Published in Kathimerini 2/9/14 (in Greek)

Greece should issue new bonds before the European elections

By Prof. Nicholas Economides, Stern School of Business, NYU & UC Berkeley

In 2009, Greece had three big problems. First, the huge public debt. Second, the very large budget deficit. Third, the lack of competitiveness. In soccer terminology, the performance of Greece regarding the first problem is a draw. Greece was able during the Papademos administration to reduce very significantly the public debt and move the maturity of a large part of it to the far future. However, the size of public debt is large and hard to bear, almost €320 billion, while the Greek GDP is €185 billion. The big success of Greece has been in addressing the second problem, the balancing of the budget and the creation of a primary surplus, that is, of surplus disregarding interest on debt. Returning to soccer terminology, regarding the third problem, Greece has a draw on regular time and loses in the penalty kicks. Greece succeeded in making many changes in the labor market, but failed with regard to many structural reforms that were either never tried or came very late in the game. The economic and social cost of Greece's success in public finance is the present high unemployment and recession. The cost of the failure regarding structural reforms and the lack of improvement of competitiveness will be paid by Greece for decades.

However, Greece has new possibilities in 2014 that have not been available since the beginning of the crisis. Wise choices are now indispensable, and choices made now will define the level of prosperity in Greece for the next ten years. There are now three main questions. First, is there a need for a haircut of Greek debt to European Countries and Institutions? Second, and most important, when and how should Greece re-enter the world financial markets? And third, how will Greece start its recovery?

How big is the Greek debt, and how much does it cost

During the last four years the public debt hovered as a spectre over Greece. But, as we will see below, it can be tackled effectively. Greek public debt (together with the moneys that support the Greek banks) is €320 billion, that is, €70 billion obligations to the private sector and €250 to the "official" sector. It has a very low interest rate, 1.8% on average. Due to restructuring that occurred at the time of the private sector haircut, the bulk of the obligations (70%) mature after 13 years. Excluding the IMF obligations (whose maturity can be moved to the future) and the T-bills that are systematically bought by Greek banks, the short term debt (that matures in 3 years or less) is only €8 billion, and therefore can be easily handled by Greece. Interest on all the debt is about €6 billion per year, which is large for the Greek economy.

Haircut on official sector debt

Greece should ask Eurozone countries (1) to move forward maturities of EU countries' and European Stability Mechanism' debt to 50 years, and (2) to reduce interest rates to 1% or less. In this way, Greece will be able to save €1-2 billion a year.

Greece should re-enter the world financial markets now by issuing a five-year "growth bond"

Greece can and should enter the financial markets before the May 2014 European elections. I propose that this be done by issuing "growth" bonds of value €8-10 billion, with maturity of 5-6 years, and interest rate of 5.5-6%. This issue will be very successful in the market given the interest rates of similar bonds of other countries (e.g. Portugal), the interest rate of the Greek 10-year bond (currently 8% interest rate), and the lack of Greek bonds of such maturities. In addition, instead of wasting the money it will collect from these growth bonds by spending them in general public expenditures, I propose that the government guarantee that these moneys will be invested and thereby create new employment. Even if Greece pays some of the maturing bonds with the money it will collect from the new 5-year bond, Greece will then be able to invest €5 billion of the remaining money from the growth bonds, and these investments can be as much as 3% of GDP. Greece has not seen such level of investment since 2008, and such investment will change radically the climate in the Greek market. And naturally foreign and domestic investors will follow, given the confidence shown by the international financial markets.

What will Greece achieve by issuing the growth bonds

First, it will solve the short term Greek liquidity problems, and will not need to wait for "solutions" from the bureaucrats in Brussels. Second, Greece will have money to invest in growth and the creation of new positions of employment. Third, it will show to all that Greece has got out of the crisis, and will bring in at last foreign investors. Fourth, the memos with the creditors will finally finish. Under those circumstances, it will be up to the Greece alone to determine structural reforms. Stand or fall, it will be up to Greece to clean its house.

What are the risks

The probability that the full amount of the growth bonds will not be covered, or that a higher interest rate will be needed, is negligible. The big risk is that the money of the growth bonds will be wasted in salaries and pensions of the "aggrieved" and will not be spent on investment and growth. And of course the other big risk is that, without the outside supervision keeping Greece from falling off the cliff, Greece will deteriorate to its old corrupt habits, and will go bankrupt again. To address these risks there is a need for temperance and a firm hand. The final risk is that Greece will surprise its European partners. But that will be a happy surprise. And people will start talking about the Greek rebound after bankruptcy just like some decades back they talked about the Greek growth after the destruction of the German Occupation and the Civil War.