

History repeating itself: From the Argentine default to the Greek tragedy?

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"Those who cannot remember the past are condemned to repeat it"
George Santayana, from *"Life of Reason I"*

Since the onset of the debt crisis in late 2009, the comparisons between Greece and Argentina have multiplied, with an emphasis more on the similarities than the differences. This is not surprising given the stunning parallels. This Commentary draws a systematic comparison between the two countries over the decade before the crisis and the management of the crisis. Overall it suggests that there may be little left to do for Greece to avoid a repeat of the Argentine default, but in larger scale.

A decade of 'quasi' monetary union and Monetary Union

Since early 2010, almost all independent observers have stressed that Greece was facing a solvency, and not a liquidity problem. This was also the case ten years ago with Argentina, yet in both cases the crisis was addressed as one having a liquidity nature.

But let us start from the beginning.

In 1991, in order to achieve inflation stability, Argentina embarked on a radical experiment: the currency board. The arrangement consisted of entering into a 'quasi' monetary union with the US by (almost) replacing the national currency and monetary policy by the US dollar and the Federal Reserve policy, respectively. Initially the new arrangement worked very well: growth returned and the confidence of foreign investors was such that large inflows of foreign direct investment, especially the banking sector, began to materialise.

Then 10 years later, Greece went through a similar experience: in 2001 it joined the European Monetary Union, giving up monetary sovereignty and its own currency with the purpose, among others, of curing years of fiscal problems and inflation. For about nine years, the balance of the experience was definitely positive: inflation was brought under control and significant growth was fuelled by abundant and cheap capital inflows induced by growing economic and financial integration within the monetary union.

For Argentina the problem developed into the 1990s. A series of external shocks (the Mexican crisis in 1994, the strong appreciation of the dollar in 1995, the crisis in East Asia in 1997, the Russian default in 1998 and, most importantly, the currency crisis in Brazil in 1999) made the national currency largely overvalued under the hard peg regime to the dollar,

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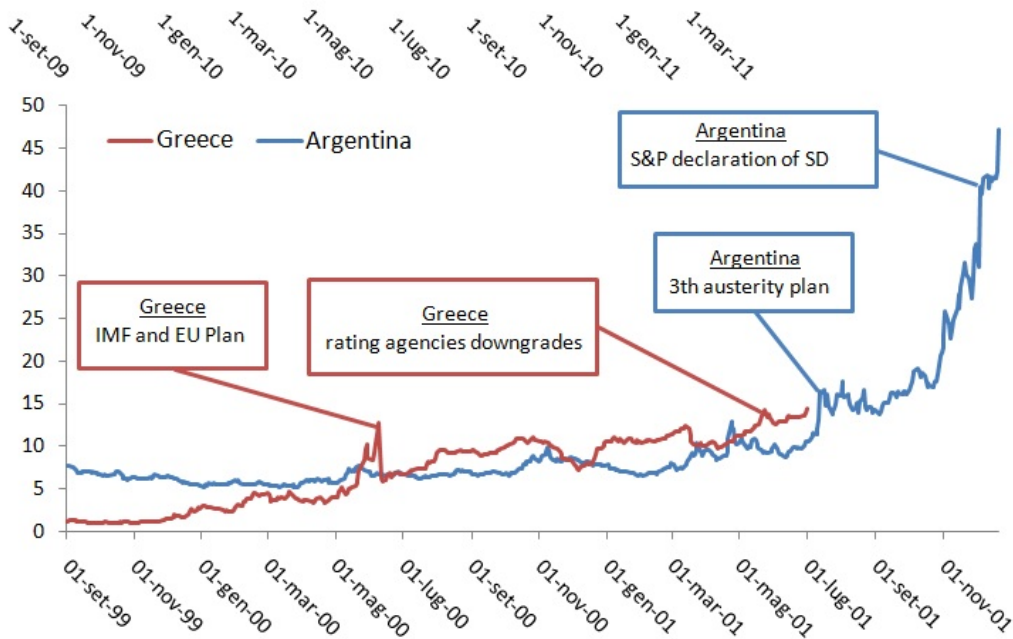
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external deficits started to emerge in a persistent fashion and growth to slow down. At the same time, fiscal imbalances, driven by widespread corruption and rampant public expenditure, had become pervasive. By 2000 investors started to worry about future developments in the country and the more generally about its solvency; as consequence the price of government bonds started to drop (see Figure 1).¹

Similarly to Argentina, the Greek troubles started to emerge on the wave of a large external shock. Following the financial crisis of 2008, the risk perception dramatically changed, capital flows to Greece reduced and with them growth. Combined with the revelation of doctored statistics, the huge public and external debt accumulated after years of fiscal and external imbalances, rapidly appeared unsustainable to international investors. As shown in Figure 1, yields on bonds issued by the Greek government soared dramatically over a very less than one year time.

Figure 1. Spreads evolution



Note: Greek sovereign spreads are measured relative to 5-yr yield on the German bund. For Argentina Strip Spreads are displayed.

Source: Datastream and Bloomberg.

Facing the crisis: Fiscal austerity and zero deficit promises

Despite a public primary balance almost always positive over the 1990s, the stock of public debt in Argentina had almost doubled over the decade (from 34% to more than 60% of GDP), driven by increasing financing needs to fund off-budget expenditures (mainly recognition of pre-existing debt such as overdue obligations to pensioners and suppliers) and current expenditures hidden by an opaque fiscal system. Starting from 1999, mostly under the pressure of the IMF and the conditionality associated with the three consecutive programmes, the government approved a sequence (four in two years) of laws aiming at controlling public deficit and restoring market confidence. The last and tougher one, the so-called 'Zero deficit law' endorsed in July 2001, committed to a balanced budget by the fourth quarter of the same year. Regrettably at the end of 2001, the deficit was not zero but it had reached 6% of GDP, growth was at -4.5 against the expected +3.5% as foreseen in the consolidation plan and violent protests broke out in the streets of the country.

¹ At the time the CDS market had not yet developed as a measure of default probability.

The current Greek experience with the control of current expenditures is not much different.² Since the start of the troubles, the Greek government has proposed and endorsed three different consolidation plans. In January 2010 (before the first IMF programme), the newly elected Greek government had planned budget reforms aimed at reducing the fiscal deficit from 12.9% of GDP to below 3% in 2012. Despite the endorsement of the plan by the European Commission, quickly enough the details of plan turned out to be not credible. In early May 2010, following the approval of official program with a loan to Greece, the IMF designed a more plausible (at least *a priori*) fiscal consolidation plan aiming at getting a general government deficit below 3% by 2014. However, at the time of the third review in June 2011, the plan's intermediate targets were assessed as not being met and the IMF conditioned the issuance of the new tranche of payments to the existence of an additional emergency plan. As result, the Greek government had to present a new austerity plan of €28.6 billion to take effect in 2012-15. The plan was approved on June 29th and it is a pre-condition for Greece to get a second emergency plan of about €90 billion from euro area member states.

One difference between Argentina and Greece is noteworthy: the latest Greek programme includes a large plan of assets sales (officially about €50 billion, but more realistically, it will likely less than this sum) as one of the key elements for debt reduction; Argentina could not resort to privatisations given that almost all of the state-owned assets had already been sold during the 1990s.

The External Aid: The IMF and the others

In the case of Argentina, when foreign creditors started to doubt the ability of the country to service the debt, the international community responded with large financial support packages. In March 2000, the IMF approved a three-year stand-by credit (\$7.2 billion) to be treated as 'precautionary'. The programme envisaged a resumption of growth, a decline in fiscal deficit and structural reforms. Even if targets were subsequently revised and reduced in the following reviews, none of them was achieved. Given the continuing external financing difficulties and the country's inability to access international capital markets, in January 2001, the IMF granted Argentina an augmentation of the stand-by arrangement to \$13.7 billion. At the same time, additional financing was arranged from official and private sources. A total plan of about \$40 billion was presented by the Argentine government as the *blindaje*, a shielding system of loans issued (other than the IMF) by the World Bank, the Inter-American Development Bank and the government of Spain ,combined with financing assurances from the private sector³ that would have protected Argentina against the lack of market access.

However, the failure in meeting fiscal targets (the third IMF review was indeed negative) was at the source of persisting troubles and on 7 September 2001, based on Argentina's commitment to implement the Zero Deficit Law immediately, the IMF augmented its first agreement for a second time, increasing lending commitment by another \$8 billion (to a total of about \$22 billion).

² Interestingly enough, in October 2001, Argentinean provinces started to pay public salaries with special 'provincial bonds'; similarly on December 2010 Greece had decided to pay four-fifth of its €6.8 billion in state hospital arrears to drug-makers through special zero coupon bonds issued by the Greek State with two-four years maturity.

³ The private sector component of the *Blindaje* was about \$20 billion over 5 years. It included the an agreement with 12 institutions in Argentina to roll over maturing bonds and purchase new public issues for \$10 billion, with private pension funds to purchase new public issue for \$3 billion and liability management operations on international bonds for \$7 billion. Interestingly the operations were premised on transactions conducted at market price (see IMF, 2004, for more details).

Once again the experience of Greece is strikingly similar in frame, but bigger in size. In May 2010, the IMF and some member states of the European Monetary Union agreed on an emergency package to help Greece facing, supposedly, a liquidity problem and imposed a tough adjustment programme on Greece aiming at reducing fiscal deficit. Despite the Government’s efforts, the intermediate objectives have been missed systematically. Facing a concrete risk of default, a new package of about €80 billion⁴ is under discussion, conditional to the endorsement of the new austerity plan.

Table 1 below summarises the size of the (approved) loans to Argentina and Greece in relative terms.

Table 1. Official Lending

Country	IMF lending		Total Official Lending	
Argentina (2001)	\$22bn	8% GDP	\$48bn	17% GDP
		10% External debt		22% External debt
Greece (2011)	EUR30bn	13% GDP	EUR 110bn	50% GDP
		7% External debt		26% External debt

Note: External debt is measured as external liabilities (Source IMF)
Sources: “The IMF and Argentina, Evaluation Report”, 2004; “Greece, Staff report on Request for Stand-By Agreement”, 2011; authors’ calculation on IMF data.

It is worth noting that the fact that Greece belongs to a real monetary union gives Greece access to another official lender: Greek banks can benefit from the European Central Bank refinancing instruments. Thanks to it, they have been able to refinance themselves by about €90 billion (40% of GDP) and survive both their insulation in the interbank market and a significant deposit flight. Hence, including all different sources of official lending, Greece has already received as much as €200 billion (i.e. more than 80% of its GDP). This is likely to increase up to €310 billion over the coming days (following the new European emergency plan) and even to a higher amount if deposits flight were to continue and the ECB to provide substitute for them (see the section below on the state of deposits). In relative terms, this is a much larger financial support than Argentina received.

The private sector involvement: the voluntary restructuring attempt

In June 2001, as it became clear that Argentina was unable to grow out of its debt problem, the government announced a debt swap⁵ to try to stabilise debt dynamics. It was a voluntary, market-based debt exchange under which short-term debt held by residents was exchanged for new debt with longer maturities. It was called the *megacanje*. Despite the success of the operation, which amounted to about \$29.5 billion, and the reduced debt service that it implied for the period 2001-05, the mega swap did not represent an alternative to the default. The implicit annual interest rate on the new debt was more than 17%, well above the expected growth rate of the economy and clearly unsustainable. Rating agencies did not consider the event as a default trigger but the following month, both S&P and Moody’s, downgraded long terms sovereign rating further. The credit event was announced in early November, when S&P lowered the rating to selective default (SD), after the announcement of a voluntary restructuring of all debt⁶ and the presentation of an additional fiscal package.

⁴ The package should also include €30 billion in private sector participation.
⁵ This is to be framed in the private sector participation envisaged by the *Blindaje*
⁶ In fact the completion of the local-leg of the debt restructuring was announced at the end of November 2001, it involved the voluntary exchange of bonds for a face value of \$51 billion. The second phase of the exchange, supposed to involve external debt, never took place.

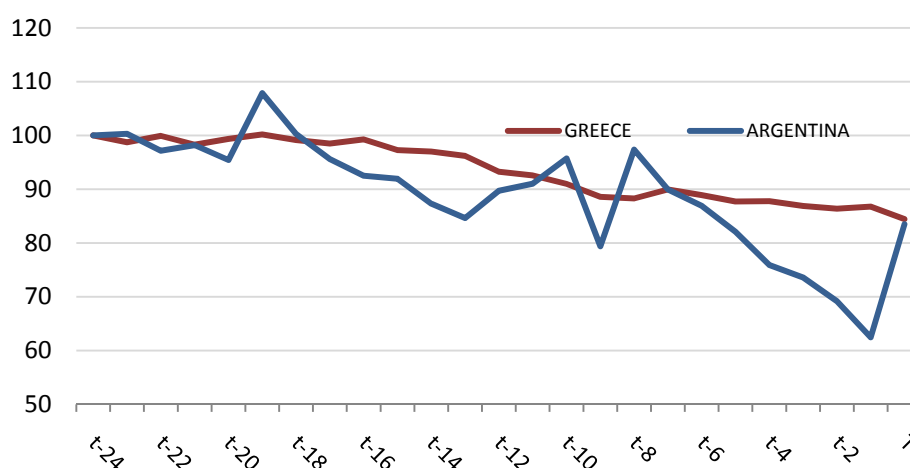
Like Argentina, the option of a voluntary restructuring is now under examination for Greece. Just as we write, at the suggestion of the French government, French banks (who are the most exposed to the Greek debt) have put forward a proposal to roll over their short-term debt coming due until 2014 (i.e. over the time frame of the second rescue package). Although details have not been disclosed, the idea seems to be designed along the lines of the Brady bonds experience in the 1990s. It seems that the banks would in effect obtain a combination of guarantees for about 50% of the bonds coming due (this might be 30 percentage points in cash and 20 percentage points in EFSF or other AAA rated bonds). The remaining 50% would be rolled into a 30-year discount bond which banks would presumably be able to hold at face value in their banking book. The economic value of these long term bonds at market prices would be very low, so that the banks are effectively taking a large 'mark to market' loss (compared to face value). But those banks that which had already written down their holds (e.g. those held in the trading book) would actually record a mark to market gain since the combined value of the one half paid in cash/guarantees plus the other half in the discount bond might very well be above the current mark to market value of a 3-year bond today. The discount bond might foresee some additional earlier payments in case GDP growth is stronger than expected. It would with all likelihood *de facto* have a junior status, at least with respect to official loans.

The final race for deposits

In Argentina the situation deteriorated irreversibly and default could not be averted any longer when locals started withdrawing deposits. At that point, the ten years of successful hard pegging were clearly over. The succession of three IMF programmes of rapidly growing size had not prevented the worst scenario: investors were not convinced about debt sustainability and the resistance of the population to further adjustments grew along with the austerity efforts of the government. On 30 November 2001, the race began: central bank reserves fell by \$2 billion in one day. In response, President de la Rúa imposed a wide range of controls on banking and foreign exchange transactions in order to stop a bank run: *el corallito*, which included \$1,000 per month limitation on personal bank withdrawals and only from account denominated in pesos. Figure 2 shows the behaviour of deposits over the 24 months that preceded the default and the rebound of the deposits after the *corallito* was introduced. From the comparison of the developments in the Greek deposits with the pattern of deposits in Greece over the last 24 months, it emerges that the volatility in the Greek data is significantly smaller, but deposits have decreased steadily.

As mentioned earlier, it should be also taken into account that belonging to a real monetary union puts Greece in a much better position than Argentina had, in terms of financing of the banking system. If Greece were not in the eurozone (or if the euro area's monetary policy had been structured like that of the US, i.e. working through money centre banks), the country's banking system would have broken down already some time ago.

Figure 2. The race to deposits



Note: T-24 is 24 months before the period considered. Argentina T= December '99. Greece T= April '09.
Sources: IMF and Bank of Greece.

History repeating itself: Where are we heading?

This commentary has emphasised stunning similarities between the experience of Argentina and Greece, both in the nature of the crisis and the approach to its management. Table 2 provides a summary of the timeline with main events for the two countries and the stunning parallels.

Given this background, the question is how should one assess the chances of Greece avoiding an Argentine scenario today? A quick look at the economic fundamentals of Greece today versus the situation of Argentina before the default is not encouraging.

Table 2. Timeline of the events

ARGENTINA		GREECE	
1991	'Quasi monetary' union with the US	Monetary union with Eurozone	2001
1994-1999	External shocks: Brazil currency crisis	External shock: Global financial crisis	2008-2010
1999	De La Rúa becomes President	Papandreou becomes Prime Minister	2009
June 1999	Governor Duhalde is reported to consider debt restructuring	Papandreou affirms that Greek economy is in "intensive care"	November 2009
September 2009	Fiscal Responsibility law to reduce government spending	Papandreou unveils radical reforms to cut the deficit	December 2009
February 2000	National strike against fiscal and labour reforms	Greek public sector workers strike against pension reform and sectoral deregulation	February 2010
March 2000	IMF plan	IMF plan	May 2010
May 2000	The Government announces \$1billion in budget cuts	The government presents draft budget containing hard cut to public spending	October 2010
March 2001	International rating agencies lower Argentina's long-term sovereign rating	Fitch becomes the third ratings agency to cut Greek debt to "junk" status after S&P and Moody's	February 2011

March 2001	Domingo Cavallo is appointed new Minister of the Economy	Reshuffle of government: Evangelos Venizelos becomes the new finance minister	June 2011
July 2011	Unions calls a nationwide strike to protest government austerity plan	Anti-austerity demonstrators gather outside parliament	June 2011
June 2001	Completion of the mega-swap	French banks draft a voluntary private sector participation in the plan to help Greece	June 2011
July 2011	Argentina Congress passes a "Zero Deficit Law", requiring a balanced budget by the 4 th quarter of 2001	Greek parliament approves, with a tiny majority, €28.6 billion of extra austerity measures	June 2011

Table 3 below shows that according to four fundamental indicators of an impending crisis, the score is four to nil for Argentina. Greece has had systematically higher public debt, larger fiscal and current account deficits and greater external debt, while the pattern for growth over the decade of the monetary agreement (1991-2001 for Argentina and 2001-11 for Greece) was impressively similar in the two countries (see Figure 3).

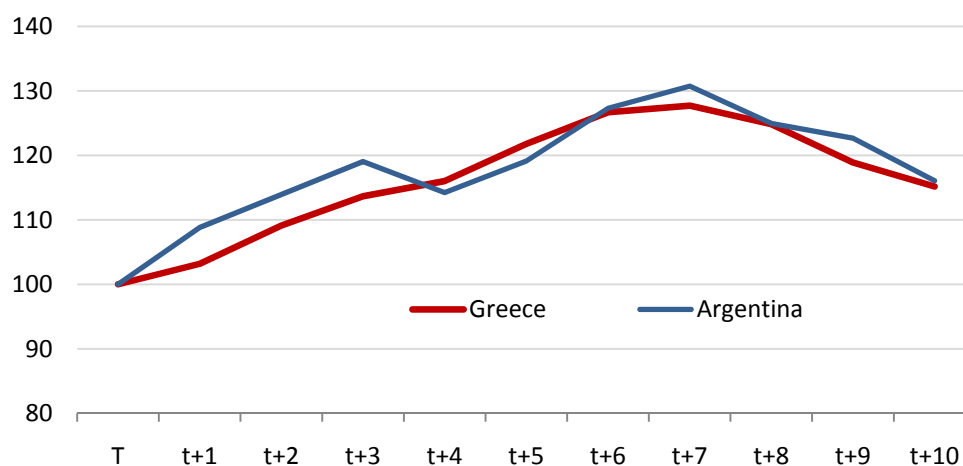
Table 3. Fundamentals. Greece v. Argentina: 4 to 0

	Argentina Average 1996-2000	Greece Average 2006-2010	Argentina 2001	Greece 2011
Public deficit (%GDP)	-2.9%	-9.5%	6.1%	7.5%
Public debt (% GDP)	40.1%	118.1%	53.7%	153.1%
Current account (% GDP)	-3.7%	-12.3%	-1.4%	-8.2%
Gross external debt (% GDP)	51%	295%	53%	328%

Note: Data for Greece 2011 are the projections contained in the Third Review under Stand-by Agreement, March 2011.

Source: IMF.

Figure 3. Real GDP growth rate



Source: World Bank

Note: T is the beginning of the new monetary regime: 1991 for the currency board in Argentina and 2001 for the monetary union in Greece.

So where are we heading? As in Argentina in 2001, the population of Greece seems determined today to push the country towards the worst of all options: a disorderly default without having implemented first the structural reforms which would allow the country to emerge leaner and stronger from this 'catharsis'.

In the short-run the behaviour of deposits will make the difference about which scenario will materialise: If deposit flight continues or increases, the Argentine scenario becomes more and more likely.

Overall the management of a large fiscal crisis has a crucial political connotation. Avoiding the worst scenario for a country as whole requires a collective commitment involving the entire political class as well as the whole population. This is ultimately a manifestation of social and national cohesion. Unfortunately Argentina dramatically lacked this element. Governments fell one after another and social unrest dominated the streets for months. Until now, in Greece, the government has managed to stay in power, despite a tiny majority in Parliament and a reshuffle of the cabinet in June, but the violent demonstrations against the austerity plan prove that social cohesion is low and the lack of support from the opposition in the Parliament witnesses also a lack of national union.

Overall there is very little Europe can do to avoid this outcome. It is often said that history repeats itself only as a farce. In the case of Greece, it may look more like a tragedy.

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