Which Second Haircut for Greece?

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"Europe Pushed by IMF's Lagarde to Consider Greek Debt Write-Off" Bloomberg reported recently. More cautious, the Wall Street Journal remarked that Lagarde had not expressly said so, although "some" saw a "public, albeit oblique, acknowledgment" of this necessity, and "some economists say" her request "would necessarily require restructuring Greek debt held by euro governments and the ECB." Rumours exist that the IMF has discreetly leaned on the EU to implement a second haircut of official debts. Kathimerini reported that the government thought the IMF would obstruct the programme's success to highlight the need for a new debt restructuring. Quite different from 2010: when Greece got her first IMF loan, First Deputy Managing Director Lipsky explicitly excluded debt restructuring and default. Both would make things much worse.

Meanwhile the necessity of another reduction is clear. In September 2010 the IMF reported "total Maastricht debts" of 307.5 billion euros for 2010. Two "rescue" packages so far totalled 240 billion euros, the haircut of private creditors was some 100 billion euros. Greece has more debts now and is in worse shape. Insolvency is a fact, though delayed in violation of the Lisbon Treaty. Eventually one will have to stop playing the emperor's new clothes, recognising the naked truth. The only question is how much more damage politicians and EU-apparatchiki will inflict before. Once the ESM cleared the hurdle of the German constitutional court, "leveraging" it to 2 trillion euros is planned, apparently by making it hold the equity tranche of EU-type-subprime lending (which compares unfavourably with US-subprime lending). More taxpayers' money would go down the drain.

Greece's first "voluntary" haircut is definitely no guideline: private creditors lost about 100 billion euros, new public sector credits were 130 billion euros. Debt reduction indeed! The haircut suffered from further, grave shortcomings. It was dictated to Greece and her people, depriving the debtor of the rights of a party. Strong-armed into "voluntary" relief, private creditors did not enjoy all their legitimate rights either. Neither the Rule of Law nor the protection of human rights, debtor rights, or economic reason were respected. As in the South before, the standard of living of many Greek has been depressed below what would be acceptable in any of the creditor countries.

Fortunately, the IMF's SDRM is hardly applicable presently. Discriminating exclusively private creditors, it is designed for countries with larger private debts than Greece now. Even wiping private debts off totally is unlikely to suffice because of official "rescue" efforts. Furthermore, another haircut after over 50 percent already cut seems politically problematic. The undue and economically inappropriate preference of public money has come under heavy criticism already. The most likely "solution" is another reduction dictated by some public creditors, making things worse again. This must be opposed.

Only proper, sovereign insolvency proceedings complying with minimal economic, legal and humane requirements, and fair to all involved, giving both the debtor and creditors the same

status of parties can solve the problem. An independent actor without any self-interest must play the role of courts in domestic cases. The best solution is internationalising the basic principles of US municipal insolvency (Chapter 9, Title 11 USC), a special procedure for debtors with governmental powers. It is easily adaptable to sovereigns. I have advocated it since 1987. It has been propagated under the acronym FTAP (Fair Transparent Arbitration Process) by many NGOs, in particular the Jubilee movement.

The main principles of the Raffer Proposal* are: protecting debtors' governmental powers, best interest of creditors, debtor protection, the right of the affected population to be heard (an appropriately democratic feature), and a public interest in the further functioning of the debtor. Arbitration respects the fundamental pillar of the Rule of Law that one must not be judge in one's own cause. The sorry record of official creditors as judges in their own cause illustrates this necessity clearly. Ad hoc arbitration, a time-tested mechanism, plain vanilla in international law, is the answer. Creditors and debtors nominate one or two arbitrators, who in turn elect one further member to reach an uneven number. The panel is given the mandate to work on the basis of the main principles of US Chapter 9 insolvency.

Naturally, the population's right to be heard has to be exercised by representation, as also possible in domestic Chapter 9 cases. Trade unions, entrepreneurial associations, religious or non-religious NGOs could exercise it internationally, presenting arguments and data before the panel. Sustainability would emerge from the facts presented and discussed. As anyone concerned can present their arguments in a transparent procedure, one can expect either agreement on one specific solution or quite small differences of opinion. Ideally arbitrators would just have to rubberstamp the plan agreed on by the parties, creditors and the debtor. Domestic US Chapter 9 exempts resources necessary to finance minimum standards of basic health services, primary education, and an economic "fresh start". Public interest in the functioning of the debtor safeguards a minimum of municipal activities.

Voice for the affected population within a legal procedure, as in US municipalities, is certainly preferable to "participation" by strikes and street fights expressing public opinion in a less wholesome way, impairing debtor economies further. This is neither in the best interest of the population that will have to live with the damages done for years to come, nor of creditors, who could get more repayment even though the populations would be better off too with a peaceful and fair settlement. Unfortunately the EU tries to abuse the crisis to demolish democracy and to reduce the rights of elected parliaments in favour of unelected bureaucrats.

In my model all creditors are to be treated equally. Private and public creditors must get the same haircut to avoid unfair burden sharing. Demanding that those creditors that have aggravated the situation by illegal lending must not enjoy preference is extremely justified. Especially in the Greek case official creditors worsening the situation must not be rewarded financially. Subordinating them is mandatory.

* For details please click http://homepage.univie.ac.at/kunibert.raffer/Athens2011.pdf or literature at http://homepage.univie.ac.at/kunibert.raffer/