Greece: End of bailouts and start of the path to a new bankruptcy

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Thursday's Eurogroup set up the final conditions for the end of the third Greek bailout program in August. Since 2010, Greece has borrowed 275 billion euros from EU countries and the IMF.

Even though the borrowing is over, EU and the IMF have imposed new long-term austerity conditions on the Greek economy, including additional sharp pension decreases and the requirement that Greece produces a 3.5% of GDP budget surplus. To achieve this, Greece has imposed skyrocketing taxes including a 24% value added tax and plans to increase taxes to those making as low as 6000 euros a year. Taxes suck out all the extra cash businesses and people have. Investment has plummeted, and consumption is 25% lower than a few years ago. Unemployment is at 23%.

With huge taxes and a business-unfriendly bureaucracy, Greece is unlikely to attract investment and will not achieve fast growth. Without growth, Greece will be unable to pay back its debt in full despite a 10-year postponement of maturities on 1/3 of its debt granted by the EU on Thursday.

The Eurogroup decision was crafted to create a cushion of cash that would allow Greece to temporary pay all its external debt obligations without issuing new bonds for about two years. Thus, the EU plan abandons the goal of Greece's return to global financial markets that was a key goal of the bailout programs. It does not help that the IMF sees the Greek debt as sustainable only in the medium run and is "unsure" of its sustainability in the long run.

Once the money cushion is spent or diminished, Greece will have an even harder time tapping the financial markets. The eight-year bailout programs have failed to bring Greece to normality. After the cash cushion is exhausted, Greece will be asking for a new bailout.

Is there a solution for Greece? Yes, but it is in quite the opposite direction of the EU and IMF plans this far. Greece needs to achieve high growth, 4-5% per year, for 5 years, and start paying its debt *after* that. To achieve high growth, Greece needs to abandon the multi-year 3.5% surplus target for the much more reasonable 1.5-2% target. With lower surplus, lower taxes and less bureaucracy, Greece will be able to attract investment and realize high growth. Once it has achieved high growth and its economy has expanded, Greece will be able to pay its debt in full. Instead the EU/IMF plan forces Greece to pay when its economy is hurting and thereby drive it in a downward spiral. Imposing the requirement of large surpluses now is catastrophic and forces Greece to never be able to pay back in full.

The correct solution for Greece does not require financial wizardry. But it does require having a longer horizon, a feature that politicians all over the world lack. The next Greek Prime Minster needs to convince the EU partners that their present plan not only makes Greece poorer but also denies Greece the possibility of ever paying its debt in full, even in the long run. And, of course, the Europeans want their money repaid in full.

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