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Greece's Pyrrhic Victories Over the Bond Swap and New Bailout

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Nearly two years after becoming the first eurozone member-state to be bailed out by the European Union (EU) and International Monetary Fund (IMF), Greece is officially bankrupt.

True, there was never any doubt about the outcome, but Greece's restructuring of nearly 200 billion euros in private debt and the agreement for a new bailout package signify something much bigger—namely, the formal conversion of a sovereign nation into an EU/IMF zombie debtor, and a doomsday scenario when the moment comes for a forced exit from the eurozone. To his credit, it's probably this potential catastrophe that German Finance Minister Wolfgang Schäuble had in mind when he proposed to his Greek counterpart prior to the new bailout agreement that it might be best for Greece to leave the eurozone. But unlike their ancestors (when ancient Spartans were asked why they wouldn't befriend the Persian king who rewarded his "friends" if they would only submit to him, they replied, "A slave's life is all you understand, you know nothing of freedom"), contemporary Greeks are driven by fear and insecurity, willing to sacrifice a possibly better future for the certain misery of the present.

But let's look rationally at one thing at a time and see why the future looks so grim for Greece.

First, the bond swap is a temporary fix and will not pull Greece out of its debt spiral, let alone end the crisis. The new bailout package actually increases the overall size of the country's debt, which means that another restructuring down the road is simply inevitable. This is the price to be paid for the EU's lack of political imagination in dealing with the Greek crisis.

Second, the bond swap was a deal forced on private investors (aside from triggering credit default swaps, expect the markets to seek revenge in the near future), yet the new bonds have been issued under foreign law. This doesn't mean that the Parthenon is at risk of one day falling into the hands of foreign creditors, but it does mean that the Greek government has lost whatever strategic advantage it may have had in the ruthless game of sovereign debt restructuring. For one, all of Greece's debt is now wholly owned by public institutions (with European taxpayers bearing much of the cost), so the next debt restructuring phase could entail political, not merely economic, consequences. Simply put, it could pave the way for Greece's forced exit from the eurozone. Indeed, given the prevailing sentiments toward Greece across Europe, it is most unlikely that European taxpayers will accept kindly the idea of getting stuck with Greece's bill while allowing a pariah state to remain in the Union. However, in the event of an exit from the eurozone, Greece will no longer be able to pass legislation to convert euro-dominated debt into new drachmas.

Third, the new bailout package, just like the first one in 2010, comes complete with harsh austerity measures that are guaranteed to cause additional economic havoc. Two years ago, the Greek economy was in a recession, with GDP having declined by 7 percent over 2009–10. Today, the Greek economy is in free fall, with GDP declining by 7.5 percent in 2011 and unemployment at nearly 22 percent. The austerity measures constitute a "scorched earth" type of economic policy designed as much to punish a nation as it is to secure funds for paying off the banks. The new round of austerity measures—which include a sharp reduction in the minimum wage, deep cuts in private sector wages and pensions, and even a cruel 20 percent reduction in unemployment benefits—may well trigger the collapse of civil society on the whole. Violent crime is already out of control, and vigilante groups are beginning to organize themselves in various parts of the country.

In this brutal economic and social environment, state revenues will experience abrupt declines. Indeed, indicative of the severe impact that the austerity measures are having on the national economy, Greece has missed its deficit targets for the last two years, and deficit projections for 2012 have already been revised upward. Its revenues for the first month of the year were lower than expected by more than one billion euros.

The most optimistic projections suggest that Greece will return to a budget surplus by 2015. However, even then, the predicted primary surplus of 20 billion euros won't cover more than 30 percent of the cost of carrying its debt.

In sum, Greece is not only bankrupt but also remains trapped in a dark, endless tunnel. No wonder its citizens, unlike its governing officials, are in no mood to celebrate the debt swap and the new "rescue" plan. They know that these are, at best, Pyrrhic victories.

For further discussion of the impact of the austerity measures on Greece's and Europe's economies, see http://www.levyinstitute.org/pubs/pn_12_01.pdf.

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