

A Greek Tragedy: A German Bailout

In a commercial case, faced with an intransigent debtor, (eschewing austerity, rioting in the streets, railing at creditors), the creditors would file an involuntary petition for a plan of reorganization. That they haven't in the case of Greece is interesting. (Practicalities notwithstanding.)

It stems from a number of things, not least the nature of sovereign debt, its unsecured nature, the absence of an accepted protocol such as US chapter 11 for dealing with distress and the difficulty in accurately ascertaining the assets of a country, the priority of claim, to name a few.

The only recourse for the creditor who is worried the ability and willingness of the debtor to repay is to protect their position by declining to roll over maturing debt, or to sell the loans before maturity (at the market price of course.) This type of behaviour tends to create contagion as selling pressure leads to price discovery in the secondary and derivative markets, triggering or encouraging further selling.

In the case of Greece, it is interesting that the creditors, private investors like privately owned banks, have not led negotiations with their delinquent borrower, governments have. And the approach of governments is also interesting. They are throwing good money after bad. The exchange offer they propose, subject to certain conditions such as austerity, are not as strong as a defacto debtor-in-possession financing. It is clearly a bailout. A proper reorganization would require Greece to clean house, to establish better enforcement of tax collection, to probably reduce marginal tax rates, to reform the economy, practice fiscal restraint and discipline, to run the country as a better business. No reorganization can save a fundamentally flawed business. There should be a suspension of interest payments on all debt until

such plan of reorganization is agreed. A restructuring of debt needs to follow. Interest costs need to be managed but these are a function of creditors' expectation to be repaid. Some form of collateralization or attachment of cash flows is probably a good idea.

Absent a credible plan, a bailout is a futile and long term counterproductive exercise.

The German people are furious that they may have to bail out Greece. They are furious at any compromise their government may propose or accede to. The Greeks are furious that they may have austerity forced upon them by creditors abroad, or arrogant regulators in Brussels. These are diversions. The German people are not being asked to bail out Greece, they are being asked to bail out German banks, amongst other creditors. The Greeks are not being exsanguinated by rapacious capitalists abroad but by the ineffectiveness of their own government, their own financial irresponsibility and intransigence in the face of financial reality.

Bailouts will do nothing but harm. They will sow the seeds for the next ill advised loan, investment and venture. Financial discipline needs as much stick as carrot. This generation has lived too long with an indulgent lender of last resort, a coddling and cosseting government, that it can no longer fend for itself.