For its own sake, Greece needs to declare default

Friday 17 February 2012, by LAPAVITSAS Costas (Date first published: 14 February 2012).

The ruthless austerity programmes imposed on Greece and the endless cycle of debt renegotiations will only come to a close when Athens takes charge of its predicament and announces a democratic and sovereign cessation of payments.

Negotiations to reduce Greek debt have been suspended after no agreement could be reached last week. At some point in the near future, Greece seems certain to default on its obligations. But the drama surrounding the talks in Athens, Berlin and Paris shows that there will be nothing co-operative about a Greek default. It is a ruthless contest dominated by the so-called troika: the European Union, the European Central Bank, and the International Monetary Fund.

At every turn, the interests and rights of people across Europe have been disregarded. Negotiations have proceeded in secrecy. Greece, whose government is led by an unelected central banker, is represented by a team of politicians and technocrats who have performed lamentably during the crisis. Those who are owed money by Greece have been represented by the Institute of International Finance, a self-styled mouthpiece for bankers.

The troika has accepted that Greek debt must be reduced to sustainable levels. However, it also wants the reduction to appear voluntary because, if the lenders were coerced, Greece would be declared in formal default, and banks and financial markets would be thrown into crisis.

The troika would also like the reduction to be on terms that would allow immediate fresh loans to Greece, and wants Greek debt held by official bodies, including the ECB, to remain intact. Not surprisingly, the circle is proving hard to square.

The debt in question is €200 billion ($246 billion). About half belongs to Greeks - banks, social security funds and others - who are first in line to bear the costs of reduction (the ’’haircut’’). Less than a quarter belongs to international banks, and a good part of the rest to hedge funds.

The deal proposed by the troika is geared to the interests of lenders, particularly international banks. The face value of the debt would be reduced by 50 per cent, and the remaining debt would be replaced by new long-term bonds bearing a low interest rate, perhaps less than 4 per cent.

The losses for international banks would be modest. Even so, they are angling for a higher interest rate. The real blow would fall on Greek banks, which would effectively go bankrupt. The Greek state is thus desperately seeking fresh loans to replenish its banks’ capital. Much of the expected reduction of its debt would, therefore, be immediately voided. A cruel blow would also fall on Greek social security funds and small bondholders, with losses probably passing on to pensions and savings.

Meanwhile, hedge funds have been buying Greek debt at low prices in the hope of being paid at, or near, full value. Since Greece has to make debt repayments of almost €15 billion in March, huge amounts of European taxpayers’ money could potentially be transferred to these vulture funds. The speculators could possibly be coerced into the deal by applying Greek law, but if the reduction were not voluntary, there could be a chain reaction across financial markets.

The worst aspect of the deal is that it is unlikely to benefit Greece in the long term. The original plan was to bring debt down to 120 per cent of gross domestic product by 2020, but ’’rescue’’ programs have forced the country into a real depression. The IMF now thinks Greek debt will be on a much higher level by 2020 - clearly unsustainable. It is seeking deeper reductions, but the price would be even harsher cuts in wages, pensions, and public spending. The social repercussions on an already weakened country would be horrendous.

It is clear that Greece has little to expect from a debt-reduction process led by the troika. It should take charge of its own predicament, abandoning the charade of voluntary haircuts. For that, it needs to default in a sovereign and democratic way by immediately declaring a cessation of payments. It should then publicly audit its debts to decide what should be paid and how. The objective should be to restart economic growth and to avoid disruption of basic social services. Debt would inevitably be cancelled, and there should be negotiations with the lenders under full public scrutiny. Only then could this dreadful saga come to a close, allowing Greek society to take the first steps on the long path to recovery.

Costas Lapavitsas

P.S.

* From The Sunday Morning Herald, February 2012:
http://www.tni.org/article/its-own-sake-greece-needs-declare-default

* Costas Lapavitsas. Reader in economics and associate dean in research at School of Oriental and African Studies (SOAS).