EconoFact Chats: The Greek Debt Crisis: Resolution and Lessons
Charles Dallara, Partners Group
Published on May 5, 2024

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I'm Michael Klein, executive editor of EconoFact, a non-partisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
The 2008 financial crisis began in the United States, but its effects were felt worldwide. The actions of finance ministers and central bankers across the globe helped prevent what could have been a cataclysmic economic downturn. But even as many economies recovered, some European countries saw spiraling debt due to both their own borrowing, and because of the high-interest rates they faced, as concerns mounted about their ability to repay what they had borrowed. The term "Grexit" was coined – Greek exit from the Eurozone, because of that country's unsustainable debt burden. There were concerns that, were this to happen, it would be the first domino to fall, and splinter the entire Euro system, a central project of European economic policy. As we know, this did not occur, and part of the reason can be attributed to my guest today, Charles Dallara. Charles spent four decades involved in international economic policy at the highest levels, including at the United States Treasury. At the time of the Greek debt crisis, he was the Managing Director of the Institute for International Finance, the IIF. It was in that capacity that he was instrumental for the restructuring of Greek debt, and through this, helping to preserve the Eurozone. He recounts his experiences at that time, as well as his prior experiences, in his new book, *Euroshock: How the Largest Debt Restructuring in History Helped Save Greece and Preserve the Eurozone*. Charles, welcome to EconoFact Chats.

Charles Dallara
Michael, it's a real pleasure to be with you today on this highly acclaimed podcast of EconoFact. I'm looking forward to exchanging views with you on this exceptional, turbulent period in European history.

Michael Klein
Well, I'm really looking forward to getting your insider's view of it as well, Charles. First of all, for our listeners, what's debt restructuring, and when and why is it needed?

Charles Dallara
Michael, debt restructuring is a situation which often arises in corporations as well as sovereign borrowers, that is, nation-states. When a borrower simply faces an unmanageable and unsustainable level of debt. And as you know, the situation revolving around sovereign debt restructuring is a rather different process, with no clear spelled out, articulated rules of the game compared to corporate restructurings, which have domestic law, especially Chapter 11, framing the approach to them. So sovereign debt restructuring is a process by which creditors and a debtor sit down around the table and decide how to reduce the debt burden in order to restore debt sustainability and economic growth.

Michael Klein
A good restructuring benefits both creditors and debtors, not compared to the original terms, but compared to the reality that emerges. But it's very difficult to come to an agreement. Why is that, Charles?

Charles Dallara
In the short run, the creditors and the debtor appear to have different objectives. The creditors want to minimize the amount of loss they suffer as a result of the restructuring. The debtor, on the other hand, wants to reduce the debt burden, which inevitably involves loss of value, loss of the value of claims on the debtor by the creditors. In the long run, though, they converge in interest often in order to maximize the long term positive impact on the economy, and restore the underlying value of assets, which might otherwise be even further damaged.

Michael Klein
Charles, you were involved in the restructuring of Latin American debt in the 1980s when you were serving in the U.S. Treasury. Can you briefly describe the problem at that time, and the Brady Plan that was used to successfully restructure the debt?

Charles Dallara
Certainly, Michael. In the late 1970s, Latin American countries borrowed huge amounts of capital in order to finance consumption and investment in their economies. Unfortunately, they borrowed too much, and they did not always invest wisely. When interest rates soared in the early 1980s as part of Paul Volcker's effort to rein in inflation, these interest rates put an exceptional and unmanageable burden on the debt of Latin debtors. As a result of this, the 1980s are considered a lost decade for many countries in Latin America, such as Mexico, Argentina, and Brazil. Throughout the decade, we worked at the Treasury Department with debtors and with banks in order to moderate the burden and manage the process of recovery from debt restructuring. Eventually, it took a radical new approach under Treasury Secretary Nicholas F.

Brady, that not only rescheduled the debt, but actually eliminated substantial portions of the debt in order to put these countries back on the road of economic growth.

Michael Klein
So, this is like what you said before, that at the beginning, there was a lot of resistance because people were thinking about what had been agreed upon, not what the reality was. But then when it became more apparent that they were in a different situation, there was an agreement that came about. I imagine getting to that agreement was not a smooth or easy path.

Charles Dallara
It certainly wasn't, Michael. I remember the reaction of the creditors, mainly commercial banks in the U.S., Europe, and Japan, when Secretary Brady announced his new proposal to actually eliminate some of the debt. They were very upset and very agitated. This is in the spring of 1989. And only very reluctantly came around to realizing that it was the only way out to restoring value in their remaining claims. So, eventually, they agreed to elimination of 30, 40, even 50% of their claims. But the result of that was that the new restructured claims were actually increasingly of greater value, Michael. And this is one of the true stories of debt restructuring, how you find common ground after difficult periods in order to move forward. And certainly, it was a breakthrough for Mexico, and many other countries in Latin America at the time to have the Brady plan help eliminate a substantial portion of their debt and clear that burden off their back.

Michael Klein
And I guess the resolution of uncertainty was really important, and that helped explain why these claims became more valuable after everything was signed and sealed.

Charles Dallara
That was certainly part of it. The other part of it, Michael, is that the new claims actually were underpinned by Treasury's Zero-Coupon bonds. In other words, in more direct terms, they were collateralized by these Treasury bonds, funded in part by the IMF and the World Bank, with no US taxpayer money involved at all. This collateralization converted these new claims of Mexico and other Latin debtors into capital market instruments, which became highly liquid and tradable in global capital markets. The combination of these forces, what you mentioned and what I just elaborated, really created an entirely new dynamic of sovereign borrowing in the global capital markets by Latin countries.

Michael Klein
So it sounds like it was pretty complicated, but the result was pretty clear cut that these countries again had access to world capital and they can begin to grow again.

Charles Dallara
That's exactly the bottom line of it, Michael. You hit the nail on the head.

Michael Klein
So in your book, you discussed this experience and many others you had. I really enjoyed the book, by the way. I found it very engaging. But the focus of the book as indicated in the title is the restructuring of Greek debt at the time of the Euro crisis. How did Greece get into such a bad situation with respect to its debt?

Charles Dallara
Michael, in the early part of the 2000s, Greece became a member of the Eurozone. They gave up their own currency and embraced the Euro as the new currency for their country. As a result, capital markets assumed that lending to Greece had very little risk in the future because they assumed erroneously, as it turned out, that Germany and other stronger northern European economies would look after, would bail out Greece if they got into trouble. Unfortunately, that didn't happen. And during much of the 2000s, up until 2009 and 10, Greece borrowed heavily, and did not invest wisely. They ran up increasingly large fiscal deficits. And in the fall of 2009, when a new government was elected, they announced, and they discovered that the size of the fiscal deficit was nearly three times the scope of what had been previously announced in global markets, Michael. The result of this was a shockwave, went through global capital markets and Greece was frozen out of the markets. There was a long history of, I would say, also a bloated public sector, and a rather inefficiently structured economy in Greece. So when you added this shock of the fiscal imbalances on top of these longstanding structural problems in the Greek economy, you had a crisis in the making.

Michael Klein
So I started off by talking about the 2008 financial crisis, but it sounds like the problems in Greece may have been a bit exacerbated by that, but it really wasn't the crisis per se. It was sort of longstanding problems in the country, and then the crisis brought these to the fore. Is that correct?

Charles Dallara
I think that is broadly correct, although there's one additional element I would bring into the picture, Michael. After the global financial crisis began to settle and the turbulence of that period in 2008 and 2009 began to moderate, other countries in Europe also begin to experience severe economic imbalances. This includes Ireland, Spain, Portugal, and Italy. So Greece was among five countries which were increasingly seen in the global markets as having severe economic challenges. This led to a great cloud emerging around the entirety of the Eurozone. And

eventually, though, it came to be clear that the most serious country in this group, not the largest by any means, was Greece because of the severity of its fiscal and structural imbalances.

Michael Klein

And as I said also in the introduction, it was seen as possibly a domino effect. Once Greece fell, then people would look around and say, who's next? So it wasn't just that Greece would perhaps have a collapse of its financial system, and no longer have access to world financial markets. But were that to happen, if in fact there were Grexit, if Greece were to leave the Eurozone, then there was a widespread perception at that time that other countries would follow.

Charles Dallara

You know, Michael, if I could just respond to that, you're exactly correct. There was a growing perception in many quarters, and this was a perception that not only I shared, but many of the creditors shared, that unless solutions were found to the Greek debt problem, substantial solutions, not temporary band-aids, that Greece could be forced out of the Euro, and this could fracture the entire structure of the Euro, which at the time was still a fairly new currency. It had only been inaugurated in 1998, so it had less than 15 years of history behind it. It had become the jewel in the crown of European economic and financial integration. So a lot rided on the stability and the integrity of the entire structure of the Euro, Michael, and no one had ever seriously contemplated a country having to restructure its debt and remain in the Eurozone. So the question that loomed in front of all of us was, if we restructure, does this lead to Greece's exit, or does a successful restructuring actually ease the pressure and allow Greece to remain in the Euro? That was an exceptionally intense debate throughout 2011, Michael.

Michael Klein

And that was a really important debate, as I remember as well. But one other thing, Charles, you know, people say it takes two to tango, or maybe in this case to sirtaki, the traditional Greek dance, and a loan involves both a borrower and a creditor. Why did creditors lend so much to Greece, and how culpable were they in creating the crisis?

Charles Dallara

Michael, they played an important role, unfortunately, in watering and fertilizing and seeding even, this crisis. There's no way around that reality. The lending practices of many of the creditors during the course of much of the 2000s, as I mentioned earlier, did not involve the kind of serious, highly professional, intense risk management that should have accompanied that lending. And the investment banks began to share the bonds. These were not traditional bank loans; that should be underscored. Most of them were in the form of Euro bonds. And the result was that the banks really took for granted that the risks were minimal, if hardly existing, in investing in Greek debt. And they saw the attractive returns which existed, especially in the early

and middle years of that decade, during which Greece had just become an exciting new member of the Eurozone. And investors could receive substantial returns compared to, for example, investing in German bonds, in Greece, without the perception that they were taking severe risks. In the end, this is why it was entirely appropriate that the financial markets bore a substantial share of the burden in the final outcome, losing 73% of the net present value, Michael, of the claims that existed at the time the crisis erupted.

Michael Klein
So I remember in 2011, when I was in the Treasury, we would get weekly reports on Greek interest rates, the spread of the Greek bonds over German bonds. Greek debt became very expensive to service because lenders demanded high-interest rates to compensate them for the risk of default. At that point in 2011, Grexit seemed not only possible, but more likely than not, at least to me. How did Greece avoid default, and avoid being forced from exiting the Euro area? And Charles, what was your role in that?

Charles Dallara
Well, there were two or three key ingredients that eventually allowed Greece to avoid default and avoid Grexit. One of those, especially at the early outset of the crisis, was substantial lending support by other European countries and the IMF. They both stepped up and provided billions of dollars worth of loans to temporarily finance the Greek economy. Secondly, Greece engaged in a serious and somewhat successful, although not entirely successful at the outset, economic adjustment and reform program to try to convince the world, and markets in particular, that it would lead to a more sustainable, competent, competitive, and efficient economy, and a more sustainable level of debt in the future. Thirdly, the creditors eventually stepped up and recognized that the risks of Grexit were real. That if it occurred, that Italy could likely well be the next country to fall out of the Eurozone, which would have been an unmitigated disaster for the future of European economic and financial integration. The stakes were very high, and the creditors recognized this, and eventually decided that the only way to solve this problem was to agree in a fairly openly negotiated, completely voluntary process of negotiation to come to terms with a huge loss on their balance sheet, and in their earnings and agreed to do that. And I must say one final element of this, Greece brought in a new government, a technocratic government in the fall of 2011, led by Lucas Papademos, a respected economist and central banker, and that also strengthened the credibility of the Greeks going forward. All of these ingredients came together, and eventually Greece was able to reach an understanding with the creditors, detailed in my book, which…largest in history write-off ever, which allowed them to pursue a stabilization and recovery program, which now is bearing considerable fruit, Michael.

Michael Klein
Yeah I really enjoyed, in the book, the discussion you had of how the negotiations went on and how fraught they were, and how people were finally brought together. I thought that was very interesting. So lenders took a big hit, but the bigger effect perhaps was on the Greek economy, [it] went through a terrible downturn with high unemployment and poverty. I imagine that was very wrenching for the people of Greece.

Charles Dallara
It was, Michael, and it was, and it was wrenching to observe still today many citizens of Greece are just now getting back on their feet after this traumatic period of job destruction, and underinvestment in the Greek economy. Unemployment soared to nearly 30 percent. Youth unemployment rose into the range of 40 percent, Michael. And the adjustment process, to be quite honest and quite fair, was too heavily borne by the Greek citizenry, and should have been spread, in my view, throughout the Eurozone. This is one of the lessons which we need to debate going into the future, Michael.

Michael Klein
Well, in a striking turnaround, *The Economist* magazine declared Greece the country of the year in 2023. And in the explanation of that, the article reads, "10 years ago, it was crippled by a debt crisis, and ridiculed on Wall Street. Incomes had plunged, the social contract was fraying, and extremist parties of the left and right were rampant. Today, Greece is far from perfect, but after years of painful restructuring, Greece topped our annual ranking of rich world economies in 2023. Greece shows that, from the verge of collapse, it's possible to enact tough, sensible economic reforms, rebuild the social contract, exhibit restrained patriotism, and still win elections." This is a very striking result, Charles. To what extent do you think the restructuring laid the groundwork for this recovery?

Charles Dallara
Well, Michael, I certainly don't want to claim that the restructuring fully accounted for or created the conditions for the economic recovery, but two or three points. First of all, I arose in reading that statement in *The Economist* magazine with a huge smile on my face, because I think Greece completely, unequivocally deserved that recognition. They've had strong political and economic leadership now for over four years under Prime Minister Mitsotakis. They indeed still have a lot of work to do to create a wholly balanced competitive economy which can generate sustained growth, but they have completed a dramatic turnaround since that period a decade ago. The restructuring contributed to it in two or three important ways. First of all, the elimination of $107 billion of debt; equal to roughly half of the size of the Greek economy at the time. Dramatically removed a cloud over their future debt sustainability, and enhanced their eventual return to borrowing in the global capital market. Secondly, the rest of the debt was stretched out over a

30-year period, Michael, with highly subsidized, below-market interest rates, which helped ensure that going forward, that would not overly burden the fiscal deficit. Indeed, Greece has run a very well-managed fiscal account over the last four to five years as a result. I think both of these factors were important, but finally, this contributed to a catalyzing of reduction of interest charges by the European official creditors. The governments of Europe decided that they had to contribute to the restructuring, not by eliminating debt as the private creditors did, but by reducing the interest charges. All of these factors contributed to it. Finally, I think that the current government deserves a huge amount of credit for rebuilding confidence. And now firms like my own, Partners Group, are investing in the Greek economy, eagerly [inaudible] possibilities for building future investments in job creation in Greece.

Michael Klein

Charles, this is a really compelling story, but I'd also like to think about its lessons. The problem of excessive debt is still with us, and in its most recent World Economic Outlook, the IMF highlights government debt as one of the key challenges facing countries. Countries need to consolidate their debt. What are the warnings from the Greek debt crisis that emphasize these concerns, and what lessons from the Greek crisis can be applied to the current situation?

Charles Dallara

You know, Michael, I think there are a lot of lessons that need to be carefully considered by Greece, by the European governments and financial leaders, and also by markets and the IMF. Everyone needs to reflect upon the role they played, not just in solving the crisis, but in contributing to the crisis in the first place. One important issue here, it seems to me, is that governments need to do a much better job of monitoring and controlling their borrowing. Even in the good times, they have to mitigate the risks that difficult economic circumstances can take an external debt picture and turn it from manageable to unsustainable in short order. And I think that much higher standards for borrowing by governments, particularly governments which have weak structural conditions, needs to be put into place. At the same time, the lenders need themselves to strengthen their own risk management. And I suggest that both sides of this equation have a lot of work to do to improve the quality of risk management and lending to sovereigns. And finally, I would add that the rating agencies themselves have a good bit of work to do to strengthen their capacity to analyze sovereign risk and articulate it in a timely fashion. The IMF needs to better understand the structural weaknesses of economies, not just external imbalances and fiscal imbalances. And both the IMF and Europe need to contemplate this essential question: “Are we prepared, and could it be done better the next time around, if there's another sovereign debt crisis in the Eurozone?” As far as I can tell, this has not been adequately addressed by European or IMF leaders, and it needs to receive considerable attention. Finally, I would add that Greece cannot declare victory without pursuing continued economic reforms for

many years to come. Some of the structural weaknesses are deeply embedded in Greek culture, Greek habits, and they need to be cleaned up only over a period of years, Michael.

Michael Klein
Well, Charles, I hope that the appropriate people take your suggestions into account. And maybe by reading *Euroshock,* a book, I really enjoyed, they will, in fact, learn those things. So congratulations on writing a wonderful and fascinating book. And thank you very much, Charles, for joining me today on EconoFact Chats.

Charles Dallara
Well, thank you for the opportunity, Michael, and congratulations to you and your team on creating not just a wonderful platform in EconoFact, but adding to it these podcasts which generate real value for a lot of listeners around the world. Thank you for the time.

Michael Klein
Thanks for that, Charles.

Michael Klein
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