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For Greece, restructuring is no longer unthinkable

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Though talk of default is taboo for politicians, such a course looks likely

BY JACK EWING

Only a few weeks ago, the idea that Greece might restructure its debt seemed like the nuclear option. Now restructuring — a polite way of saying "default" — is not only thinkable, but even likely.

"Some kind of rescheduling must now

NEWS ANALYSIS

be the central scenario," said Daniel Gros, director of the Center for European Policy Studies, a research organization in Brussels.

Of course, among politicians talk of default is taboo. "Any notion of restructuring is off the table for the Greek government, has never been put on the table of negotiations and has never been part of any suggestion or proposals made by the I.M.F. to Greece," the Greek finance minister, George Papaconstantinou, said during a news conference Sunday in Washington, where he was attending a meeting of the International Monetary Fund.

Revised figures Thursday from Eurostat, the European Union's statistics agency, underlined just what a deep hole Greece is in. Total government debt was €273 billion, or $365 billion, at the end of 2009, or 115 percent of annual gross domestic product. Interest alone could come to €97 billion over the next five years, estimates Carl B. Weinberg, chief economist of High Frequency Economics in Valhalla, New York.

There is no way Greece can manage that burden, he and other analysts say, without far more massive aid than the €30 billion that other European Union members have pledged. Yet political resistance is growing to even that relatively modest rescue plan.

Since Greece formally requested the E.U. aid on Friday, as well as €15 billion from the International Monetary Fund, Chancellor Angela Merkel of Germany and Finance Minister Wolfgang Schäuble have strained to placate domestic critics by promising that the money would come only with harsh conditions attached.

The aid "depends solely on whether Greece continues its strict austerity plan," Mr. Schäuble told the newspaper Bild in an interview published Sunday.

The political blowback to aid is leading analysts to argue that bondholders must share the pain. "I can't see the Germans doing it forever without a contribution from the private sector," Mr. Gros said.

The question in the room, then, is how a reorganization of Greek debt payments might work — and what the consequences might be if Greece failed to honor its obligations in full.

Many economists still regard a full-fledged, Argentina-style default, with investors losing over half their money, as too scary to contemplate. Even a so-called haircut, in which creditors absorb

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The unthinkable becomes likely

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a relatively modest reduction in the face value of Greek bonds, could frighten investors and prompt a sell-off of Portuguese and Spanish debt. That would result in dire consequences for the euro zone and the region's already beleaguered banks, which hold most of Greece's government bonds.

A milder alternative — spreading out Greece's debt payments — is starting to look like the best of an array of bad choices. "Only a multiyear restructuring of the bond obligations, coupled with substantial deficit reduction, can achieve a permanent adjustment of Greece's fiscal obligations without actually defaulting on the paper and giving all stakeholders a haircut," Mr. Weinberg said in an e-mail message Sunday.

Mr. Weinberg has proposed converting all Greek bonds due until 2019 into a pool that would be refinanced with 25-year bonds. Assuming a 4.5 percent interest rate, this plan would cut Greek financing requirements by some 60 percent, or €140 billion, he estimated.

Mr. Gros of the Center for European Policy Studies has proposed a similar plan. He favors simply extending the maturity of existing notes by five years, at the same interest rate. In other words, a 5-year bond paying 6 percent annual interest would become a 10-year bond, still paying 6 percent interest.

Both plans would relieve Greece of the pressure of continually trying to raise money in increasingly unfriendly capital markets to refinance maturing debt. Instead, Greece could concentrate on reducing its deficit, which stands at 13.6 percent of gross domestic product according to the latest upward revision. Perhaps more importantly, Greece would win time to restore its economic competitiveness.

With some kind of debt rescheduling, investors would continue to collect interest, and would get all their principal back in the end. They would just have to wait longer.

Such a plan might appeal to policy makers worried about the effect of default on the European banks they have just finished bailing out.

One of the big unknowns is which banks or funds own the Greek debt and would suffer from any haircut or outright default. Data from the Bank for International Settlements in Basel, Switzerland, suggests that the biggest creditors by far are France, Switzerland and Germany.

According to the B.I.S., Greek debt to France, including by the Greek private sector, is €75 billion. Greece owes €64 billion to Swiss banks and €43 billion to German institutions. Even if only a third of the credit is owed by the government, the sums are still ominous.

But there is no public information on which banks or investors hold the debt or how much. Nor does anyone know how many of the bonds sit on bank balance sheets, or in mutual funds — in which case private investors would suffer.

The biggest danger may be that some institutions are overexposed to Greek debt and could be hit disproportionately. Hypo Real Estate, an institution in Munich owned by the government after a bailout last year, has disclosed that it holds Greek bonds worth €7.9 billion.

For now, talk of restructuring is taboo among politicians. Many private economists also still believe that Greece might squeak by.

Analysts at UBS, the Swiss bank, rate the risk of default at below 50 percent. But the task facing Greece is "extremely demanding," said Stephane Deo, an economist at UBS in London. "The data are really frightening."

"At some point you could have a rescheduling," Mr. Deo said.

As other economists begin to spin possibilities, they must confront the fact that there is no blueprint for restructuring the debt of a euro-zone country.

When European nations created the euro, they neglected to plan for the possibility that one of their own would become the sovereign equivalent of a subprime lender.

JONATHAN ERNST/REUTERS

Finance Minister Papaconstantinou said there were no restructuring plans now.

"There is no legal framework," said Hans-Bernd Schäfer, an affiliate professor of law and economics at Bucerius Law School in Hamburg. The euro's founders believed — foolishly, in retrospect — that a treaty setting debt and deficit limits would be enough. "I consider that a huge failure," Mr. Schäfer said.

Still, he said, a long history of sovereign defaults around the world offers precedent. There is a chance that Greece and its European partners could pull off an ad hoc but orderly debt restructuring that would not destroy the euro or the European banks that hold most of Greece's debt.

"It's possible but with risks," Mr. Schäfer said.

The biggest challenge for Greece and its E.U. partners would be to fashion a restructuring plan that would maintain the credibility of the euro, while avoiding a financial panic that could spread to other overindebted countries like Spain and Portugal.

The other challenge would be to get bondholders on board. To get them to trade in their bonds for longer-term debt, Greece and its backers would need to convince creditors that restructuring offered them the best chance to get their money back.

There is a chance that, if Greece declared itself unable to make its debt repayments on schedule, some hedge funds or other creditors could go to court to try to seize Greek assets. International property seizures were once the norm, as when Britain occupied Egypt in 1882 after the country fell behind making payments on loans to build the Suez canal.

Mr. Schäfer of Bucerius Law School doubts that many courts would support a Greek asset seizure. In any case, Greece would not need to worry that some hedge fund would try to impound a Greek warship docking in a foreign port. Military equipment, embassy buildings and other property essential to the functioning of government is exempt from claims under international law.

Still, the risk of court action by dissident investors illustrates the complexity of any restructuring.

The history of sovereign defaults, which have been commonplace in the last century, offers plenty of reasons for investor alarm. Drastic write-downs are the norm. For example, owners of Argentine debt took a 67 percent haircut in 2005, economists at Commerzbank noted in a report Friday.

The threat of such a drastic loss might be enough to convince most investors to support a restructuring.

As taxpayer opposition to a Greece bailout grows, a few German politicians have called for the country to quit the euro zone and start printing drachmas again.

Such a course would allow Greece to follow the time-tested strategy of profligate nations throughout history. The drachma would plunge in value, and Greece would instantly regain its competitiveness on international markets.

The downside would be devastating, though. The cost of servicing Greek debt would skyrocket in inverse proportion to the currency devaluation. Default would become almost inevitable as the government no longer collected tax revenue in euros.

Not only the Greeks would suffer. As Marie Diron, senior economist at Oxford Economics in London pointed out, Germany has benefited from its euro-zone neighbors' inability to devalue their way to competitiveness, as Italy and others habitually did before there was a common currency.

For that reason, Germany and other European countries will probably continue to stand behind Greece. "Germany has benefited from Greece and Spain not being able to devalue their currencies and I think they know that," Ms. Diron said.