



Can Greece Avoid Default?

William R. Cline argues that, contrary to the demands by some that Greece radically restructure its debts, the country can take other steps to reach fiscal sustainability.

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Steve Weisman: The odds of Greece avoiding default in Europe are widely debated. This is Steve Weisman with William R. Cline, senior fellow at the Institute, to talk about Greece's debt burden and what Greece has to do to avoid a default that might plunge Europe into a deeper crisis. Bill Cline's Policy Brief has also just come out. Bill, walk us through Greece's prospects.

William R. Cline: Basically, the package that has been put together in July substantially reduces the interest rate that Greece has to pay, and it very substantially reduces the annual repayments of principal, turning debt into 30-year bonds. And by my calculations, they can very substantially reduce their debt burden over the next several years and re-establish their solvency without having to have a bankruptcy-type forgiveness of their debt.

I think that's particularly important, because at this juncture, if instead they transitioned to a severe bankruptcy, I think there would be shockwaves that would affect Italy and Spain and the other bigger countries at risk. And the damage from that would be quite great.

Steve Weisman: What do you mean by "bankruptcy-type restructuring?" There's talk of a 50 percent haircut on debt. Is that the equivalent?

William R. Cline: I would consider that to be a very deep cut. So far, the debt has essentially been stretched out in terms of its maturity, and interest rates have been kept more or less at earlier, pre-panic levels. Now, if you had a 50 percent write-off, that would obviously be much deeper forgiveness. And you get something like an Argentina situation if the deeper you go, the more you essentially make that country a pariah from the capital markets for the next couple of decades.

Steve Weisman: Right.

William R. Cline: I think a lot of the people who say you should have a 50 percent haircut for Greece do not understand that half the debt is already held by the public sector of one sort or another. About 50 billion euros is held by the OECD [Organization for Economic Cooperation and Development] under its securities markets program, for example.

So unless you're talking about a 50 percent haircut for all public holders, you're talking about a 100 percent haircut for the private holders. Query: can you inflict 100 percent forgiveness on private holdings of Greek debt without causing really massive contagion to the rest of Europe?

Steve Weisman: Would the other countries having difficulties demand equal treatment?

William R. Cline: I don't think so, because I think they know that it's not in their long-term interests to become a debt pariah. I think one of the dynamics involved here is that the markets are making the assumption that the official holders will tend to have seniority ...

Steve Weisman: Right.

William R. Cline: So whatever the depth of the cut is, the depth of the cut for them is going to be much greater. And you get these really high risk spreads reflecting that.

Steve Weisman: What is it about this debt burden that makes it more manageable than some other analysts say?

William R. Cline: I think a lot of people who look at this say, "Oh, well their public debt, the GDP is 170 percent -- Oh, that's obviously unsustainable, they've obviously got to cut it in half or something like that." But there are lots of problems with that figure.

For starters, the OECD says that Greece has 33 percent of GDP in financial assets in the public sector. And to me, it only makes sense to look at net debt.

Secondly, Greece has about 50 billion euros of privatization it can carry. That's about 20 percent of GDP. So, the other part of the chorus is that the GDP will be growing over time. So I get the net debt ratio starting out at 120 percent, not 170 percent, and going down to less than 70 percent by 2020.

There's one more aberration in the data, which is that as Greece purchases zero coupon German bonds to be the collateral for this debt exchange they're carrying out with the private holders, well, the gross debt is going to go up. But that's an asset. So the net debt doesn't change at all. So there's another distortion in the picture of what the debt burden is.

Steve Weisman: But even though the debt is balanced by these assets that you mentioned, Greece still has to pay off that debt, doesn't it? And therefore, the amortization and the debt service is going to be pretty difficult for it to pay.

William R. Cline: The collateral is clearly an asset, because you can't double count.

Steve Weisman: Right.

William R. Cline: You're either going to default, and the collateral gets transferred, or you're going to pay and you keep the collateral, you sell it off again, and you've got the asset. Now, how does Greece "pay off" this debt? The actual absolute level of debt does come down, but the main driver of that is its 50 billion euros of privatization.

Steve Weisman: Right.

William R. Cline: There's also about five percent of GDP from buying back the debt at a cheap market price. They can take something like 15 billion euros off of their debt.

Steve Weisman: Just by buying back?

William R. Cline: By spending 20 billion euros, and buying back 35 billion euros worth of debt.

Steve Weisman: Why don't they do even more of that?

William R. Cline: Funny you should mention that. People worry about the private sector involvement not being fully subscribed. My solution to that is if it's not fully subscribed, they should take the money that they don't have to set aside for collateral and use it to buy back bonds at a discount.

Steve Weisman: Greek bonds are trading at something like 40 percent of par value. Would they buy it at 40 or 50 percent?

William R. Cline: My calculations conservatively say they could buy it at 60 cents on the euro.

Steve Weisman: And the bond-holders would be happy because ...

William R. Cline: Bond-holders would be very happy, because it would be a voluntary sale.

Steve Weisman: But the privatization, just reading the news stories, seems to be going slowly and subject to some protest within Greece of selling the family jewels and that sort of thing. What are the prospects?

William R. Cline: You see, I think the core issue here is the political determination to do all this. I mean, the privatization is one part of it, but equally important is getting to so-called primary surplus, which means the fiscal balance is a surplus before you pay the interest. That's the primary concept.

Steve Weisman: Mm-hmm.

William R. Cline: And the history of debt defaults has been one of political determination of the default or the not default. Compare Chile to Venezuela in the 1980s. Chile had a much higher debt ratio. Chile paid off every cent of its debt, and Venezuela had a 35 percent haircut in the Brady plan.

Why? Because the politics in Chile were that they were determined to maintain their international credit reputation. The politics in Venezuela were more populist.

Interestingly to me, in Greece, there seems to be a very strong determination among the whole political establishment to make this work, and to maintain the reputation that Greece has on its debt. Yes, they have to face protestors on the street.

Now, the moment that changes to the situation in which a major political faction which could conceivably win an election says, "This debt is unfair, the people who hold it have to take a 70 percent or a 50 percent haircut," as one of the parties did in Argentina in 2001, the Peronist [party], the whole situation can come tumbling down very quickly. But I think the political will is there. And you just saw it in very recent fiscal measures.

Steve Weisman: Let's come back to another point that you made, which is presumably that Greece will grow. But there are those who see the trends as not very good for that. Why should we think that Greece is going to be able to grow, since all these cutbacks are inflicting layoffs and other factors that would contribute to a contraction of the economy?

William R. Cline: I think that you get a temporary contraction of the economy and then you can start growth again from a new, lower base. I mean, if you look at the growth record that Greece compiled in the decade up to 2007, they were growing at 4.5 percent per year in real terms.

Now, the growth that is required in real terms in the basic plan that's been laid out by the IMF [International Monetary Fund] and the EC [European Council] is only 2.5 percent over the next decade. So, it seems to me that they already have a fairly conservative growth assumption. So, I think they can make these growth rates.

Steve Weisman: I've been talking with you about the financial crisis of the last few years. I'm reminded of the debate going back to 2008-9 over banks in the United States, in which some said, "They're insolvent, take them over, break them up, give haircuts to the bond-holders, get it over with." You cautioned against that and now you're cautioning against a quick and destructive judgment in this case. Do you see an analogy?

William R. Cline: I think there is an analogy in the sense that you can make matters worse by trying to get a quick fix. I think it's very difficult to envision a forced deep forgiveness of Greek debt without having Italy and Spain have a substantial surge in their interest rates. The market would go after them, and they're just much bigger economies with much more important consequences.

So yes, I think we probably could have made things much worse by, in addition to all of our other uncertainty, saying that Bank of America and Citigroup and the others should simply shut their doors and send in your request to the FDIC to get paid when you get around to it.

Obviously, the analogy is not exact. Probably the biggest difference here, to me, is that Greece is a small part of a big economy, sort of like a young nephew in a large, powerful family, and the family can either make sure that that nephew makes it, or it can spoil the family's reputation by inflicting certain behaviors on the nephew. And I think that's basically counterproductive.

And I think that's why they've so far have stepped up to the plate and made quite substantial EU [European Union] financing arrangements. And I think they would be wise to stick in that mode rather than to go in some sort of an ideological punitive mode, that we've got to make the market be chastised. Because I think that under these more lenient terms, Greece can make it already.

Steve Weisman: Thank you, Bill.

William R. Cline: Thank you, Steve.

