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THE SECOND EU AID PACKET TO GREECE BRINGS IT CLOSER TO BANKRUPTCY

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The last few weeks were extremely critical for the future of the Greek economy, and were proved to be especially dark for Greece. With a public debt over 150% of its GDP, Greece needed avert substantial reduction of its sovereign debt of the order of 50% that would bring it to the levels of 60-90% of GDP which are sustainable for the Greek economy. Instead of the 50% reduction, the second EU aid packet proposes a reduction of debt by 20%. A careful examination of the terms by analysts from Barclays and other banks show that in practice the "haircut" will be much smaller, on the average approximately 9-10%. But when Greek bonds are traded in the market 30-40% below their face value, why does Greece agree to pay its creditors 20-30% more than the market price. Can the Greek government explain why it gives a "bonus" of 30-50 billion to the private creditors in the process of bonds exchange?

What does the second aid packet mean for Greece? That Greece lost possibly the last chance to get out of the crisis. After the second aid packet, the annual interest from the sovereign debt will be 18-20 billion for thirty years, that is, 9-10% of GDP, or 25% of state revenue. To understand this better, the Greek public sector, currently running an annual deficit of 25% of its revenues, will need from now on a surplus greater than 25% of its revenues because interest alone will cost 25% of its revenues. Even if all the reforms are successful (and it is necessary to make these reforms) it is extremely unlikely that Greece will be able to pay these amounts for the next thirty years. The crisis and the recession are extended to many years, and we are only at the second act of the tragedy of the Greek debt. The way things are going, the third act, in a year or less, will be the real bankruptcy (not the selective one) with catastrophic effects.

Why did Greece lose this chance? There are two main reasons. First, Greece never made a plan for the long run sustainability of the Greek economy. Without a plan, a national strategy for the debt, and evidence to support its position, Greece never went to the EU to tell the truth, that unless its debt is reduced very significantly (by 50%), it will be unable to pay it in full. In contrast, the Greek government made the term "bankruptcy" taboo for 20 months. Thus, it did not create a strategy for the biggest problem of the Greek economy. Second, Greece never negotiated its debt with its creditors. Greece was absent in the negotiations for the second aid packet. The packet was agreed by Germany, France and the ECB and then it was announced to Greece. Thus, it is not surprising at all that the terms of the second aid packet are very beneficial to the European banks and especially onerous for Greece.

I have repeatedly proposed a solution that resembles at first glance the "solution" of the second aid packet – exchange of present bonds with new bonds that would have collateral AAA bonds of other countries or Eurobonds that Greece would buy. However, the solutions I proposed had a substantial haircut of the bond value (30-50%) that would have made the Greek debt sustainable. In contrast, Greece is left with an unsustainable amount of debt by the "solution" of the second aid packet, and it is driven to bankruptcy with mathematical certainty.

With the second air package, Greece lost a chance to proceed in a drastic haircut of its debt. It accepted the bad reputation effects of selective bankruptcy that resulted from the exchange of bonds, without receiving in exchange a drastic haircut. Greece accepted the further reduction of its credit rating and of its banks in exchange for only small benefits. With an amount of debt that cannot fully pay, Greece is lead with mathematical certainty to long term recession and bankruptcy. Will Greece ever create a national strategy for its debt?

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