The History *of* Debt Relief

From de Larosière to Rhodes, Mulford to Ortiz, and Herrhausen to Gurría, the struggle for debt solutions goes on.

By Klaus C. Engelen

In 1986, then-Senator Bill Bradley called for third-world debt relief at a meeting in Zürich. That was highly controversial. But the debt conversion and reduction move led, a few years later, to the success of debt relief in the form of the Brady Plan. Issuing "Brady Bonds" helped former problem debtors in Latin America regain access to capital markets.

Ever since Greece's left-wing Syriza party under its radical leader, Alexis Tsipras, won a big election victory on January 25, 2015, and took extremist right-wing coalition partners, European leaders have been facing the eurozone's first anti-austerity government and its calls for massive external debt relief.

The Greek economy is still in an alarming state. GDP has shrunk by 25 percent since the start of the crisis in the spring of 2010. The unemployment rate is 25 percent, and youth unemployment hovers around 50 percent. External debt at about 175 percent of gross national product is not sustainable. Rescue loans from the European Union, the European Central Bank, and the International Monetary Fund have reached about €240 billion.

When the new Greek government calls for debt relief, the battle lines are drawn. Speaking for the largest creditor country, German Chancellor Angela Merkel takes the position: "I do not envision fresh debt cancellation. There has already been voluntary debt forgiveness by private creditors; banks have already slashed billions from Greece's debt."

It might be useful to look back at how earlier debt crises were tackled so that problem debtors were put in a position to regain market access, and how this compares with the way European leaders in the spring of

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2010 rose to the challenge of countering an insolvency of Greece and contagion threats on international bond markets to other eurozone member states. For the euro area, the question of what to do with the debt overhang of some member countries remains critical.

How politicians, bankers, and international officials have dealt with earlier debt crises and contagion risks through debt restructuring and debt conversions brings flashbacks to some who have been reporting on debt crises around the world for decades. Due to these firsthand and still-vivid experiences, many who went through these turbulent times in financial markets and who observed the financial firefighters at close range will have difficulty in understanding some of the "political lending" decisions of European leaders when hell broke loose. With Greece, European policymakers embarked on a rescue without requiring the financial sector to absorb part of the burden right from the beginning.

German Chancellor Angela Merkel takes the position: "I do not envision fresh debt cancellation. There has already been voluntary debt forgiveness by private creditors."

THE MEXICAN "DEBT BOMB"

Beginning in August 1982, when Mexico's Finance Minister Jesús Silva Herzog Flores declared that Mexico would no longer be able to service its debt, the international financial system was threatened by globally spreading "systemic risks." It was a huge shock for banks exposed to insolvent sovereign debtors such as Mexico, Brazil, and Argentina through syndicated loans on their books. The large U.S. banks in particular had sometimes lent more to Latin American sovereign debtors than their capital buffers could cover. By 1982, the nine largest U.S. money-center banks held Latin American debt amounting to 176 percent of their capital; their total lesser-developed country debt was nearly 290 percent of capital. Looming were the financial, social, economic, and political upheavals in the debtor countries that were cut off from having access to international capital markets.

As the Institute of Latin American Studies calculated in its paper *Debt Crisis in Latin America,* in the wave of recycling petro dollars through ever-larger syndicated bank loans in the years 1975 to 1982, Latin American debt to commercial banks increased at a cumulative annual rate of 20.4 percent. External debt increased from $75 billion in 1975 to more than $315 billion in 1983, or 50 percent of the region's GDP. Debt service (interest payments and repayments of principal) grew even faster, reaching $66 billion in 1982, up from $12 billion in 1975. The debt crisis turned out to be the worst in Latin American history. According to some estimates, real wages in the ten years after 1980 in urban areas dropped between 20 percent and 40 percent.

"In 1982, falling international oil prices, rising world interest rates, and massive capital outflows pushed external creditors to refuse to roll over Mexico's short-term debt, leading to subsequent suspension of Mexico's interest payment," notes Guillermo Ortiz Martínez, former Mexican finance minister and central bank governor.

Latin American economies, like peripheral Europe in the 2000s, let government expenditures run well ahead of revenues. Governments were able to finance large deficits with external debt which reached levels similar those of Greece, Ireland, Spain, and Portugal before the current crisis. While private and public spending was rising, productivity was not. Once excess liquidity dried up and interest rates rose, the unsustainability of Latin America's debt became evident."

In the summer of 1982, the role of crisis manager fell to Jacques de Larosière, then managing director of the International Monetary Fund. Paul Volcker, then-chairman of the Federal Reserve Board, helped to organize a bridge loan for Mexico, part of which was extended by the Bank for International Settlements.

In November 1982, de Larosière summoned the members of the Advisory Committee for Mexico, headed by William R. Rhodes, a top Citicorp banker, to the New York Federal Reserve to give them the shocking IMF numbers on the financing requirements and told them what the banks would have to do.

HOW THE BANKS WERE FORCED INTO THE RESCUE

As Bill Rhodes recounted in his 2011 book, *Banker to the World,* there was no question at the time that the banks had to be part of the rescue from the beginning—and his committee had to organize their rescue dollars.

De Larosière told the bankers that in the coming year, Mexico would need $10 billion to cover interest payments due on public sector debt alone. The IMF could only provide at the maximum $1.3 billion per year. Mexico faced a current account deficit of $4.5 billion, as well as the repayment on short-term loans arranged at the start of the crisis in August from the Bank for International Settlements. In addition, Mexico's official reserves would require $1.5 billion. Other countries providing bilateral aid could be expected to fund $2 billion.

But that left a hole of $5 billion these commercial banks would have to come up with, de Larosière said, providing new loans for Mexico in that amount while also agreeing to restructure the loans that were coming due. They had to do their fair share to help Mexico's recovery.

De Larosière then asked the banks "to commit in writing to $5 billion in 'new money' for 1983, a rollover of short-term loans, and a long-term debt rescheduling." He warned that eventually a similar support arrangement would be needed. De Larosière left the meeting telling the bankers, "I am going to go ahead with the IMF loans. But I have to be able to say that the banks will be able to put in this new money."

In the summer of 1982, the role of crisis manager fell to Jacques de Larosière.

Representing Citibank, the bank with the largest exposure in Latin America, Rhodes was left with the Herculean task of getting banks in all parts of the world committed to increasing their exposure to Mexico by 7 percent. It took until March 15, 1983, when 526 creditor banks had signed on to raise the committed $5 billion as promised to the IMF.

As it turned out, Rhodes, a long-term senior vice chairman of Citi, who started his banking career in 1957, has been in the maelstrom of global financial crisis for the last five decades as the world's top financial firefighter through debt negotiation agreements for Argentina, Brazil, Mexico, Peru, Uruguay, and Jamaica. Later, in the Asian crisis of 1997–1998, when the Republic of South Korea experienced liquidity problems, he chaired the international bank group that negotiated the extension of the short-term debt of South Korea's banking system.

Referring to those turbulent years, former Federal Reserve Chairman Paul Volcker recalled that "as country after country began to melt down during the Latin American debt crisis, Rhodes was the man who regulators and politicians turned to repeatedly to bring the agreements [with debtor countries and banks] home."

On the Latin American debt front, Mexico's Angel Gurría also comes to mind. For decades he was Rhodes' sparring partner on the Mexican side. Gurría also worked with the U.S. Treasury on the first issue of Brady Bonds. As General Secretary of the Organization for Economic Co-operation and Development since June 2006, Gurría is still very present on the international stage.

Then-U.S. Treasury Secretary James Baker used the 1985 IMF-World Bank annual meeting in Seoul to formalize the participation of the private banks in what was called the "Baker Plan" for international lending. Considering the huge exposures especially of the large U.S. banks, formal writedowns of debt would have left some of them insolvent. Gaining more time in which the debtor economies could regain strength was essential. In such a strategy, the big banks had to provide funding together with the IMF and the World Bank to help the countries undertake structural reforms and liberalize their economies.

In a presentation "What Can the Developed World Learn from the Latin American Debt and Mexican Peso Crisis" to the National Association of Bar Executives on September 12, 2011, Guillermo Ortiz, then chairman of Grupo Financiero Banorte, argued: "In light of current European debt problems, it is revealing to analyze how Latin American authorities faced the debt crises of the 1980s. They basically took three steps: First, they engaged in fiscal adjustment through IMF stand-by programs; second, they stimulated growth through structural reforms; and finally, they sought debt relief through the Brady Plan.… In my view, there was a clear understanding between the IMF, the U.S. Treasury, and commercial banks that Latin America had to adjust without new money or debt restructuring. The claim was that banks were in no position to recognize losses on sovereign lending."

DANGEROUS "DEBT RELIEF" TALK

Talking about debt relief brings Deutsche Bank Chairman Alfred Herrhausen to mind. I happened to work with him to publish his cautious, but at the time extremely controversial, proposals to offer Latin American countries debt relief to ease the plight of the people and get their economies running again. For a top banker at the time even to think aloud about "debt restructuring" was considered taboo.

Handelsblatt published Herrhausen's piece just ahead of the IMF-World Bank annual meeting in the fall of 1987. His proposals became the talk of the annual meeting. He was attacked from all sides for thinking of "haircuts" for Latin America. Some of his German competitors, who later ran their banks into the ground, denounced Herrhausen as an "innovative softie." My headline in *Handelsblatt* ran: "If bankers talk about debt relief, those thinking ahead live dangerously."

Herrhausen (who was murdered in November 1989) was very much upset by "so much hypocrisy among his banker colleagues." He said it's time "to stop this tragedy in Latin America." And he took a swipe at his competitors, "who could only see his move as a ploy because Deutsche Bank had already written off 70 percent of Latin American debt."

Rhodes was left with the Herculean task of getting banks in all parts of the world committed to increasing their exposure to Mexico.

BRADY BONDS LED TO REGAINING MARKET ACCESS

In the move to eventually organize market access for Mexico and other major problem debtors, David Mulford, then Undersecretary of the U.S. Treasury, played a key role. In 1988, he was able to persuade Nicholas Brady, the new U.S. Treasury Secretary, to use Treasury thirty-year zero-coupon bonds as collateral for a new instrument to be offered by the countries to the banks at a substantial discount for the exchange of debt presently held by the banks.

In his autobiography, *Packing for India: A Life of Action in Global Finance and Diplomacy,* Mulford recalled his fight for what later were called "Brady Bonds":

> *To break this relentless trend and to provide some measure of debt relief to the indebted countries, now struggling to implement more pro-growth policies, we would need to induce the banks to accept a write-down of the debt in a form that gave them the benefit of better security, greater certainty of fundamental value in the future, and a realistic prospect of escape from their still-excessive exposure to the troubled debtors. In addition, the relief provided to the debtor countries would have to be sufficient to change the expectations of markets and investors as to the outlook for the apparently ever-increasing prospect of a rising corpus of debt. Unless we could show some positive change whereby debt levels would level off or decline modestly, there would not be a sufficient prospect for re-creating growth that would attract new capital from other non-governmental sources.*

Asked about the Greek debt crisis in the Latin American mirror, Eduardo Levy-Yeyati, a Brookings Institution fellow, pointed out at the Luxembourg Financial Forum in June 2011:

> *The first approach to the Latin American debt problem was denial. Supposedly, all that was needed was time to implement drastic fiscal adjustment, for which the International Monetary Fund, sponsored by the United States, would provide the needed refinancing. In 1985, the Baker Plan elaborated on this approach by introducing private sector involvement through the voluntary rescheduling of bank loans, so as to lengthen the fiscal adjustment period. The result was a massive debt overhang that discouraged investment and triggered frequent spells of capital flight and disappointing growth that was reflected in growing debt ratios. This became known as the lost decade for Latin America.*
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> *Only in the 1990s did the players involved in the debt rescheduling recognize that an insolvent country requires some genuine debt relief, in the form of a reduction in the nominal value of its debt, or a "haircut." This new understanding took the form of the Brady Plan, which exchanged unrecoverable, unmarketable bank loans for discount marketable Brady bonds—bonds that would be the seed of the emerging markets asset class.*

In Europe, argues Levy-Yeyati, "the consensus is halfway between denial (restructuring of any kind 'is not on the cards,' as stated by ECB President Jean-Claude Trichet), and a Baker-style solution." A Brady-style solution "would not solve Greece's lack of competitiveness or unbalanced fiscal accounts, but it would offer a clean and a strong incentive for Greece to adjust."

This however leaves the question: Although European policymakers pushed through—as part of the second Greek rescue bailout—"the world's biggest PSI debt restructuring in peacetime," a mountain of external debt, some of which is very long-term at very low interest rates, is now owed to public and supranational creditors. But neither creditor governments nor the supras such as the ECB or the IMF are ready for debt relief and haircuts.

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The debate about Greece, noted *The Economist* in its April 20, 2011, issue under the heading "Follow Brady, not Baker," now has a Latin American dimension.

IS THE EURO CRISIS SO MUCH DIFFERENT?

Most of those who lived through earlier financial meltdowns like the Latin American debt crisis would acknowledge that in many respects the euro crisis is different. For some, the Latin American sovereign debt crisis was maybe easier to tackle since the banks were not exposed by holding government bonds but had been participating in loan syndications.

As we saw in Mexico, the banks were forced right from the beginning to come up with "fresh money" to keep the debtor country afloat for some time. On the other side, Greece and other problem euro member states had issued euro bonds and other debt instruments that were bought not only by banks but a wide range of investors.

Periphery Scorecard

	Greece I & II	Ireland	Portugal	Cyprus	Spain
Period covered by EU assistance	May 2010–June 2015	December 2010–December 2013	May 2011–May 2014	May 2013–March 2016	December 2012–December 2013
Financial instruments	I: Bilateral loans from euro area member states (Greek Loan Facility); IMF II: EFSF; IMF	EFSF; EFSM, IMF, bilateral loans from the UK, SE and DK; Irish reserves	EFSF, EFSM, IMF	ESM, IMF	initially EFSF, transferred to ESM
Amount granted by EU instrument	I: up to €77 billion II: up to €120 billion	up to €40 billion	up to €52 billion	up to €9 billion	up to €100 billion
Total size of assistance including other lenders	I: €107 billion (IMF: €30 billion) II: €130 billion (IMF: €9.7 billion)	€85 billion (including IMF: €22.5 billion; National Pension Fund: €17.5 billion)	€79 billion (IMF: €27 billion)	€10 billion (IMF: €1 billion)	€100 billion
Amounts paid out by EU instruments at present	I: €53 billion II: €142 billion (€24 billion transferred from I to II)	€40 billion	€50 billion	€5.7 billion	€41 billion
Amounts paid out by other instruments at present (including IMF)	I: €20 billion II: €12 billion	€45 billion	€27 billion	€0.4 billion	
Main areas of policy conditionality	•Fiscal consolidation •Fiscal governance •Competitiveness •Financial stability	•Financial stability •Fiscal consolidation •Competitiveness	•Fiscal consolidation •Competitiveness •Financial stability	•Financial stability •Fiscal consolidation •Fiscal governance •Competitiveness	•Financial stability •Banking sector recapitalization

Source: Eurogroup

Slow-Walking Debt Solutions

Looking back at the history of financial crises, the current situation has much in common with the crises of the past. The situation in Latin America at the end of the 1980s in particular appears to provide some valuable experience in the need for a solution to structural over-indebtedness.

There are also differences, however, to consider. On the one hand, Greece is a member of a currency union, which suggests a unique set of challenges that must be faced in a highly integrated monetary and financial system. On the other hand, the creditor profile has changed, which could be accompanied by a change in the incentives for tolerating a non-sustainable situation. In Greece, we have seen an unprecedented substitution of public sector creditors for private creditors. This has created a situation in which nearly all of the country's exposure is to other governments and/or public institutions, while the share of private sector claims has been reduced to nearly negligible amounts (also as a result of a voluntary debt relief granted by private bondholders in 2012). The current situation is thus to a certain degree similar to the situations usually dealt with in the Paris Club: Tackling unsustainable bilateral public sector exposures.

The creditors do not have a strong incentive to find a quick solution.

Compared to the situation in the late 1980s, this might have an effect on the creditors' incentives to pursue a quick return for the debtor country to a sustainable debt trajectory. The way (bilateral) public sector claims against sovereigns are accounted for in public accounts allows the creditors to maintain even a high-risk exposure at considerably lower costs than private creditors (due to the lack of capital requirements and/or provisioning requirements). Governments do not compile balance sheets and therefore they are not required to disclose the current value of the claim. Apart from refinancing costs (that is, the difference between borrowing and lending rates), public sector exposure does not lead to costs in national budgets as long as there is the prospect that the debt could be repaid at some (undefined) point in the future. This is the main reason why the Paris Club has for decades refused to grant stock treatments (a lowering in the nominal value of debt) for highly indebted countries, and rather embarked on flow treatments—lowering of interest rates and lengthening of maturities.

Translated to the situation in Greece, we are in a situation in which the creditors do not have a strong (economic) incentive to find a quick solution to the debt overhang problem. For them, finding a sustainable solution would clearly imply realizing hidden losses which they can for the moment cheaply cover in their accounts. Furthermore, creditors facing the threat of sovereign insolvency in a monetary union can count on central bank support. As was done in the run-up to the Cyprus rescue, creditors again are (mis)using Emergency Liquidity Assistance loans from the national central bank with the backing of the ECB. Greek commercial banks, declared to be solvent, get ELA funds from the Eurosystem and help putting off the sovereign's default.

Greece as the debtor, however, has a strong incentive to find a solution, as it knows that it will not be able to regain access to capital markets unless it can provide a sustainable public debt situation.

—K. Engelen

Although the threatening insolvency of Mexico in the summer of 1982 had major systemic risks for the global financial system, especially for the major U.S. banks, there was a big difference. Mexico's debt crisis didn't happen to a member country of a monetary union with the euro as its currency, acting within a European treaty framework and operating on the foundations of the "European solidarity" mantra, supported by the eurozone's political and business elites.

The threat of insolvency of a member country in the spring of 2010 pushed European leaders and those responsible at the helm of the European institutions—the ECB, the European Commission, and the Eurogroup of finance ministers—into uncharted waters. Allowing Greece to become insolvent could have contagion effects, putting other highly indebted member states such as Ireland, Portugal, and Spain, along with core countries such as Italy, in danger of ever-higher risk premiums for government bonds.

What complicated the situation was that since the euro was launched in 1999, the monetary union had been perceived as a currency bloc where country-specific differences—in political, economic, and cultural terms—were supposed to be ignored for the purpose of European unity and European solidarity.

This explains why, for instance, the ECB over the years conducted central bank policy and economic analysis without taking into account market-relevant "country

Dwarfing Lehman?

In the view of Guillermo Ortiz Martínez, who during his days at the IMF and as sparring partner of Angel Gurría experienced Latin American financial turbulences and who also chaired the board of the Bank for International Settlements in 2009, the euro crisis is self-made by Europe's leaders.

The funding concerns of the eurozone have broadened to more basic questions "regarding the effectiveness of euro area policymaking and sustainability." The European fiscal crisis has turned to a political crisis, "and it is the linkage between the two is where the problem lies." Ortiz sees "an eroding confidence in the political process, as European leaders have consistently fallen short by giving mixed signals to both debtors and creditors."

Guillermo Ortiz Martínez

One of the main problems for Europe is "that institutions, with the exception of the ECB, are not designed to make decisions, but to deal with processes. Thus, they are ill-equipped to deal with a financial crisis. Only the ECB has the power and ability to make decisions, but the mandate and scope of the bank is in the sphere of monetary policy and financial stability. … [T]he escalating crisis and the problems described regarding the institutional framework have forced a reluctant ECB to go well beyond its traditional responsibilities. … Furthermore, as the fiscal crisis remains unresolved, the concern that policymaking is ineffective has morphed into the question of the very existence of the euro."

The former Mexican central bank governor and finance minister sees two ways out of the euro debt crisis—a fiscal union or a monetary union breakdown. Establishing an effective political mechanism of coordination and decision-making on the fiscal front should be accompanied by debt relief and a credible structural reform. Policymakers should keep in mind that currently there is no exit strategy and that the costs such disintegration would entail are enormous, both for the eurozone and the entire global economy.

There is no way that a monetary union rupture could occur in a simple and orderly manner. Says Ortiz: "The consequences are unknown, but in my view the costs of the Lehman Brothers collapse would be dwarfed by comparison."

—K. Engelen

risks." This led to major distortions in economic analysis and may have misled market actors, including the rating agencies. In a cloud of country-by-country opacity—look at the ECB reports, papers, and speeches—the risks of the unsustainable external debt buildup in Greece and other euro area economies could easily escalate to a crisis point. There was no early warning system in the eurosystem to speak of.

For 2010, Greece had taken on sovereign debt in the staggering amount of $341.6 billion, or 127 percent of GDP. This happened under the eyes of the ECB and despite the regular official economic monitoring by the huge bureaucracy of the European Commission in Brussels.

The global contagion risk was apparent not only to France, the country whose banks had the highest Greek exposure, but also to the United States right from the beginning.

Banks and other financial institutions in the United States had an exposure to European banks of about $3.6 trillion at the beginning of the euro crisis in 2009–2010, according to the Bank for International Settlements. It isn't surprising, therefore, that the United States from the beginning was and is part of the euro rescue.

WHY THE PRIVATE SECTOR WAS LEFT OUT IN THE BEGINNING

Alarmed by ominous early warning signals for Greece, former Deutsche Bank CEO Josef Ackermann started to prepare for an expected Greek meltdown in late 2009. At the time, Ackermann was also chairman of the major global bank association, the Institute of International Finance, that was later used by the Eurogroup in the PSI debt restructuring.

Addressing the Greece problem initially as one of liquidity rather than of solvency made sense in order to buy time, ring-fence other countries (especially Spain), and avoid widespread contagion. Ackermann saw to it that Deutsche Bank's chief economist Thomas Mayer (together with Daniel Gros of the Center for European Policy Studies in Brussels) started working on proposals to close the institutional gap for the euro area to deal with sovereign defaults by designing proposals for a "Euro(pean) Monetary Fund."

Eurozone countries were supposed to be shielded from a financial meltdown. Such an EMF should be capable of organizing an orderly default as a measure of last resort. Through the new institution, the funding could be structured in such a way as to minimize moral hazard.

In early 2010, Ackermann and other bank CEOs offered to put together a $30 billion "bridge loan" on a public-private partnership basis. This way, the bankers could help to secure Greece's external liquidity needs for a year. Ackermann's motive behind this proposal and his well-reported trip to Athens was to give eurozone governments enough breathing room to establish something like a European Monetary Fund to cope with Greece and other highly indebted euro members in the periphery. Ackermann and the other CEOs would commit half of the bridge loan, with the other half coming from governments. The bridge loan would be processed through Germany's state-owned KfW Group.

Behind Ackermann's IIF-backed bridge loan initiative was the experience with earlier debt crises, where getting the private sector involved right from the beginning was considered essential.

In its April 28, 2010, issue, *Handelsblatt* reported that on February 26, Ackermann had flown to Athens to negotiate such a two-year jumbo loan with Greek Prime Minister George Papandreou. On that day, the interest rate was 6.1 percent.

"In hindsight, this Ackermann deal could have avoided the eurozone collision with the markets," confessed a high-ranking central banker. "Unfortunately, Merkel's chief economic advisor, Jens Weidmann, rejected this timely private-public rollover loan, one that in retrospect looks like peanuts compared to the $1 trillion emergency financing that the public sector now needs to keep the eurozone from unraveling."

TWO BAILOUT PACKAGES AND A NEW FIREWALL INFRASTRUCTURE

In early May 2010, the Greek government, the EU Commission on behalf of the Eurogroup, the ECB, and the IMF came to the rescue with a three-year adjustment program. The first bailout package totaled €110 billion, of which €80 billion was raised through bilateral loans from member states plus a €30 billion IMF loan. The assistance was conditioned on implementation of austerity measures, structural reform, and privatization of government assets.

A month later, on a temporary basis, the European Financial Stability Facility, a special purpose vehicle headquartered in Luxembourg, was established as a rescue fund for eurozone members in distress. On a permanent basis, the European Stability Mechanism, also located in Luxembourg, followed as a permanent firewall for the eurozone with a maximum lending capacity of €500 billion.

Gurría is still very present on the international stage.

In October 2011, eurozone leaders had to come up with a second €130 billion bailout loan for Greece, conditional on an unprecedented "private sector involvement" government bond restructure deal.

How much the four eurozone program countries—Greece, Ireland, Portugal, and Cyprus—have received in financial assistance as of April 21, 2015, is shown in a survey provided by the Eurogroup Secretariat (see table).

THE WORLD'S BIGGEST DEBT RESTRUCTURING

It took until February 2012 before the Eurogroup finalized the world's biggest debt-restructuring deal, affecting the "private sector involvement" of some €206 billion of Greek bonds. Under the agreement, private investors were asked to accept a writeoff of 53.5 percent of the face value of Greek governmental bonds they held. According to the study that Jeromin Zettelmeyer, Christoph Trebesch, and Mitu Gulati did as fellows at the Peterson Institute for International Economics, the Greek debt restructuring of 2012 stands out in the history of sovereign defaults.

As the authors note, "It achieved very large debt relief of over 50 percent GDP with minimal financial disruption, using a combination of new legal techniques, exceptionally large cash incentives, and official sector pressure on key creditors. But it did so at a cost. The timing and design of the restructuring left money on the table from the perspective of Greece, created large risks for European taxpayers, and set precedents—particularly in its very generous treatment of holdout creditors—that are likely to make future debt restructurings in Europe more difficult."

As the authors continue, "the exchange resulted in a vast transfer from private creditors to Greece, on the order of €100 billion in present value terms, corresponding to 50 percent of 2012 GDP. … But we also show that the 'haircuts' suffered by creditors on average were considerably lower than the 75 percent widely reported in the financial press at the time of the debt exchange, namely, on the order of 59–65 percent." According to the study, large banks and regulated institutions accounted for more than 60 percent of outstanding principal, while the final participation rate was 97 percent.

The study makes other important points. "The Greek debt exchange can claim historic significance in more than one respect. It set a new world record in terms of restructured debt volume and aggregate creditor losses, easily surpassing previous high water marks such as the default and restructuring of Argentina 2001–2005. It was the first major debt restructuring in Europe since the defaults preceding World War II—defying statements by European policymakers, issued only month earlier, who had claimed that sovereign defaults were unthinkable for EU countries. … Finally, it occupies a special place in the history of sovereign debt crises—along with the Brady deals, for example, and with the 2000 Ecuador restructuring—by introducing a set of legal innovations which helped to engineer an orderly debt exchange, overcoming the collective action problem facing Greek and EU policymakers as they sought to restructure a large amount debt dispersed among many private creditors."

EURO LEADERS MADE THE GREEK RESCUE MUCH MORE COSTLY

On May 29, 2013, the IMF came out with its highly critical evaluation. The staff severely criticized European leaders for the length of time that Greece remained laden with excessive debt, asserting, "An upfront debt restructuring would have been better for Greece although this was not acceptable to the euro partners." In his study on the controversy within the IMF regarding its huge involvement in the euro crisis, Paul Blustein points out, "That contention drew outraged rebuttals from Brussels and Frankfurt, with a number of officials accusing the Fund of historical revisionism." Blustein quoted Olli Rehn, the EC commissioner for economic and monetary affairs, saying, "I do not recall the IMF's managing director Dominique Strauss-Kahn proposing early debt restructuring, but I do recall that Christine Lagarde [French finance minister at the time of the first Greek rescue] was opposed to it."

With €30 billion, the IMF funded 27 percent of the Troika rescue lending on a three-year arrangement with Greece. At 3,200 percent of the Greek quota with the Fund, this surpassed by far the normal access (200 percent quota), cumulative access limit (600 percent of quota), and the previous historic record breaker, South Korea with 1,900 percent of quota in 1997. This happened with considerable opposition from within the IMF staff.

Herrhausen said it's time "to stop this tragedy in Latin America."

By taking over euro area crisis management alone, leaving financial sector expertise at a distance in the beginning of the crisis, and only engaging the major banks and other financial institutions to help organize the Greek government bond restructuring through the Institute of International Finance, European policymakers certainly made the Greek bailout much costlier for generations of taxpayers in their countries. Susan Schadler, a former deputy director of the IMF's European Department, supports that argument in a recent paper. Says Schadler, "The byproduct of the 2010 bailout was a sharp increase in the share of Greek government debt held by the official sector—the IMF, the ECB, and countries and institutions of the European Union. By end-2012, over 60 percent of total debt was in official hands. To the extent that debt (even after the restructuring) indeed proves to be unsustainable, the official sector will take the bulk of the losses. These losses were anticipated. … [T]he Europeans, by confirming the IMF's senior creditor status and accepting ultimate financial responsibility, implicitly took on the cost of the strategy chosen." Meaning: taxpayers in the eurozone creditor countries also will be on the hook for the huge IMF loans to Greece.

The question of what to do with the debt overhang remains critical.

ARE THE GREEK RADICALS "PLAYING ARGENTINA"?

One veteran of debt crisis management around the world—who encountered the provocative new Greek Finance Minister Yanis Varoufakis as an economics teacher—has advice for the Eurogroup (on the basis of anonymity): "They should look at the rogue debtor strategy of Argentina. That country has for decades been putting the blame for its economic ills on the IMF, then on the United States, and now on the vulture funds and U.S. judges. The radicals in Athens now are putting all the blame for the misery in Greece on former governments and rich tax fugitives, on the Troika austerity and the Germans, knowing that most euro leaders are horrified by the idea of a Grexident or Grexit. That gives the Greeks a lot of room for blackmail." He even pointed to some literature on the issue: an instructive piece in the *Chicago Journal of International Law* by Arturo C. Porzecanski, "From Rogue Creditors to Rogue Debtors: Implications of Argentine Default."

No agreement could be reached on Syriza reform pledges at either the recent IMF-World Bank spring meetings in Washington or at the informal ECOFIN finance ministers meeting in Riga on April 24 so that the institutions (formerly called the Troika, consisting of the European Union, the ECB and the IMF) could release some of the remaining €7.2 billion from the second Greek bailout program.

Since taking over the government, Prime Minister Alexis Tsipras and Finance Minister Varoufakis have played cat and mouse with the Eurogroup finance ministers. Tsipras and Varoufakis have challenged the Brussels austerity doctrine, arguing that 80 percent of the rescue billions was used to bail out international banks and investors. The world's largest "voluntary" debt restructuring in peace time for Greek government bonds held by private banks and investors is ignored.

The Eurogroup wants Greece to accept core parts of the second rescue program's reform commitments—pension reduction, labor market liberalization, reform of tax collection, and privatization—as preconditions for any fresh money from Brussels. Instead, laments German Finance Minister Wolfgang Schäuble, the new Athens government "has destroyed all the numbers."

David Mulford played a key role.

The European Central Bank is being misused to provide billions of euros through the Bank of Greece providing Emergency Liquidity Assistance loans to the country's banks to close the deposit outflow leakages. What made a bad situation much worse was that Athens' new rulers launched a vicious attack on Germany, demanding war reparations matching all outstanding Greece external debts and even threatening to seize German assets on Greece's soil.

Looking ahead—with all the provocations and insults emanating from Athens' new rulers—there are geopolitical concerns. But recent trends, however, toward looser austerity policies in the European Union along with somewhat stronger economic growth may turn out to be a safety net for Greece.

In the end, the major eurozone powers—with the United States as NATO partner working in the background—have to figure Russia and its President Vladimir Putin into their geopolitical equation. Since Putin invaded the Crimea and started an undercover war in the Donbass region of Ukraine, the Greek rescue also has acquired a geopolitical aspect. This became apparent when Greek Prime Minister Tsipras visited Moscow with a broadside against prolonging Western sanctions against Russia, and returned with new contracts for building a Greek hub for Russian gas exports into Europe.

The IMF criticized the European leaders for the length of time that Greece remained laden with excessive debt.

But some Eurogroup finance ministers are no longer putting up with Athens' backtracking and adding insult to injury. "EU frustration at Greece boils over" read the *Financial Times'* front page headline when the paper reported on the Riga meeting. There, Dušan Mramor, the finance minister of Slovenia, formally suggested that if bailout talks did not progress more quickly, the eurozone should prepare a "Plan B."

In the turbulent negotiations with the Syriza government, the finance ministers, especially those from smaller, vulnerable countries, have expressed their utter frustration and anger. They are under a lot of pressure at home from the voters because their taxpayers are charged with the bailout costs despite much lower per capita income, lower wages, and lower pensions than the Greeks.

Over the weekend after the stormy Ecofin meeting in Riga, Alexis Tsipas was on the phone with German Chancellor Angela Merkel and Eurogroup chairman Jeroen Dijsselbloem. And on the following Monday, the headline from *Eurointelligence* in Brussels was "It's Chefsache now," suggesting that finance ministers start to think about "Plan B" if a deal is not reached by June. ◆