Dealing with the debt

| By Judah Massias

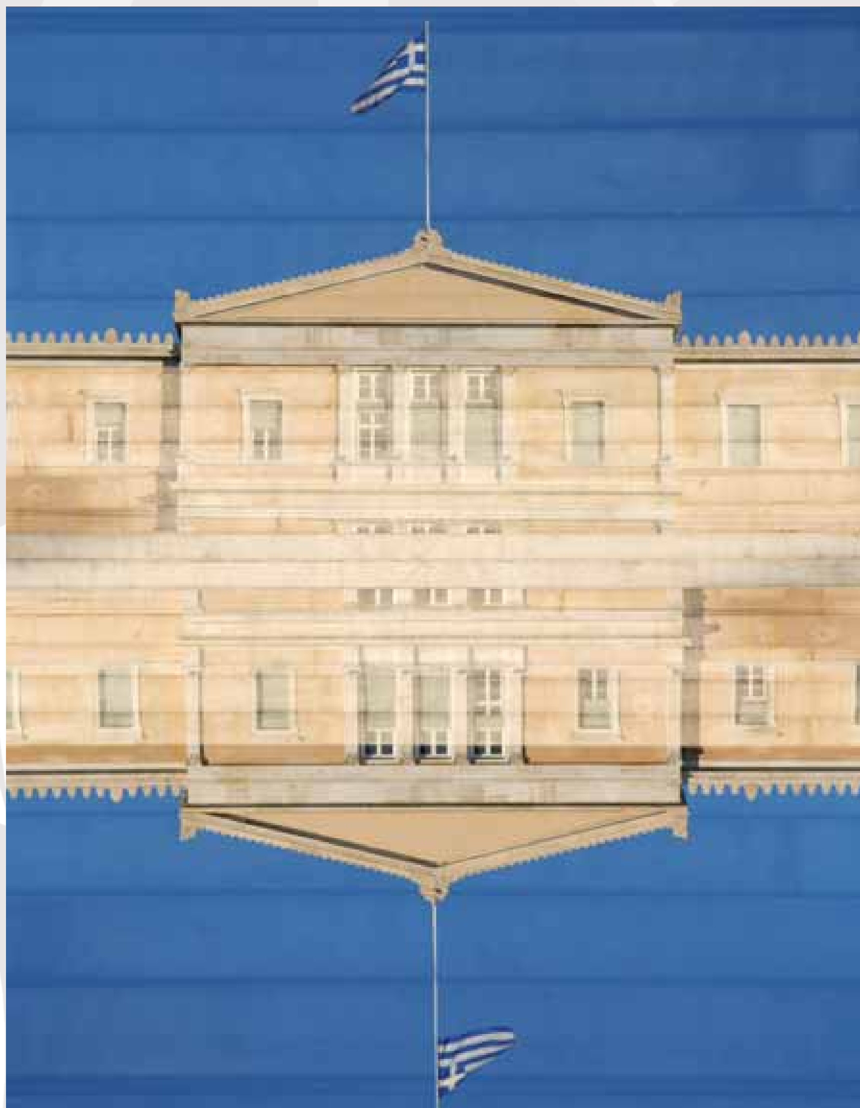
Greece, one of the smaller countries of Europe, has become the focus of the world's financial system. Greece is a member of the euro zone, a group of 17 nations of the EU that chose to adopt a common currency, the euro. Greece has become all-important at these times because it has a vast debt of nearly $500 billion, or more than 120 percent of its GDP.

Greece is a loose cannon because its volatile political system prevents taking the necessary steps to improve the economy. Greece is important because it has difficulties meeting its debt payments, and it may go bust. If that happens, there are fears that it may drag down the whole euro zone, something that will have very negative global economic repercussions.

To avoid a possible financial meltdown, the member states of the euro zone are straining every nerve to prevent a Greek collapse.

There are justified fears that a Greek collapse may trigger a domino effect that will affect Italy and Spain, the third- and fourth-largest economies in the euro zone. There are also fears that a Greek collapse could cause a bank crisis in France, the second-largest economy in the euro zone, because French banks bear the brunt of the Greek debt. Last month the large Franco-Belgian DEXIA collapsed. It went under because of the weight of its debt, much of it backed by Greek paper which had lost much of its value. There are fears that further falls in the value of Greek bonds will endanger other French banks.

To avert this looming crisis, the euro zone countries, with assistance from the IMF, decided on a far-reaching aid package. The main points of this package, which will be borne in part by most European taxpayers and will cost between 130 billion-150 billion euros, are the following.



Greek Houses of Parliament

The banking system will cut 50% of the Greek bonds held by them and valued at 200 billion euros, or 60% of the Greek debt. The other 40% are held by private investors. As a sweetener, the banks will receive 30 billion euros. Furthermore, the banks will have to increase their capital base by raising 100 billion euros.

The banks will have a tough time canceling 100 billion euros in debt, and some fear that the 30 billion euros in aid will not be enough and the governments will have to come up with a few billion more. In the current financial situation, it will not be easy to raise so much money. The large banks may be able to do it, but the smaller banks many not; consequently, they may need more government help.

Greece is costing the euro zone governments nearly 250 billion euros, more than the total GDP of the country.

But despite the vast sums poured in to bail out Greece, there are many who believe that this is only a temporary measure and that sooner or later Greece will not be able to meet its debts. George Soros, the investor billionaire, said that the new package would last from a day to three months. Other global economic luminaries shared this view.

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Soros was right. Barely a week after the new bailout was announced, Greek Prime Minister George Papandreou declared that he would hold a referendum on the new bailout terms. Since most polls show that more than 60% of the electorate is against the deal, the chances of its being approved are very slim and Greece will default.

This decision caused dismay in Paris and Berlin and Chancellor Angela Merkel and President Nicolas Sarkozy had a hard time convincing the Greek premier to retract

Jonathan Katz, an economic consultant at HSBC bank, told Financial Horizons, "The euro zone will have to weigh the consequences of a Greek default . They will have to assess the damage to the whole system and perhaps offer Greece a better deal, such as cutting 70% of the total debt for example . Otherwise, a default will affect other euro member states. Greece will have to leave the euro zone. In addition the whole system of countries with different levels of economic development and different fiscal policies sharing a single currency will disintegrate."

If the debt crisis is not resolved, the situation will intensify, and it is doubtful whether the rich countries like Germany, Holland and Finland will be willing to keep on pouring in good money after bad. Even now, the population of these countries are not very happy to be paying Greece's debts. And they will be less so in the future.

In Germany, for example, there is mounting resistance to the huge amounts of German taxpayers' money being diverted to bailouts. Many Germans believe that they should not be made to pay for the irresponsibility of others. These attitudes are having political as well as legal repercussions.

It is not only in Germany that hard questions are being asked. Finland has demanded guarantees for any Finnish tax money used to bail out Greece. Finland named Greece specifically because the Finnish government has serious doubts about that country's ability to meet its debts. Meanwhile, Holland is in favor of expelling euro member states if they are not up to the task.

The UK, despite having kept out of the euro zone, participated in the bailout of Greece and that of the Irish Republic but has now made it clear that it is not willing to give one more penny for any future bailout. This is not a wise move. The British Chancellor of the Exchequer George Osborne is very happy that the UK is not a member of the euro zone but as it is Europe's financial center, the fall-out of any euro crisis will have a very negative effect on the British economy.

Britain may not be part of the euro zone, but like other EU member states, its economy is closely linked to the euro zone. A Greek default can cause a domino effect that may harm other euro zone countries and Britain as well. .

Many point at Italy and Spain as the two countries most likely to go under. But Moe Cohen, a Gibraltar-based CPA, is not so sure. "It is true that Italy has a very large public debt, approximately 1.9 trillion euros, but it has a lot going in its favor. The political desire to curb public spending is there, but more importantly the level of household debt in Italy is relatively small, which means that the government can raise money at home. Spain is in a different situation it has a much smaller debt of 14,000 euros per capita compared to nearly 34,000 euros in Italy, but Spain's ability to raise money in the home market is less than Italy's," he says.

The European Parliment in Brussels

Up to now, Spain has survived the crisis.

The new center of government in Madrid headed by the right-wing Partido Popular, the Spanish government may be more willing to take the tough but necessary steps to put Spain's finances in order.

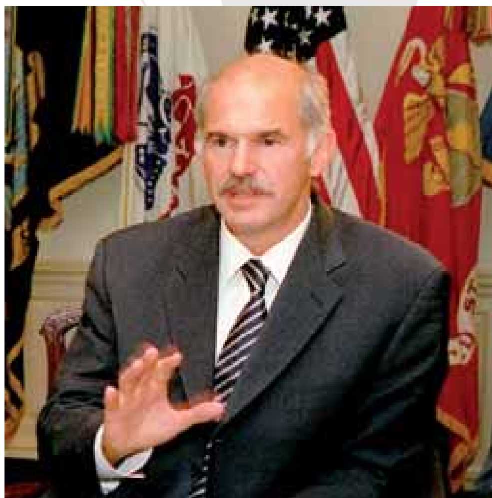
While a breakdown of the latest aid package deal to Greece may cause a domino effect in Europe in general and the euro zone countries in particular, that is not the only danger. The global debt problem was caused by the sub prime crisis, which started in 2008 and compromised the entire banking system. Many countries, including the US, poured in vast sums of money to prevent a collapse of the global banking system. The US probably poured in more money than any other country and, in the process, accumulated debts of $14 trillion, which amounts more or less to its annual GDP. But in contrast to many European countries, the US can repay its debts.

There is a danger that if the creation of new debt is not managed wisely, it may cause a renewed financial crisis in the future that will be much more difficult to resolve. ■

The turmoil continues

The decision by Greek Prime Minister George Papandreou to hold a referendum on the Greek bailout had a bombshell effect on the financial markets. The chances of an affirmative vote in the referendum were slim. Greece would not get more aid, and the country would have defaulted.

Since then, Papandreou has retracted his proposal, but the political turmoil in Greece continues. Without a stable government in Athens, it is doubtful that any government can carry such a controversial measure as an aid package with strings attached, strings that will greatly affect the standard of living of the Greek population.



Prime Minister George Papandreou

The reaction of the financial markets to a possible Greek default has been dramatic. Many believe that a Greek default will bring about the demise of the euro. This may be true, but is the euro necessary?

The single European currency may be a good thing on the road to European unity, but you can't have a single currency if you don't have a single fiscal policy and if you don't have homogeneous economies.

This is not true of the euro zone, and the result has been situations like the one in Greece and those of Ireland and Portugal in the recent past.

In these circumstances, a graceful exit of the euro from the world's financial stage may not be a bad thing.

Edouard Cukierman, managing partner of the Catalyst Fund, is very heavily involved in the European economy. A few weeks ago there was a successful conference called Go 4 Europe, and he is apprehensive about what will happen next.

"For years Greece has been subsidized by the EU. Greece has large debts, a large government deficit. The euro zone countries and the IMF suggested a deal in which 50 percent of Greece's debts would be written off. What more can the country expect?" he says.

Cukierman believes that recent developments are endangering the euro zone and the whole concept of European solidarity.

The taxpayers in the northern tier countries of the euro zone refuse to act as the paymaster to inefficient European economies like Greece. The problem has become a political issue.

Cukierman fears that elections may bring in governments determined to dismantle the euro which, in the long run, would not be good for Europe.

Luc Muller, CEO of the German Otto Group, views the Greek problem more cynically. "Whatever happens, whether Greece accepts the latest bailout terms or whether it defaults, the results will be the same. The Greek debt will be paid by the euro zone countries. So why make a big issue out of the whole Greek problem? The solution is to have the European Central Bank underrate the bonds issued by euro member countries. That will stop the crisis in its track. ■