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Statement by Mr. Pereira on Greece
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Introduction. Our experience. Main Views.

In our Chair, Argentina has been through a very long and sad history of Stand-By Agreements which were aimed at bailing out a debtor country but ended up rescuing private sector creditors, leaving behind massive capital flight and untenable social and economic consequences.

In Argentina, we know too well what the real consequences are of making believe that solvency crises are liquidity crises. Our own experience proves that bail-out packages or debt restructurings that disregard "debt sustainability" and economic growth as a main feature of its design, leaving it to "future market access", are destined to be short lived.

We are also too familiar with the consequences of "structural reforms" or policy adjustments that end up thoroughly curtailing aggregate demand and, thus, prospects of economic recovery. The so-called "structural reforms" promoted by the Fund hurt deeply countries' institutional quality and capacity. We have reviewed the projections of the staff, the recommendations and policy conditionalities. We do not share the views, for instance, that the widespred cuts in public expenditures, that a sharp decline in GDP, or that a major reduction in replacement rates of the pension system (from average 75 to 60%) will solve the Greek solvency problem. If anything, such measures risk to compound the problem.

An in-depth analysis of real repayment capacity should be the starting point of any Program of this kind. This is, indeed, one of the key lessons from Argentina's crisis: debt restructurings or bail-out packages should be crafted only after a country's repayment capacity has been adequately assessed.

In fact, repayment capacity scenarios or exercises could be complemented with correcting

mechanisms. Such is the case, for instance, of the issuance of warrants, or “GDP coupons”. A “base case” is defined, and then these type of instruments make up for eventual deviations. The issuer pays for these instruments if economic growth is better than expected in the baseline scenario. Even the United Nations created a study group to analyze and promote the issuance by Sovereigns of these types of instruments. Above all, they are countercyclical in nature, a paradigm of good faith, and maybe more importantly, they emphasize the obvious: repayment capacity should be the main driver in debt tolerance and debt profile analysis. At the end of the day, “market access” is the consequence of repayment capacity, not the other way around. The risk here is that one of postponing, and maybe, worsening the inevitable.

We do, however, would like to stress that we do not oppose, rather we agree to, an assistance package to the Greek Republic. That said, we think that the Program should not contain procyclical policy conditionalities that would undermine aggregate demand or growth prospects. In addition, while we believe that the assistance package would be more effective if supplemented by a voluntary debt restructuring that would focus on repayment capacity as its starting point; we do believe that “ownership” is a major feature of any Arrangement. Thus we concur with the granting of the request for a Stand-By Arrangement as requested by the Greek authorities.

Let us point out in greater detail our main observations.

A comprehensive strategy is needed

Any tenable strategy for rescuing Greece must be comprehensive and rooted in three key inter-related pillars: 1) ample and frontloaded financing assistance; 2) minimizing output impact across a reasonable time period; and 3) a pre-emptive voluntary debt restructuring. Greece is facing a deep medium-term solvency crisis.

Pro-cyclical adjustment could exacerbate the downward spiral

Past experience from different countries proves that the biggest driver of debt explosion is the inevitable collapse in tax revenues that governments face in the wake of a deep and protracted economic recession. Greece will not be an exception. The staff openly recognizes that the “closed Greek economy” will face a prolonged output contraction prompted by the extraordinary pro-cyclical fiscal adjustment agreed. If the recession turns out to be deeper than expected, more resources will be needed for a longer period of time. It is now palpable that tapping international financial markets will be unworkable in the oncoming years (triggering insolvency concerns), implementation of austerity measures will be socially unfeasible (as proven by the painful recent events of general strikes and popular unrest), and may compound the problem, and then the financing gap would most likely be widened despite the collapse in imports. The bottom line is that the virus of recession will always spread faster than any advocated fiscal remedy. The only way to sustain Greece’s ability to

repay is by increasing its GDP, not the other way around.

Amplifying the future financing gap and prompting panic reactions

Concerns have already arisen regarding the size of the resources needed to bailout Greece down the road. Perhaps this explains why the strategy to lure markets proves to be short-lived despite the unprecedented financial support in coordination with European members. Tellingly, there is a credibility and sustainability problem about the future implementation of the Program given its narrow focus on austerity measures. Thus, investors are already rushing to the exit with potential "domino effects" elsewhere. Since this is still a global systemic crisis, the strategy of squeezing public financing and isolating the country blaming it for past fiscal indiscipline or lack of competitiveness will most likely fail. With a downward spiral, social and political instability could ultimately bring about the restructuring that today we are so eager to prevent. Constitutional litigation could also block the daunting austerity measures or structural reforms put forward for approval.

The Greek credit crisis is rapidly turning into a wide Eurozone liquidity crisis with unexpected consequences—much is at stake now

Continuous current account deficits during the last years in peripheral countries of the eurozone were functional to sustain intra-euro demand, with private over-indebtedness on the other size of the same coin. Much is at stake now for the EU monetary union as a whole. Outward spillovers are tackling other key countries and its negative impact on Central and Eastern European countries seems likely. First, there was disagreement about the role of the Fund. In an odd anachronism, the Fund was not supposed to discipline advanced economies. Appearances led to undue delays. Then the ECB publicly announced that it would neither allow European banks to borrow using Greek bonds as collateral nor to monetize Greece's debt using its balance sheet. Indeed, a decision was made to avoid debt monetization through increases of ECB's money supply, an option that was deployed aggressively by the US and the UK to weather the recession. Finally, draconian austerity measures coupled with unprecedented financial support were agreed, but sequencing, effective coordination and timely disbursement has remained vague. All in all, the EU may be facing a historic decision.

Back to basics

The Fund's financial assistance is supposed to give confidence to members that resources will be temporary available under adequate safeguards to provide them with the opportunity to correct maladjustments without resorting to measures *destructive of national or international prosperity* … a forgotten provision anchored in the core of the Fund's mandate (Article I of the Articles of Agreement).

The alternative of a voluntary Debt Restructuring should have been on the table

Since solvency problems will not get by without some form of debt forgiveness, we observe that an orderly process would have been better. This Chair prayed for the need to agree on a set of international rules and procedures to handle sovereign debt restructuring when we discussed exiting strategies back in February (Gray/10/477). We knew that the strategies of "competitive disinflation" (namely, protracted recession, higher unemployment, and deflation) were flawed given the systemic nature of this crisis and the scale of the post-crisis imbalances. When we asked about this issue at the Board, the staff echoed a resounding no. Yet, the European authorities would have been well-advised to come up with an orderly debt restructuring process. The bottom line is that the approved strategy would only have a marginal impact on Greece's solvency problems.

Learning harsh lessons from past crisis and mistakes

Harsh lessons from our own past crises are hard to forget. In 2001, somewhat similar policies were proposed by the Fund in Argentina. Its catastrophic consequences are well known. Today, other countries are involved, but the Fund's policies remain the same. Beyond economic theories, there is an undisputable reality that cannot be contested: a debt that cannot be paid, will not be paid without a strong process of sustainable growth.
It is of paramount importance that the policies designs for a country in economic trouble tackle the real problems and not only de short-run financial ones (like the Fund often does). In this sense, monetary and fiscal policies should foster growth, productivity and sustainable and balanced economic recovery. Countries should not bind themselves to monetary fictions that destroy their production capacity and employment levels.

A sound and equitable burden sharing of their costs would have been good for the reputational costs of the Fund (that it could be blamed for simply buying some time or ensuring that foreign banks will be paid in full over the next year before the inevitable happens) and it would have been even better for the Greek population and its growth prospects.

In concluding

We can go along with the consensus on the basis that the authorities are fully convinced that this is the best possible alternative for their own country. Some reassurances are provided by the recent parliamentarian approval of the Program. Our own experience proves that there are no magical solutions, and difficult trade-offs are always involved in every single policy option; it is very likely that Greece might end up worst-off after implementing this program. The adjustment measures recommended by the Fund will reduce the welfare of its population and Greece's true repayment capacity. We have no doubt that the ability to repay critically hinges on sustained and socially inclusive growth. A collapsing economy will lack the social

and political basis to put the country back on its feet.