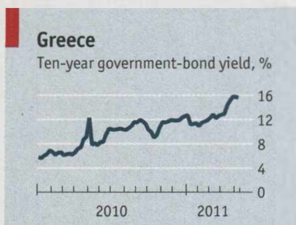
Greece's debt crisis

# Trichet the intransigent

31

**The European Central Bank's refusal to consider a restructuring of Greek debt could wreck the euro zone**




IF THE stakes were not so high, Europeans' incompetence in the euro-zone debt crisis would be comic. One year after the Greek rescue was launched, it is manifestly failing (see page 81). Yields on ten-year Greek bonds are higher than they were a year ago. Both the Greek government and its European and IMF rescuers admit that the country has no hope of tapping private capital markets in 2012, a central assumption of the original plan. It is plainly time for Plan B. But rather than get on with it, Europeans are bickering like children in a playground.

The biggest fight is between Germany and the European Central Bank (ECB). Germany's politicians do not want to lend Greece more money without a "game-change" in the rescue plan. That could include bold new concessions from the Greeks, such as pledging privatisation proceeds as collateral for new rescue funds. Or it could imply a debt restructuring. Although the Germans are reluctant to impose losses on holders of Greek bonds, they have become convinced that a "reprofiling" of the country's debt is advisable.

The ECB is adamantly opposed. It wants to continue with today's failed plan, with more Greek austerity in return for more loans. The bank's officials have argued, in increasingly hysterical tones, that any tampering with Greek debt, even a modest extension of maturities, would be a catastrophe. One has predicted it would cause a crisis far worse than the collapse of Lehman Brothers in 2008. Privately, ECB officials are even more extreme, threatening that if Greece restructures its debt, they might refuse to allow Greek bonds as collateral for lending by the ECB. Such a withdrawal of liquidity would doom the country's banking system and might even lead to Greece's departure from the euro zone.

It is certainly reasonable for the bank to worry about the impact of a Greek default on the European banking system and its own balance-sheet, and about the risk of further defaults in Ireland, Portugal and even beyond. But rather than digging in its heels, the ECB should insist that Europe's politicians reduce those risks by coming up with funds to recapitalise hard-hit banks. Perhaps, in a calculated piece of brinkmanship, the ECB hopes that by raising the stakes around a restructuring it can persuade Europe's governments to blink first and provide more cash for Greece. That would be risky. The still more alarming possibility is that, blinded by pride, the bank and its hitherto sensible president, Jean-Claude Trichet, are unable to accept that a euro-zone country is bust.

Whatever the ECB's motives, the Germans are right. When Plan A is clearly not working, there is no point in pigheadedly pursuing it. That means looking for a plausible Plan B.

### Blind bank's bluff

A privatisation-for-loans scheme is not a serious short-term option, both because there is plenty of opposition in Greece to a fire sale of assets and because the Greek government doesn't have official title to much of the land it plans to sell. So, in practice, Plan B involves going in one of two directions: either other EU members must give Greece enough money, for long enough, to reduce its debt burden to a sustainable level, or that debt must be restructured. It is hard to imagine Europe's taxpayers accepting a drip-feed of endless transfers to Greece. That leaves restructuring as the only sensible way forward.

It is time for the Germans and the IMF to call the ECB's bluff. Together they should demand, and instigate, a restructuring of Greek debt. Germany should push other European governments to cough up money to support Greek banks and, if necessary, to make whole the ECB. The fund, which knows how to restructure debt, must ensure the process is run in a competent manner. The ECB will then be faced with a choice: go along with an orderly restructuring, or trigger a much greater mess by in effect forcing Greece out of the euro zone. Surely Mr Trichet does not want that to be his legacy. ■

---

The Afghan campaign

# Single or quits

**Afghanistan is doing a little better; Barack Obama should not rush out of it**

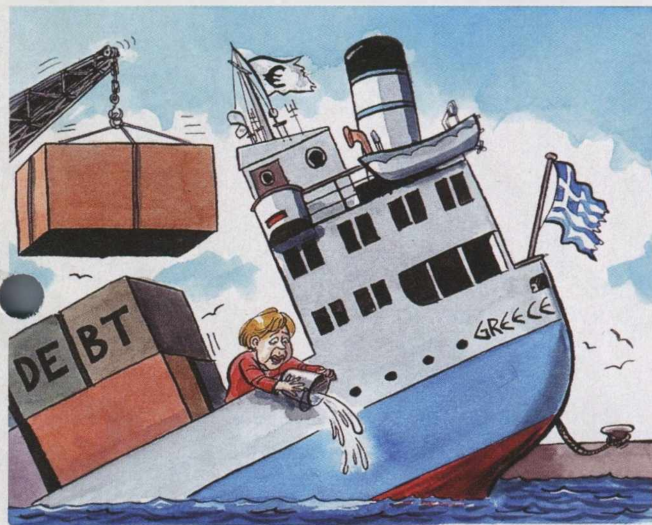
AMID the wreckage of broken promises and failed plans that litter the ten-year mission in Afghanistan, the only certainty has been the campaign's capacity to disappoint. Rotten government, a vast cost, resurgent Taliban and the mounting death toll all argue that this is a patch of dusty ground where the outside world has overstayed its welcome. Now the killing of Osama bin Laden has at last satisfied one of the war's chief aims. Barack Obama is to assess troop levels in Afghanistan as part of a long-scheduled drawdown in July. Why shouldn't America's president declare victory and pull out fast?

Tempting as it is, that would be a mistake. The coalition has set the end of 2014 as the deadline for the Afghan government to take charge of security. That is still the date to aim for, because it gives scope for an Afghanistan that will be broadly stable. In July Mr Obama can certainly pull out a few thousand of the 90,000 or so troops he has there, to meet his pledge. But for the outside world rapidly to withdraw military and financial support would invite collapse inside Afghanistan and strife ▸▸

# Charlemagne | Decision time

328

**Germany continues to dither over how best to rescue the euro**




WORKING in the bombastic Nazi-era edifice in Berlin that once housed Hermann Göring's air ministry, then the headquarters of the Red Army and later much of East Germany's communist government, Wolfgang Schäuble knows more than most how Germany's democratic resurrection and reunification are bound up with European integration. But as the German finance minister wheels himself in to talk to the foreign media (he has been paralysed from the waist down since an assassination attempt in 1990), he cuts a lonely figure. A veteran of German unification, he is the leading pro-European in the cabinet. His instinctive response to the euro-zone crisis is more European integration. Germany is, after all, the euro's principal beneficiary. But his country is ever more sceptical of the European Union and the single currency. German Europhiles feel beleaguered.

Ministers are torn between promises "to do whatever it takes" to defend the euro and the hostility of their voters towards serial bail-outs. The result has been a succession of erratic incremental steps, forced by events and largely driven by tactics. Germany acted to avert the imminent financial collapse of several countries, but often late and never decisively enough to resolve the crisis once and for all. Instead, a year after the rescue of Greece, then of Ireland and now of Portugal, anxiety seems to be growing.

The EU, with power spread across institutions and countries, is ill-designed to act swiftly in a crisis. Germany has to provide leadership, if only because it has the deepest pockets. But it too often seems dysfunctional, partly because of its own decentralised system and partly because being Europe's creditor-in-chief is unpopular. These days Angela Merkel, the chancellor, may be treated in Brussels as an empress, but in Berlin she is just one of many warring nobles.

Take the latest upheaval. Somebody leaked news to *Der Spiegel*, a German news magazine, of a secret meeting of finance ministers in Luxembourg on May 6th to discuss Greece. That was accurate. But the claim that the country was threatening to leave the euro seems to have been wrong, though it caused yet another market convulsion. Jean-Claude Juncker, prime minister of Luxembourg and chair of the euro group of finance ministers, says there was no talk of restructuring Greece's public debt. But who can believe a man whose officials denied that the meeting was taking place, and who has spoken of the need for "secret, dark debates" in economic policy-making? Mr Juncker all but admitted that Greece could not pay its debts, saying it would need "a further adjustment programme". In Berlin this week Mr Schäuble kept mum about this, to avoid feeding "speculation", though his ministry is now looking at debt restructuring.

In truth it is not speculation but indecision and timidity that are at fault. Germany has made expensive loans to troubled countries, but does not like big fiscal transfers. It said the EU's big bail-out fund would be temporary, but it is being made permanent. Money for rescues is being raised with joint guarantees, yet Germany will not accept common Eurobonds. It has resisted immediately imposing losses on bondholders, yet insists they must share the pain from 2013 and has started to discuss lengthening debt maturities despite fierce resistance from the European Central Bank. It denounces financiers for causing the crisis, but has backed arguments against Ireland burning its bank creditors.

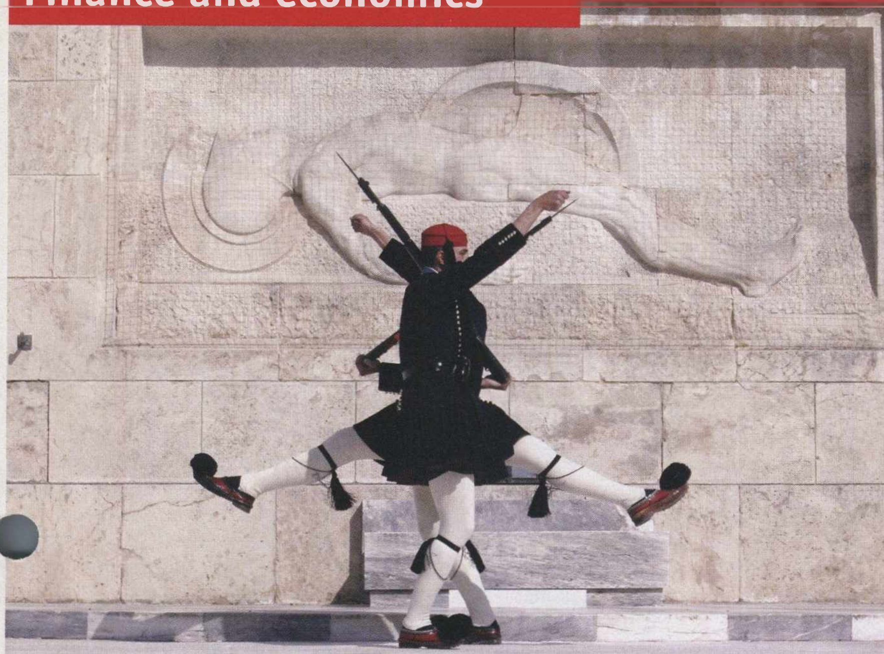
More than once, Mrs Merkel has countermanded Mr Schäuble. She prevaricated over who should succeed Jean-Claude Trichet as ECB president, finally backing Italy's Mario Draghi long after he had won over other leaders and, indeed, Mr Schäuble. Even *Bild*, Germany's leading tabloid, elevated Mr Draghi as an honorary German, depicting him with a Prussian helmet. "What does Germany want?" asks an exasperated Eurocrat in Brussels. Plainly, Germany does not know. To one Berlin economist, "Germany is like an unguided missile over Europe."

**Time is not on my side**

None of this is to say that Germany is the main cause of the euro's crisis. As much or more blame lies with those that spent irresponsibly, failed to reform in good times and were blind to property bubbles. Yet German hesitation has hindered the search for a solution. Its strategy, in so far as there is one, has followed a twin track. One has been to push others to adopt Germanic rigour through tougher fiscal rules and a "fitness programme" to make economies more competitive. This is meant to prevent a future crisis. As for today's ills, caused by the sins of the past, the answer has often been just to play for time: to try to repair Europe's banks, insist on deficits being trimmed and hope that growth makes the problem more manageable. EU finance ministers want to postpone the reckoning again, perhaps with new loans for Greece, stretching out repayments, reducing the interest rate or even considering a modest voluntary reprofiling of current debt.

But time has a cost. Austerity in troubled countries is deepening recession. Markets doubt that Greece and others can repay their debts even with much more time and fresh loans. And the crisis is tearing at Europe's political fabric. Voters in creditor countries resent endless bail-outs; in debtor countries they resent endless belt-tightening. Even Berlin may be realising that it is time for hard choices. That could mean restructuring debts, imposing losses on creditors and helping banks in danger of collapse. Or it could mean restructuring the euro area through common Eurobonds and fiscal transfers. One option crystallises losses now and raises fears of financial turmoil; the other means an open-ended commitment that risks political rejection. Neither is easy. But prolonged indecision could lead to something even more painful: break-up of the euro, which to pro-European Germans would be a repudiation of post-war history. ■

Economist.com/blogs/charlemagne



Also in this section

82 Guilty at Galleon
82 The man known as the Mooch
83 Commodities: crash or blip?
84 Buttonwood: Three market narratives
86 Commodities trading in Asia
86 The problem of money-market funds
88 Economics focus: Fiscal rules

32a

For daily analysis and debate on economics, visit
Economist.com/economics

Europe's debt saga

# Every which way but solved

ATHENS AND LONDON

**A bail-out strategy as bankrupt as Greece should be ditched. It probably won't be**

IF APRIL is the cruellest month for poets, May is the harshest one for European leaders. A year ago they tore up the rule book to bail out Greece and to ward off market attacks on other fiscal reprobates in the euro area. The first anniversary of the rescue mission has been nothing to celebrate. Despite a year of grinding hardship Greece looks ever more likely to have to restructure its debts. The official rescue funds hastily mustered in May 2010 have had to be deployed twice more since then, first to support Ireland late last year, and now to keep Portugal afloat.

The most pressing concern is Greece. The big hitters in the euro area—in particular Germany and the European Central Bank—are squabbling furiously about how to deal with the country's debt burden. News of a "secret" meeting on May 6th between finance ministers from Greece and its main euro-area creditor states leaked out along with a report that Greece might leave the euro. That claim was strenuously denied. But policymakers seem unable to agree on much else.

The original plan in May 2010 was conceived on the notion that Greece faced an acute but temporary funding problem. A liquidity issue could be addressed by using official lending from the euro area and the IMF of €110 billion ($157 billion) to replace funding from the markets, which were by then demanding punitive rates. The country would meanwhile take drastic steps to reduce its deficit. That would rebuild investor confidence and allow Greece to return to the bond markets, partially in 2012 and completely by mid-2013.

That schedule now looks hideously overoptimistic. Investors have become even more loth to provide long-term funding: ten-year bond yields now exceed 15%, compared with a peak of 12.3% a year ago. This reflects, in part, an appreciation that Greece's fiscal woes are even graver than they first appeared. The starting-point in 2009 for both debt and the deficit turned out to be worse than realised; tax revenues have proved disappointing as austerity measures have undermined growth. As a result Greek government debt at the end of last year was close to 145% of GDP and the deficit for 2010 was a colossal 10.5% of GDP, well above the original target of 8.1%.

Even the most cohesive and determined government would be hard-pressed to get out of this kind of fiscal mess. Instead, the Socialist government of George Papandreou is split over the prospect of yet more painful reforms. There is talk of installing EU officials at Greek ministries where the most foot-dragging has occurred. The hardest task will be pushing through a €50 billion privatisation programme which is openly opposed by Mr Papandreou's closest cabinet allies, Tina Birbili, the environment and energy minister, and Louka Katseli, the labour minister.

If the sovereign-debt crisis had been confined to Greece, it could be treated as a special case that did not threaten the euro area as a whole. But that has been given the lie by the fall of Ireland and Portugal. Each of these economies had particular features that made them vulnerable. In Ireland, unlike Greece and Portugal, a toxic banking system contaminated the state's finances. In Portugal a decade of wretchedly low growth testified to problems afflicting the whole economy.

But when three different countries stumble, the claim of *sui generis* does too. Once safely tucked inside the euro area and benefiting from low interest rates, all three mismanaged their economies and public finances. Greece and Portugal ran huge current-account deficits while Ireland presided over a prodigious property boom that disguised underlying fiscal weaknesses through flaky housing-related revenues. In varying degrees all three lost competitiveness, as measured by unit labour costs compared with Germany's. (Much the same story can be told of Spain's far bigger economy, even though for the moment investors seem to be giving it the benefit of the doubt.)

The original diagnosis of Greece was wrong. Its fiscal malaise was too profound to be sorted out by a bridging loan. The same mistake may well be being made with the bail-outs of Ireland and Portugal: the salve of temporary liquidity support does not necessarily help countries with deeper fiscal weaknesses.

Not before time some European countries are having second thoughts. Behind the scenes Germany has been pushing for Greece to "reprofile" its debt—a soft form of restructuring that would leave principal and coupon payments intact but extend ▸▸

bond maturities. That would not go far enough in tackling Greece's indebtedness but it would relieve other euro-area states of the need to send extra funds to Greece in 2012, and it would also protect banks that hold Greek debt in their books at par from having to take write-downs. But the European Central Bank is adamantly opposed to any form of restructuring; others are nervous, too.

Even though it would be hard to sell to restive northern European electorates, the temptation may be to postpone the inevitable yet again with the drug of more official funds. That might calm markets in the short term. But it would leave European leaders where they have been for most of the past year—struggling to control the situation because the solution of a big haircut on Greece's debt is too unpalatable. Restructuring will be needed, and probably not just in Greece. ■

Hedge funds

## Power and piñatas

LAS VEGAS

### Anthony Scaramucci, hedge-fund ambassador

MOST hedge-fund managers like to stay out of the spotlight. The guilty verdict handed down in the Galleon trial on May 11th will make many in the industry even more publicity-shy. But Anthony Scaramucci, the boss of SkyBridge, an $8.1 billion fund of hedge funds, relishes it. On May 11th "the Mooch" took the stage to welcome around 1,500 people to the SkyBridge Alternatives (SALT) conference in Las Vegas. In only its third year, the conference has become a sort of Davos for the hedge-fund world, complete with clapped-out politicians as speakers.

Mr Scaramucci, a former Goldman Sachs executive, co-founded SkyBridge in 2005. The firm has expanded quickly: SkyBridge acquired some of Citigroup's hedge-fund units in 2010, which helped it quadruple in size. Mr Scaramucci's ambitions go beyond being a run-of-the-mill Wall Street executive, however. He's appointed himself ambassador-at-large for the hedge-fund industry. "Everyone wants to be veiled up, secret and in the dark," he says. "I'd rather go the opposite way." Last year he turned heads when he accused Barack Obama at a televised town-hall meeting of "whacking" Wall Street "like a piñata". Mr Obama promptly took a stick to his argument.

Between running SkyBridge and being dressed down by Mr Obama, he found time to serve as adviser to Oliver Stone, a Hollywood director, in "Money Never Sleeps", the sequel to "Wall Street". Ever the negotiator, he ensured that SkyBridge got on-screen publicity as the sponsor of a gala attended by Gordon Gekko, the film's main character.

In his book, "Goodbye Gordon Gekko", a biography-cum-self-help guide published last year, he talks about his humble upbringing by Italian-American parents on Long Island, lambasts the culture of greed and ego on Wall Street and reflects on his success. "I am a capital artist," he writes without apparent irony. "My canvas just happens to be Wall Street and my brushes are the money managers for whom SkyBridge raises capital." Not everyone appreciates Mr Scaramucci's sense of perspective. But lots still show up in Vegas.

Scaramucci would do the fandango

The Galleon trial

## Guilty as charged

LAS VEGAS AND NEW YORK

### The verdict is finally in

IN A phone call recorded by the government in 2008 Raj Rajaratnam, the boss of Galleon Group, a large hedge fund, called Danielle Chiesi, an executive at another fund, to thank her for sharing a tip. "But it's a conquest, right?" he asks her. "It's a conquest," she responds. "You're a warrior. I'm a warrior."

On May 11th Mr Rajaratnam lost the battle he was fighting against government prosecutors. He was convicted on 14 counts of securities fraud and conspiracy, and faces many years in prison when he is sentenced in July. A New York jury found that Mr Rajaratnam made nearly $64m from trading based on tips he ferreted out from a network of corporate executives and traders about firms like Goldman Sachs, Google and Intel. He rewarded them generously for confidential information. He paid Anil Kumar, then an executive at McKinsey, $500,000 a year for tips about the firm's clients, for example.

This is the first insider-trading case in which the government has used wiretaps, and they were pivotal in Mr Rajaratnam's conviction. The jury heard dozens of conversations that showed him as foul-mouthed, boastful and conniving. In one Mr Rajaratnam and his brother, Rengan, talk about getting another McKinsey executive to leak information. "Everybody is a scumbag," says Rengan, and they laugh.

Mr Rajaratnam, a risk-taker in his trading, took the same approach to fighting the government's charges against him. He hired a public-relations manager to set up a website, rajdefense.org, which attacked supposedly biased news articles and posted documents relevant to his case. His lawyers argued that the information Mr Rajaratnam traded on was publicly available, pointing to news reports that speculated about upcoming deals and results.

But it proved impossible to distract the jury from what was said in those calls. The defence case also stumbled when Rick Schutte, a former Galleon president who testified that Mr Rajaratnam was just a meticulous researcher, revealed under questioning that Mr Rajaratnam and his family had invested $25m in his new hedge fund.

The trial afforded a glimpse inside what used to be one of the industry's largest and most respected funds. Galleon, which managed $6.5 billion at its peak, gathered staff every morning at a meeting, and employees were fined if they were late. Analysts and portfolio managers had to circulate weekly reports with their best trading ideas. Mr Rajaratnam sat in front of six computer screens during the day. Internal instant messages, e-mails and company documents revealed an intense and competitive culture that blended legitimate research with illegally obtained tips.

Mr Rajaratnam will appeal but if it stands, the conviction is a major victory for emboldened prosecutors, who are making insider trading and market abuse a priority. Enforcement of insider-trading law tends to go up after periods of market stress, according to Laura Beny at the University of Michigan Law School. In the past 18 months, the US Attorney's Office has charged 47 people with insider trading. Mr Rajaratnam is the 35th to be convicted.

"A long-term full-court press to root out insider trading in the hedge-fund business" is how Janice Fedarcyk, an assistant director at the Federal Bureau of Investiga- ▸▸