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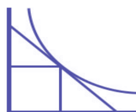

"THE OPTIMAL BUNDLE"

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Special Report on the Greek Sovereign Debt Crisis

What is the Greek Sovereign Debt Crisis? In 2010, Greece had experienced a substantial increase in its debt levels and investors feared it could not meet its debt obligations. That year, a group of creditors—primarily, the other Eurozone countries, the European Central Bank, and the International Monetary Fund—gave Greece a bailout with several conditions including austerity, an obligation to reduce its government budget deficit. Economic conditions in Greece have worsened since then, with unemployment now at 25.9%. Greece is currently negotiating with its creditors to relax some of the obligations of the current debt agreement.

On Losing the War

If economic booms and busts are like battles, Greece has surely lost the war. Greece's economy been in horrific conditions since 2010, and the damage is still ongoing. Data from the World Bank reveals that Greece's real GDP per capita has fallen from $26,861 (in U.S. dollars) in 2010 to $21,956 in 2013, the most recent full year available. This is a massive 18.3% decrease in a key economic indicator, which suggests Greece's problems have gotten worse. Additionally, European Commission data shows that Greece's unemployment rate has gone from 10.8% in January 2010 to the most recent November 2014 rate of 25.9%. The latter unemployment rate is higher than even the highest rate during the U.S.'s Great Depression. It is evident that the Greeks have decisively lost crucial economic battles since 2010. Given this data, the surprise now is not about the verdict. The shock is that they are still not waving the white flag of surrender. - CL

Greece's unemployment rate is 25.9%, a mark eclipsing that of the U.S. in the Great Depression.

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Greek prime minister Alexis Tsipras (left) and finance minister Yanis Varoufakis (right) enter the next stage of negotiations.

Waiting to Grexhale

Investors breathed a sigh of relief early last week. Greece reached an eleventh hour agreement Tuesday with its international creditors to secure €240 billion in continued bailout funding. Its willingness to push the envelope has roiled financial markets in the past month. The yield on Greek 10-year government bonds rose as high as 11.21% this month before settling at 9.24% after trading Thursday. An increase in bond yields indicates fears that Greece may not repay its debt. Greek bond investors have reason to worry – a 2012 debt restructuring shed the face value of Greek debt by 53.5%, reduced interest rates, and extended maturities. In all, the debt lost 74% of its overall value. International investors now hold €370 billion in Greek debt – a similar restructuring would cost them about €270 billion. The new agreement gives Greece four months to act. In the meantime, investors will hold their breath once again.–KGM

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Get Them to the Greek

What happens when a kid is not grounded anymore, but now his friends cannot go out to play? Greece is currently experiencing a similar situation, considering its neighbors are not playing ball. Its trade deficit reached a peak of 4 billion EUR in July 2008, making it highly dependent on its neighbors for imported goods. Because Greece shares a common currency with other Eurozone members, it had to suffer through the late 2000s recession without the ability to devalue the currency, which would have made exports more attractive. Even so, Greece was able to decrease the deficit to 1 billion EUR in December 2014 through aggressive austerity. Although this is a substantial improvement, the deficit has stayed at its pre-financial crisis value for the past two years. Countries like Germany and Italy, two of Greece's top 5 export destinations, were inching towards recession. In other words, Greece finally decreased the trade deficit substantially, but the other European countries are now unable to play--or rather, trade--with Greece. It looks like Greece will have to sit alone in the sandbox. –CM

Greece has been a member of the Eurozone since 2001.

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Are Greece's Creditors Being Reasonable?

Pro: Time for Greece to Stop Passing the Buck

It takes two to negotiate. The Greek government has won the misguided sympathy of *Washington Post* columnist Katrina vanden Heuvel. She claims that "Syriza is a pro-European party. It does not want to leave the EU. Its leader, Alexis Tsipras, says that it wants to honor Greece's debts. But debt that cannot be repaid will not be repaid." The premise of vanden Heuvel's argument rests on the myth that it is inherently impossible for Greece to pay down its debts at current levels and the ruling Syriza Party has offered a reasonable compromise. The Greek government is casting its creditors—the International Monetary Fund, the European Central Bank, and the European Commission—in a negative light to portray itself as a victim. While some changes to the current debt agreement are sensible, the its insistence that creditors should write off half of its sovereign debt invalidates the idea that its demands are reasonable.

Greece's debt-servicing schedule is neither unusual nor unfair compared to the budget schedules of other European debtor nations in recent decades. Under the current agreement, Greece must run a budget surplus (before interest payments) of 4.5% of its GDP this year. As recently as 2013, debtor nations like Portugal, Italy, and Ireland paid 5%, 4.8%, and 4.4% of GDP in interest respectively. Creditors have already taken a 74% loss on their debt in real terms from a prior haircut, where the Greeks received several concessions of lower interest rates and extended loan maturities. Greece's interest payments have already fallen from 7.7% of GDP in 2011 to 4.2% last year. According to the Greek government, they will eventually decline to just 2.2% of GDP in 2022. Far from getting a raw deal, Greece got a bargain.

Although creditors should reject Greece's demand to write off half of its debt, they should consider other reforms. To his credit, Irish Finance Minister Michael Noonan proposed additional reductions of interest rates and extended repayment dates. While creditors are open to reasonable concessions, the Syriza-led government has not reciprocated. In a seven-page letter to the Eurozone, the government even included policies that could raise costs, including a "basic income scheme" for retirees and an increased minimum wage. Apparently, meeting the other side halfway is overrated.—JK

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Con: Give 'em a Break Already

If any country is aware of the concept of tragedy, it would be Greece. Contrary to what students learn in their high school literature classes, the one major qualification for a tragic figure is acting in ignorance. With this financial crisis, acting in ignorance was the tragic flaw of the troubled hero: the Greek government did not realize the extent of the measures they would have to take in order to combat this financial conundrum. The void of competent leadership in Greece during the immediate aftermath of the late 2000s financial crisis put the country on the road to ruin. Greece's demands that half of its debt be written off may seem extreme, but its critics fail to realize the extremity of the situation.

Greece did not go far enough in austerity, and when they realized that, it was already too late. Look at America, arguably still recovering from the Great Recession of 2007-2009, which some economists worried would lead up to a crash worse than the Great Depression, with an unemployment rate of 28%. Greece is in many ways what America would have become if such nightmares came true. To make matters worse, the bailouts were not directed towards helping Greece's economy recover, but to satisfy creditors at its expense. Only about 11% of this money went to the Greek government. While the creditors benefited in the short-run, Greece remains in the thick of one of the worst economic situations in Europe.

Despite the Greek government's past mistakes, the steps it is taking now are much more effective at reducing its debt burden than it was a few years ago. They are standing down on anti-austerity measures. They are accepting the programs of the eurozone. Despite its adversarial campaign rhetoric, even Syriza is willing to reach a primary surplus. It has also expressed a willingness to reach primary surplus at the cost of some of its spending pledges. Michael Ball, portfolio manager at the $850-million money manager Weatherstone Capital Management, suggests investors should have more confidence in the Greek government: "I think people look at it and say, 'The worst is behind us.'" Take pity on this greek tragedy, people.—RG

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