Goldman on the €5bn deal

Aegean anger: a presidential guard stands by Athens' monument to the unknown soldier this month as public sector workers protest at austerity plans to tackle the Greek debt problem. Derivative deals helped to conceal its full extent EPA

It is a tale that in some respects echoes the furore surrounding the subprime mortgage crisis in the US in 2007 – where big investment banks were blamed for ramping up systemic financial risk by packaging and selling on high-risk mortgage loans to investors.

Tensions surrounding the 11-year-old single currency zone, which Greece joined in 2001 and now embraces 16 countries, have never been more intense as one of its founding assumptions – that government bonds issued by member states are of equal standing – is put to the test by the markets.

Goldman burst on to the Athens scene in 2002 by arranging a massive swaps transaction aimed at reducing the cost of financing that country's public debt, which had reached a level that exceeded annual gross domestic product. The deal involved some €5bn ($6.8bn, £4.4bn) of off-market cross-currency swaps linked to outstanding Greek debt, where bonds denominated in yen and dollars were swapped for euros.

Because it was treated as a currency trade rather than a loan, it helped Greece to meet European Union deficit limits while pushing repayments far into the future.

Bankers and officials say the swaps were legal, that they were in line with EU accounting rules that prevailed at the time, and that similar transactions had already been arranged between investment banks and other southern eurozone countries including Italy and Portugal. The nature of the Goldman deal was, however, that it remained out of public view and did not show up on Greece's balance sheet until the following year, when the country's debt-to-GDP ratio fell from 105.3 per cent to 103.7 per cent.

The deal was put together by Antigone Loudiadis, herself of Greek origin, who was Goldman's head of sales at the time for its European fixed-income and currencies unit. Goldman is said to have taken about €1bn of credit risk, which it hedged with a German bank, while Greece's debt management agency paid an unprecedented €200m in fees and charges. Goldman transferred the swap in 2005 to National Bank of Greece, the country's biggest commercial lender. NBG set up a special-purpose vehicle called Titlos and transformed the swap into a 20-year securitisation bond, which stayed on its books – thus giving the government a further breathing space.

'Hedge funds sold or shorted Greek bonds because of economics – not because they have an agenda against Greece'

In spite of the high transaction costs, the 2002 deal established Goldman's reputation in Greece as a "can-do" investment house. "It was a large, lucrative deal that made other investment banks green with envy," says a Greek banker.

Goldman still keeps a relatively low profile in Greece. Unlike other investment banks, it has not set up an Athens representative office, though it draws on the local knowledge of staff based elsewhere in the group, such as Ms Loudiadis. But since the Panhellenic Socialist Movement of George Papandreou, Greece's prime minister, came to power last October, Goldman has become better known.

Gary Cohn, its chief operating officer, has met Mr Papandreou twice in Athens in the past three months. Goldman, along with Deutsche Bank, also took George Papaconstantinou, the finance minister, on his first investment roadshow last November when he visited London and Frankfurt. The US bank is expected to help organise others to the US and Asia as Greece tries to widen its investor base for bond purchases. "Goldman is in pole position to advise Greece on raising funds in this time of crisis," says one former finance minister.

That is in spite of the bank's involvement in the controversial currency swap of eight years ago, about which Eurostat, the EU's statistical agency, this week said it was seeking further information. The deal was carried out just ahead of a tightening of Eurostat's rules on how countries should account for public debt. Nikos Christodoulakis, another former finance minister – who was in charge in 2002 – told the Financial Times yesterday: "Regarding the swap with Goldman Sachs, it was recorded according to Eurostat rules."

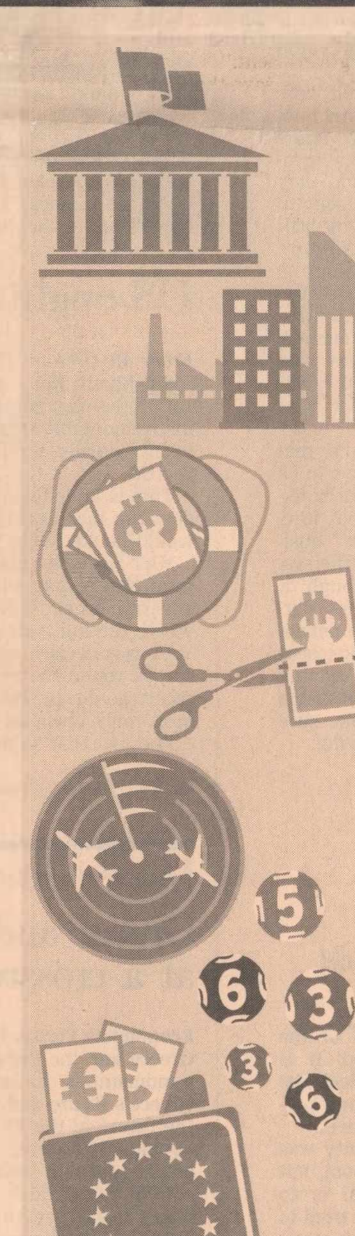
Goldman declined to comment on Eurostat's announcement on the Greek currency swaps or on Athens introductions performed for the Paulson group. However, insiders, including former Greek finance ministry officials involved in these deals, express surprise at the assertion that Eurostat had not long been fully informed about the deals, as their detail has been in the public domain for several years.

Since the emergence of the Greek crisis, Brussels has sought to tighten the rules that govern the reporting of member states' fiscal statistics even further. The new Athens government has meanwhile attempted to clarify what went on under its predecessor. A finance ministry report on the "credibility of public finance figures", released last month, says in a footnote: "The significant revisions observed in the debt figures at the end of the 1990s and start of the 2000s are due to a significant extent to the use of specific financial products such as securitisations. The statistical recording of these products at that time was unclear."

Investor unease, however, extends beyond the current turmoil over Greece or antics in the world of sovereign credit default swaps. In recent years, a number of European countries have used complex financial deals such as securitisations or derivatives trades to flatter their accounts, usually by bringing forward the recognition of revenues – or by deferring the recognition of liabilities into the future. And a brace of investment banks have helped to arrange these deals, often for fat fees (see below and right).

As with the Greek swaps deal, the banks involved in these deals stress that they were all legal. Some also suggest that their frequency has fallen sharply in recent years, not least because of changes in Eurostat requirements.

Still, some officials in Brussels are left irritated. "Some of what has happened really sticks in the craw," says one senior European Commission official. "You have the sense that banks have been playing all sides of this, making money whatever happens to Greece."



State bank dividends
Securitised by Greece

Publicly owned property
Backing for many Italian bonds

Sinking funds
Future gains brought forward

Tax receipts
A Belgian way of fiscal outsourcing

Air traffic control fees
Sold on to outside investors

Government lottery income
A reliable revenue stream to use

Payments from European Union
One more source to be securitised

But the big issue now is whether this simmering anger could turn into a more serious backlash if market pressures build.

Unsurprisingly, most senior bankers – and hedge funds officials – argue that it is entirely unfair to blame them for the current woes. Most notably, they argue, if countries such as Greece are in trouble today, that is largely because they have mismanaged their finances over many years, running up vast debts as budget deficits have grown amid a steady decline in competitiveness.

If the euro is under pressure now, they add, that reflects the lack of a fiscal agreement or political infrastructure to manage the currency union, rather than speculative attacks by hedge funds.

"It is ridiculous to blame hedge funds – that is really a case of shooting the messenger," says one senior Wall Street hedge fund official. Or as Johannes Jooste, portfolio manager at Merrill Lynch Wealth Management, puts it: "The reason why the Greek bond markets sold off and credit default swaps rose to records was because of the poor state of the country's public finances. Hedge funds sold or shorted Greek bonds because of the economics, not because they have some agenda against Greece."

Nevertheless, if the crisis builds, there are two issues that could provoke more finger-pointing. The first is the murky nature of the markets in which investors are placing their bets. Sovereign credit default swaps, for example, are conducted away from any exchange, which makes it impossible to track volumes of trading in a timely manner or even tell exactly who the main buyers and sellers might be.

As a result, there is widespread unease, both inside and outside the financial world, that canny investors can sometimes drive prices by spreading rumours or employing heavy-handed trading tactics to make quick profits.

The second concern is that some of the investment banking, derivatives and securitisation deals struck in the eurozone countries in recent years have been arranged in slightly occluded circumstances of their own.

"At some banks, things have sometimes gone on at a local level that head office might not really understand," admits the European head of one American investment bank. "Skeletons could tumble out."

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Accounting-driven transactions

From Belgian tax to funds put aside in Puglia . . . all on borrowed time

Greece is hardly alone in having managed to flatter its national accounts by employing the services of big investment banks. Numerous other state entities across Europe have engaged in derivatives deals with similar intentions – and sometimes using the most exotic of revenue streams, *writes Gillian Tett*.

In Italy, regional authorities including Liguria and Puglia have put their so-called "sinking funds" to creative use. With the help of banks such as Nomura or UBS, they have invested these pools of money – into which they are required by law to set aside funds to pay off bonds – in credit derivatives or other assets in recent years. By using the entire future putative value of their sinking fund, they could flatter their books by bringing forward expected future gains.

But perhaps the biggest arena for such accounting-driven transactions lies in securitisation – using the revenues from state assets to back bonds that are sold to new investors. This allows governments to enjoy the benefits of future cash flows up-front while deferring until later the recognition of liabilities.

If the bonds are "ring-fenced" from the state budget – meaning bond investors have direct recourse to the assets and cash flow – these deals were often considered to be partly off-balance sheet. Activity has dropped, though, since Eurostat, the European statistical office, tightened its rules in 2002 and again in 2005.

Italy has been one of the most enthusiastic securitisers of state property. It has also sought on occasion to securitise social security receipts, medical payments and even lottery tickets – using banks including UBS and the former Lehman Brothers.

The approach has not been confined to Mediterranean countries. Belgium has even made an effort to securitise the process of tax collection. In this structure, bonds are issued backed by the future collection of unpaid taxes, which means investors bet on whether the tax inspectors do their job.

Many bankers insist these deals have tangible value that extends well beyond any accounting games. After all, they point out, the investors who buy these securitised bonds, and the agencies that rate them, have a motive to impose real scrutiny on the performance of the underlying assets or programmes. When it comes to the performance of Belgian tax teams, say, investor scrutiny might provide better oversight than anything bureaucrats could achieve.

The one thing that is apparent, however, is that many European countries have been living on borrowed time, in the sense of recording cash flows up-front – but sometimes hoping that future liabilities magically disappear.

FINANCIAL TIMES

"Without fear and without favour"

Wednesday February 17 2010

Brussels and the Greek debt trick

The EU shares the blame for Greece disguising its deficit

Squid may be a popular delicacy in Greece, but it is causing more than a touch of dyspepsia in Brussels.

As information has emerged in the press in recent days about a trick the Greeks employed that disguised their fiscal deficit, the European Union has had a sense of humour failure. It has demanded more information about some derivatives transactions Athens entered into with investment banks, including a notorious one early in the decade with the great "vampire squid" itself, Goldman Sachs. The Commission wants to know whether the Greeks broke any rules in the way that it accounted for these transactions.

There is a sense of rounding up the usual suspects. The Greeks have already received a gamma minus for their national accounts. And it is hard to deny that the Goldman deal did create an optical illusion. It involved some €5bn of currency swaps at off-market rates and its effect was to let Greece borrow money without recording it as part of its public liabilities.

But it is hard to see what further information Brussels can require. The Goldman deal has been in the public domain for some time. Moreover, in its own manual on government deficit and debt accounting, published in 2002, the Commission gave member states the freedom to use derivatives to adjust deficit ratios. The deal simply took advantage of a loophole that Brussels had itself helpfully proffered. When the EU tightened the rules subsequently, Greece dropped a similar deal.

This does not excuse the Greek government of the charge of irresponsibility. It has saddled the Greek people with a huge financial burden. But if Greece broke the spirit of the rules, it was with the connivance of others. Brussels and eurogroup members must have known and accepted what was going on. The Goldman deal was not a massive infraction. Its impact on public debt is about 1.3 per cent of GDP according to the debt manager who negotiated it. Greece estimates its public debt at 120 per cent of GDP. Perhaps Brussels preferred to look the other way rather than risk having to declare euro members in contravention of the stability and growth pact and fine them.

It is no doubt embarrassing that the unravelling of Greece's finances has led to this connivance being exposed. It may rankle with German taxpayers who may conclude that Greece was given a far easier ride than they were led to believe. But this cannot be blamed solely on the Greeks. It is a European failure.

Barclays bounces

UK bank produces strong results and a deft bonus move

A year ago, Barclays acknowledged the suffering of its shareholders as it skipped a final dividend and regretted the fall in its share price. Yesterday, announcing a near doubling of group pre-tax profit to £11.6bn in 2009, the banking group talked about how it could contribute to society. This is an impressive performance and an astute change of emphasis.

The first of the big UK banks to report, Barclays has set the bar high. Underlying pre-tax profit rose from £1.6bn in 2008 to £5.6bn – a percentage increase even better than the headline number, boosted by the sale of Barclays Global Investors to BlackRock. Greatly improved by the BGI disposal, return on equity was 24 per cent. Several divisions, including UK retail banking, made less profit than in 2008 but profit at Barclays Capital rose 89 per cent to £2.46bn.

Barclays also showed its more sensitive side. Marcus Agius, chairman, said banks must serve society. In this rare foray into a results announcement, he pointed up the scale of Barclays' lending within the UK economy. Meanwhile, the two top executives – John Varley, chief executive, and Bob Diamond, group president – have declined annual bonuses for the second year running.

The results vindicate Barclays' decision to avoid direct government help, which would have hobbled it across a range of decisions. Even so, the performance was still aided by low central bank interest rates and implicit taxpayer guarantees that a bank this big would not be allowed to fail.

Foregoing the bonuses was smart tactics, but will not end public anger over bankers' pay. While the proportion of BarCap's revenues spent on compensation may have dropped from 44 per cent to 38 per cent, attention will still focus on the average six-figure bonuses being paid. Sacrificing the annual bonus could even backfire, as it contrasts with the incentive packages that remain untouched; and serves as a reminder that senior executives can afford the luxury of self-denial in a way that others cannot.

But the bonus restraint's real purpose is to enable Barclays to be part of talks on the shape of banking. It argues, correctly, that forcing banks to adopt "narrow" business models will not make the system safer. Now, even though it would mean pain for bankers, Barclays should engage in the debate about devising a framework where big banks can safely fail. Having done so much to keep a seat at the table, the bank should make sure it has something worth saying.

The murky Gulf

Dubai needs an open state to prosper in an open world

Dubai is a creature of the latest wave of globalisation. It is a modern global transport, commercial and financial hub. Its attitude to transparency, however, is medieval. That is why markets have been baffled by Dubai's recent problems. Investors do not know where to look to gauge the country's troubles.

Restructuring talks between Dubai World, the government-owned conglomerate, and its creditors are at an early stage. No offers have yet been made regarding the new terms of the $22bn debt that is being renegotiated. But rumours suggesting that they will recover only one third of their money have rattled lenders to the emirate.

The cost of insuring $10m of Dubai's government debt has risen steeply to $651,000. (Before the Dubai World restructuring, this figure was half that.) The price of Islamic bonds issued by the city-state continued their decline: they have lost 9 per cent of their value since January. The uncertainty of the Dubai World talks is contaminating the rest of Dubai – and no wonder.

In the statelet, as in the other members of the United Arab Emirates and in Saudi Arabia, the line between the public and the private is blurred. The state of Dubai, its ruler, his personal business interests and the investments of the state, have been conflated. It is also unclear how much debt the royal, statal, state-owned and parastatal institutions even have.

This opacity and ambiguity was constructive during the boom, but is now destructive. Dubai is to blame: it had only recently tried to define relationships between state-owned institutions and the state when this opacity threatened to land it with a large bill. Even now, investors are not sure which of the parts of Dubai Inc will be left holding which losses.

But there ought to be no concerns about the existing explicit debts of the state of Dubai itself. Creditors of state companies may lose out if the businesses they back do not perform. But the emirate will meet its commitments – not least because Abu Dhabi, the oil-rich capital of the UAE, would never permit a sovereign default.

A bail-out by its neighbour and rival would be painful for Dubai: in January, shortly after Abu Dhabi propped up its little sibling, the Burj Dubai – the tallest building in the world that towers over the city-state – was humiliatingly renamed the Burj Khalifa in honour of the ruler of Abu Dhabi. Dubai lives in the shadow of its deep-pocketed neighbour – but it benefits from the shelter.

Letters

Don't deny Greece what may be its last chance

From Mr Christian Kopf.

Sir, Otmar Issing ("A Greek bail-out would be a disaster for Europe", February 16) is confusing matters by equating multilateral liquidity assistance for Greece with "transferring taxpayers' money" to that country. No one is advocating additional transfer payments for Greece. Instead, the debate is about providing multilateral liquidity assistance that would allow for an orderly adjustment of the country's fiscal and external deficits. Since the creation of the International Monetary Fund, such liquidity assistance has regularly been granted to countries threatened with loss of market access, and the European Union co-funded similar assistance programmes to Hungary, Latvia and Romania last year.

It is commonly accepted practice that multilateral credits rank senior to any market debt the sovereign has incurred. If Greece were to restructure its government debt at some future stage, it should be expected to impose a haircut on privately held bonds while continuing to service any multilateral debt to the IMF or the EU in full. Even under an adverse outcome, there would be no transfer of German or French taxpayers' money to Greece.

In exceptional circumstances, the letter and spirit of the treaties on the EU do call for financial assistance to member states, and this assistance has been provided to other EU countries in the past. Prof Issing is right in pointing out that this crisis is "probably the last [chance] for Greece . . . to adapt fully to a regime of stable money and solid public finances". Greece should not be denied this chance by withholding bridge financing from it.

Christian Kopf,
Richmond, Surrey, UK

Greek crisis is about a structurally low level of taxation

From Mr David Mackie.

Sir, It has become commonplace to argue that a move to greater fiscal integration in the eurozone would somehow solve the Greek fiscal crisis ("Trust is wearing thin in Europe's union of opposites", February 13).

But a move towards greater fiscal integration would not help. Greece's fiscal troubles are not about the absence of intra-regional cyclical transfers.

Indeed, Greece has thus far had a shallower recession than the rest of the eurozone. The peak-to-trough move in the level of Greek gross domestic product has been 3.2 per cent, while in the eurozone as a whole it has been 5.1 per cent. And Greek unemployment is no higher than in the region as a whole.

Rather, the Greek fiscal crisis is about a structurally low level of taxation relative to public spending. In 2009, Greek public spending at 52.0 per cent of GDP was only slightly above the eurozone average of 50.7 per cent, but Greek public revenues at 39.3 per cent of GDP were well below the eurozone average of 44.6 per cent.

Presumably in a fiscally centralised union everyone would face the same welfare system and the same tax rate; in this case, the Greeks would have to pay more taxes than they currently do.

The only way Greece can avoid the pain of fiscal tightening would be if the rest of the region were to permanently transfer tax revenues to Greece to fill the gap.

This could in theory happen, but it is not an obvious consequence of a move to a fiscal union.

Indeed, such transfers could theoretically take place under the current regime.

David Mackie,
Head of Western European Economic Research,
JP Morgan,
London EC2, UK

Schoolboys don't respect gender

From Mr Peter Motton.

Sir, In his letter on Latin and French mottos (February 12) Ian Swan raises some interesting points. He states that "Keep your faith" is an interpretation of "Garde ta foy". I would suggest that is a translation of the three words. A better translation might be "Keep thy faith", which reflects the antique spelling "foy". He also illustrates that schoolboy humour is no respecter of gender: "foie", of course, being masculine.

An interpretation of "Garde ta foy" might involve a step beyond the literal, such as "Keep the faith", a possible modern equivalent of the motto. Meanwhile, could you ask Lucy Kellaway to consider rearranging her motto to read "Rutrum Nomina Rutrum"? Looks and sounds better to me.

Peter Motton,
Rockville, MD, US

Henry the Navigator at the forefront of Lisbon's Monument of Discoveries Ipon

One was good, one good for nothing

From Mr G. Cabral.

Sir, Ian Swan provided a good example of the flexibility of a French motto. I would like to add another one: "Talent de bien faire" was the motto of Prince Henry the Navigator of Portugal (1394-1460).

That motto was later adapted by popular culture to a well-known Portuguese prime minister of the 20th century as "Talent de rien faire".

G. Cabral,
Macau

Verse from Isaiah quoted does not refer to John the Baptist

From Mr Zalman Shoval.

Sir, I am afraid both Lucy Kellaway (February 8) and Lorenz Jorgensen (Letters, February 9) got it wrong; citing the phrase in Isaiah (Chapter 40, Verse 3) as "a voice crying in the desert" or "the voice of one crying in the desert" is based on a misunderstanding of the Hebrew text, perhaps due to the absence of punctuation marks.

What the verse (freely translated) actually says, and it's only thus that it makes sense, is: "A voice crying: In the wilderness prepare the way of the Lord, pave in the desert a road for our God."

As the consecutive verses show, it is an appeal and a message to the people of Judea and Jerusalem – and not a prophesy about John the Baptist.

Zalman Shoval,
Tel Aviv, Israel

US ought to be praised for resisting VAT's siren call

From Mr Graham Bannock.

Sir, Shaun Kelly (Letters, February 12) argues that there are no insurmountable technical obstacles to introducing a value added tax in the US.

This is undoubtedly correct, but it does not mean that such a course would be advisable.

VAT is a good revenue raiser, so good that it may encourage higher government expenditure. In Europe, where the multi-stage invoice system VAT was devised and whence it has spread round the world, tax rates rarely go down; the trend is inexorably upwards.

The fact that so many countries levy VAT is not in itself a recommendation for the US to adopt it. On the contrary, it is to the credit of the US that it has resisted the siren call of VAT for so long.

One problem is that the administrative costs of the tax for small businesses, the majority of all business, are so high. Big business does not mind VAT and can even make money out of it by earning money on unremitted tax balances. For a small company, by contrast, the cost of administering the tax can easily be 2-3 per cent of turnover, often as much as the net margin on sales.

Most of the arguments for VAT (other than that it makes it easy to raise more revenue), for example that it is fraud-proof, favours exports and is economically neutral and fair compared with simple sales taxes, are either wrong or grossly exaggerated.

Public expenditure deficits are created by government policies and their solution does not necessarily lie in new taxes. The US, like most countries, needs tax reform perhaps, but not VAT. Just reflect on the deficits of countries that have the VAT system already, including the UK and Greece.

Graham Bannock,
London W1, UK

IASC supports convergence plan

From Mr Gerrit Zalm.

Sir, I was surprised to read your interpretation of recent enhancements to the governance of the International Accounting Standards Committee (IASC) Foundation ("IASB softens stance on convergence", February 16), and in particular your assertion that a constitutional emphasis on adoption of International Financial Reporting Standards (IFRS) represents a weakening of the trustees' support for the ongoing work to converge global accounting standards.

Nothing could be further from the truth. The trustees of the IASC Foundation strongly support the work plan that the International Accounting Standards Board has established with the US Financial Accounting Standards Board, which will reduce the differences between, and improve, IFRS and US standards. By reducing differences and thereby reducing any cost of transition, convergence will "promote and facilitate" the possible adoption of IFRS. The completion of the existing convergence programme will also achieve the objective set out by the Group of 20 at its Pittsburgh summit. For many other jurisdictions convergence is an important stepping stone on the path to adoption of IFRS. The recent enhancements to the constitution of the IASC Foundation reinforce our commitment to this process.

Gerrit Zalm,
Chairman of the Trustees,
IASC Foundation

Shareholders must approve adverts

From Mr Eugene D. Cohen.

Sir, The article "Democrats hit back on political advertising" (February 12) misses the best idea to have surfaced, one that goes directly to what it means for a corporation to speak and corporate integrity.

Developed by Brian E. Frosh (Dem), Maryland state senator and judicial proceedings committee chairman, a bill now pending in the Maryland legislature would require that, before a corporation can place a political advert in Maryland, it would have to be submitted to the shareholders for approval. In that way, voters will know that the advert truly reflected the corporate owners' views and was not merely the views of an officer or a few directors. The bill has some additional features that would apply to Maryland corporations concerning the liability of officers and directors in connection with spending corporate resources on such adverts.

What Mr Frosh understands, which the other proposals seem to miss, is that corporations, which did not exist at the time the constitution was written, are purely creatures of state law, and the states, consistent with the constitution, may impose such conditions. Indeed, they could banish corporations entirely. Thus, while the supreme court has given corporations first amendment rights to political speech, it has not taken away the states' power to say who is the corporation and who is speaking when the corporation speaks.

Eugene D. Cohen,
Phoenix, AZ, US

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Greece and the EU at a crossroads

Economists Forum (Arminio Fraga): Greece and the European Union face a momentous challenge. At stake is Greece's future and, to some extent, the future of the EU itself. It is obvious that a very large economic adjustment will have to be at the core of any durable solution to the crisis. It also seems clear that the required adjustment will demand time and external support to be viable. Greece's situation is dramatic but it is by no means the only such fiscal challenge the region, or the world, now faces. Some tough decisions are going to have to be made in the near future. Here a bit of history can be enlightening.

The case of Argentina since 2000-2001 was a particularly interesting one because for the first time the locus of negotiation moved clearly from the balance of payments to the government's budget. The consequences were quite straightforward: a populist government, having to decide between its suffering people and the greedy bondholders, opted for the people. The rest of Argentina's experience is well known.

Moving to the present, Greece ran its macro policies in extremely loose fashion after joining the European Monetary Union. Markets went along collecting the spread paid by Greek bonds as if it was just a gift. Deficits ballooned and debts piled up. Government debt is approaching 120 per cent of gross domestic product and the country's net external liabilities add up to 90 per cent of GDP. Last year the budget deficit reached 13 per cent of GDP and the current account deficit reached 12 per cent of GDP. Since 2002 the unit labour cost based exchange rate for Greece appreciated by some 20 per cent vis a vis a basket of currencies. Greece has no independent exchange rate, but in an economic sense the debt to GDP ratio is really more like 150 per cent of GDP.

If Maastricht rules were to be pursued and the debt ratio brought down to 60 per cent of GDP over, say, 10 years, the primary budget would have to swing from a deficit of 8 per cent of GDP to a surplus of 7 per cent of GDP (using the numbers recently provided by the Greek government). Even just stabilising the debt ratio at the current high level will require an adjustment of 10 per cent of GDP.

This is what investors are looking at. The widening of spreads is no raid on a healthy, well-behaved issuer, but simply the wake up reaction to a country that put itself in dire straits. By the way, these are the same investors that were so welcomed when they were financing a fiscal orgy. How come no one complained in the upswing of this swindle?

This of course brings to mind the issue of burden sharing or private sector involvement, a favourite European topic, forcefully and ably defended by Germany and others over the years. The official sector seems to be comfortable these days bailing out creditors all over the place. For now governments seem inclined to take the path of least short-term pain, regardless of the long-term consequences. But at some point taxpayers will either get fed up with this burden or will figure out that this system is poorly designed and leads to regular boom/bust cycles – or both.

Here, technically speaking, we are talking about debt restructuring, and that brings with it the fear of contagion. This is a relevant matter, and one that no doubt is in the minds of policymakers and investors alike. Soon a decision will have to be made. Recently the bondholders of most banks and investment banks got away without a scratch thanks to the largesse of their governments. It should surprise no one that this time many are making the same bet.

These are difficult decisions, to be taken at a point where most of Europe is not in compliance with Maastricht debt and deficit limits. A system where government budgets were to be balanced over the cycle and not to exceed 3 per cent of GDP is now being severely tested. Each country individually may not have the incentive to preserve the common good of sound fiscal policy. Markets are challenging the free ride of some and a line will have to be drawn. Greece has crossed the line and could collapse if help is not made available. Its options are grim.

Full text:
www.ft.com/economistsforum

Unfounded slur

Stefan Stern: The "casino bank" slur is unfair . . . to casinos. Let me explain. With the news of Barclays' impressive results, we should brace ourselves for a continuation of the debate over "excessive risk-taking" by the banks (even though the £11.6bn profits were boosted by the one-off sale of Barclays Global Investors in December). It will be alleged, once again, that investment banks have been reckless, and that they are behaving like casinos.

But as Chris Brady, dean of the BPP business school in London, always tells me, good casinos are managed extremely carefully. Their appetite for risk is limited. And, crucially, their basic supervisory management and attention to detail – changes in people's behaviour, for example – is intensive. Prof Brady recommends the film *21*, based on the novel *Bringing Down the House*, about a group of MIT students who worked a con in Las Vegas. In it a veteran employee notices that something odd is going on, something that a bank of computers and CCTV have missed.

In London there is an old saying that "management is what you do when the markets close". The bosses of SocGen must have wished they had managed rogue trader Jerome Kerviel a little more closely, and not waited for markets to close before checking up on what he was doing.

No self-respecting casino would have made this mistake.

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