



EUROPE ECONOMONITOR

# How I Stopped Holding My Breath for a Greek Restructuring and Learned to Love Illiquency Support

Anna Gelpern | May 10, 2010 6:47PM

Leading economists and editorialists say Greece will restructure its debt (here, here, here, here and here are just a few examples). Many say so because they see so much in common between the spiraling European crisis and past crises in the emerging markets. The analogy has merit, and until recently, I too subscribed to it. Now I am not so sure. This is because the benefits of restructuring *now* are oddly remote, because Greece has the legal leverage to extract a deep debt haircut if and when it can maximize its benefits, because the EU needs time to get its act together and seems willing to pay for it—and because, as a descriptive matter, the global political commitment behind the no-restructuring option is without precedent. And sovereign debt is nothing but political commitment. I elaborate below.

Until now, I had presumptively joined debt lawyer friends in holding my breath for a Greek sovereign debt restructuring. Everything felt so familiar – an overextended government, improbable forecasts, chest-beating officials, IMF missions, contagion warnings, escalating “contingency” packages, plunging currencies, riots, more chest-beating officials, bank runs, more riots ... This could be Argentina, Ecuador, Korea, Russia, Ukraine, Uruguay ... We have seen it all before, this time is never different, we know how it ends, and every part of the script is an awful cliché.

Six months into holding our breath while rolling our eyes, we are turning so blue we could pass for Na’vi without makeup. And I am starting to wonder whether it makes sense to exhale for now. Here is why:

1. As a matter of baseless prognostication, call me crazy, but I believe the politicians. The level of multilateral political commitment that has already gone into the trillion dollar EU-IMF package *for Europe* is out of all proportion to what we have seen in the emerging markets crises that formally resemble Greece. It makes popular legal commitment gizmos (no-bailout clauses, no-restructuring covenants, currency pegs and the like) look quaint in the extreme. I read the events of the past week as a statement that the world—and this includes the United States and Asia—wants to keep the EU and the Euro, at least for now. IMF involvement at this level suggests that we are quite past the story of Germany bailing out their banks by bailing out Greece. To be sure, the political winds could shift, and the EU and the world could disintegrate, but that is not a debt restructuring story. Maybe a realism-kills-idealism, currency-union-as-bubble, or global moral turpitude story, but not a debt restructuring story.

*Trivia detour:* Apropos commitment, isn't it interesting that the European Commission will issue *collateralized* debt (secured by its €141bn budget)?

2. As a legal matter, a Greek debt restructuring would be simpler than most, thanks to the sheer goofiness of Greek contracts. The technology is all there, and yes, much of it is the same as the technology used many times before in small emerging economies. But perversely, a debt restructuring now is unlikely to bring needed debt relief for Greece. Among other things, Greek banks are massively exposed and would need to be recapitalized by the defaulting government or the foreign public sector. True, Argentina did it before, but it got the benefit of stiffing a bunch of foreigners for free in the bargain, which is not a foregone conclusion here (see No. 4 below). And Argentine officials could afford to stick it to local pension funds for internal political reasons. Don't think Greece compares.

3. A debt restructuring now does not spare Greece the pain of adjustment – perhaps it does not even make much of a difference for the quantum of suffering. Paul Krugman says Greece is set to suffer in the extreme even if it defaults completely. And it will not default completely.

4. A debt restructuring now is likely to hurt the worst in the very markets that Greece needs the most for recovery. This is the old European bank story with a dash of the old interconnectedness story. Even if Greek debt by itself does not bring down undercapitalized European institutions, everything that attends a Greek default would do the trick. An EU credit crunch is not good for Greek exports. In contrast and with the partial exception of Latin America in the early 1980s and Russia/LTCM contagion, recent emerging markets debt crises did not pose such a serious threat to the rest of the world. See No. 1 above.

5. It follows that Greece should restructure if and when a restructuring would credibly result in debt relief and growth. This is the Boone-Johnson message, though I would not purport to pass on the realism of their preconditions. If and when Greece chooses to restructure—in or outside the EU—it will have ample capacity to impose draconian haircuts, but also dispense delicious carrots; and with luck, the EU will have put in place a resolution infrastructure to absorb any necessary burden-sharing.

6. Herein lays the CAVEATISSIMO. This moment of global political commitment buys time for the EU to put together a credible burden-sharing framework, so that a Greek debt crisis does not sink the entire EU boat with Greece in it. This includes a mechanism for resolving EU financial institutions, fiscal policy reform, and other politically costly measures that will test the union. In fact, one could (and half of me does) interpret the trillion-dollar move as a step in the direction of insulating the rest of the EU from Greece, which makes Greek default more, not less likely—but in the context of an EU departure.

And so I sigh two feeble cheers for Illiquency support.

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