Worst case for Greece may not be a default

786

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Athens would be free to focus on growth rather than ever tougher cuts

BY LANDON THOMAS JR.

On the face of it, a Greek debt default has very little to recommend it. Hyperinflation, a run on the banks and the spread of contagion to larger euro zone economies like Italy are just some of the effects that could materialize if Greece

NEWS ANALYSIS

ever decided to stop paying either part or all of the interest on its debts.

But as Greece struggles to impose yet another round of spending and wage cuts, economists are beginning to wonder whether the consequences of a default or a more radical debt restructuring, dire as they may be, may be no worse for Greece than the miserable path it is currently on.

Greek government officials said Monday that, in preparation for a conference call with the International Monetary Fund and European officials, a fresh round of austerity measures would be put in place. These could include cutting as many as 100,000 public-sector jobs by 2015 and sharply paring back the country's generous pension benefits.

Investors shed risky assets in the United States and Europe on Monday in a sign of increasing pessimism over the lack of a resolution to the Greek debt crisis. In Europe, market indexes fell 3 percent and the euro declined. The mood carried over to the United States, where bond prices rose and stocks on Wall Street declined.

Greece's last-minute concessions, made under duress, may well be enough to release the next installment of aid funds and keep Greece solvent for the rest of the year. But the much deeper pain that will result as thousands of laid-off government employees enter the already swollen ranks of the Greek unemployed is spurring talk of a more radical approach.

"Greece must now begin an orderly default, voluntarily exit the euro zone and return to the drachma," the economist Nouriel Roubini wrote in an essay posted Monday on his Web site.

Like a number of other economists, Mr. Roubini argues that Greece can no longer afford to suffer through an extended period of price and wage compression to restore its competitiveness.

Default and a euro exit would carry a steep price — most probably a run on Greece's banks, rampant inflation and international isolation — but at the very least the country would be able to sharply reduce its debt yoke and could focus on growth as opposed to cuts.

For the moment, Greek officials are adamant that neither a default nor a euro exit and devaluation are in the cards. One senior policy maker in the Finance Ministry even offered to send his questioner a case of 2005 Dom Pérignon Champagne if Greece ever repudiated its debt.

Behind the bravado, however, analysts

GREECE, PAGE 16

Default may be option for Greece

GREECE, FROM PAGE 1

are crunching the numbers to see what a default or other such scenario would look like — and it is not a pretty sight.

First of all, the numbers are very large, especially compared with past sovereign defaults. Total Greek debt is about €370 billion, or $500 billion. Argentina's debt was $82 billion when it defaulted in 2001; when Russia defaulted, in 1998, its debt was $79 billion.

In a recent report, Willem H. Buiter, chief economist at Citigroup, presented two possible default scenarios. In the first, Greece forces private-sector creditors to take a loss on their bonds of from 60 percent to 80 percent, but manages to stay inside the euro zone by keeping current on the smaller amount that it owes its official lenders, such as the European Union and the I.M.F.

As Greek debt is right now trading below 40 cents on the dollar, this step, while painful, would reflect market reality. But it would also most likely have to be part of a broader agreement to recapitalize European banks, which is unlikely at this point.

While technically a default, the loss, or haircut, would not be an outright repudiation of Greece's debt. Mr. Buiter argues that it would not have to lead to Greece's ejection from the euro zone, especially if the European Central Bank continued to lend to Greek banks and accept government bonds as collateral — preventing a bank run and keeping the Greek banks solvent.

In fact, discounting Greek debt would have the benefit of reducing in a significant manner Greece's overall debt burden of 172 percent of gross domestic product. Greece's current deal with the banks, as part of its second bailout package, has the banks taking just a 21 percent loss, which does not achieve anywhere near the same level of debt reduction.

A more extreme outcome would have Greece actually walking away from its financial obligations, like Argentina and Russia did, and leaving the euro zone. This, Mr. Buiter says, would lead to close to 100 percent losses for bondholders, as well as total economic collapse in Greece as the euro gave way to a devalued drachma and an inflation spiral.

As there is no formal treaty mechanism for a country to be expelled from the euro zone, such a step would have to be taken by Greece independently — probably with the view that, as in Argentina in 2001, a cheaper currency and control over monetary policy would at least ease the pain of austerity.

While such a disorderly Greek default is seen as the least likely scenario, analysts agree it cannot be discounted altogether. There would be a bank run in Greece as savers pulled out their euro deposits, high levels of inflation as Greek society came to grips with a devaluation of the new drachma of at least

KOSTAS TSIRONIS/BLOC

A newsstand in central Athens on Monday. Greek government officials said that austerity measures could include cutting as many as 100,000 public-sector jobs

40 percent, and undoubtedly significant contagion to other countries similar to what happened after the Argentine default.

Economists also warn that a Greek default could put further pressure on Italy, the euro zone's third-largest economy, which, though solvent, is struggling to enact austerity measures, find a way to stimulate growth, and cope with market uncertainty about its bonds.

Merrill Lynch estimates that the shock to growth in Europe, while not as

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severe as the financial crisis of 2008, would be material, with overall output contracting by 1.3 percent in 2012.

"Orderly or not, we have no idea what the effect of a default would be on other countries, especially Italy," said Peter Bofinger, an economist who advises the German Finance Ministry. "If there is just a 5 percent chance that this affects Italy, then you don't want to do it."

One reason for concern about contagion is that Europe's rescue fund, the European Financial Stability Facility, is unlikely to have the funds or the flexibility to provide immediate assistance to countries of Italy's size.

The crucial question, econ is when the Greek governm cide that not paying large p even all, of its debt is in its in

In the past, the point has that as long as Greece's pri — its deficit excluding i ments — is higher than its cing burden, there is no ince fault, as the country would budget shortfall even after This was a point made by I.M mists in a report last year why it was not in the interest o economies in Europe to defaul

In 2010 and 2011, that has in the case for Greece. But as the minister, Evangelos Venizelos lined in a recent speech, he expec even as it struggles to cut spending increase revenue, Greece should re ter a surplus before interest paymen of €3 billion next year.

On the surface, such a number may not mean much — especially as Greece's overall budget deficit for 2012 is still likely to be around 8 percent and too high to satisfy the target set by Europe and the I.M.F.

But as government officials weigh the pros and cons of staying hitched to a punishing austerity regime or triggering some form of a default, knowing that your budget would be in balance if you stopped paying the bankers that got you into this mess in the first place can provide quite the temptation.