Bailout deal means more pain for Greece

By Tim Mullaney, USA TODAY

Updated 2/21/2012 8:30 PM

The new deal to bail out Greece a second time will force banks and other private creditors to write off more than half of what they're owed and slash interest rates on the rest — but still won't be enough to rescue Europe's most financially strapped country from years of grinding recession.

By Louisa Gouliamaki, AFP/Getty Images

A Feb. 19 protest in front of Greece's Parliament against austerity measures approved by the government.

Officials of the European Union, private creditor groups and the International Monetary Fund defended the latest debt-restructuring deal Tuesday, as critics said Greece's fast-shrinking economy will shrivel even faster under the austerity the EU demanded in exchange for contributing 130 billion euros ($172 billion) through 2014 to the deal. Those terms call for Greece to cut its budget for defense, state-employee pensions and other expenses, and to slash its minimum wage and reduce the ranks of public employees, who now are 40% of all Greeks working.

The deal sets off a race between the downward spiral of Greece's economy and hope that lower debt payments and better access to credit for Greek companies will kick-start private-sector growth. Greece's economy is expected to shrink 6.5% this year, says IHS Global Insight, while the deal shaves about $20 billion a year from interest and principal payments through 2020. The key is if growth resumes before Greeks are exhausted by years of deprivation and demand change, said Diego Iscaro, an IHS economist in London.

STORY: In Greece, debt deal gets a mixed reception
STORY: Greece secures bailout to avoid debt default

"I don't think this is going to solve anything," Iscaro said. "Not only do they not have a strategy for growth, it doesn't look like they've even thought about it."

How it works

The biggest change the deal makes is that Greece will refinance all of the 206 billion euros ($273 billion) it owes to private-sector creditors, said Frank Vogl, a spokesman for the Private Creditor-Investor Committee for Greece, which represents most of Greece's private lenders.

Holders will have the right to exchange existing bonds for 70 billion euros of new debt from Greece and 30 billion euros in government notes backed by a eurozone bailout fund, in a deal expected to happen by the middle of March, he said. Private debt would be reduced by 107 billion euros.

The new bonds will initially pay just 2% interest, far below the market rate on Greek debt now, Vogl said. Combined with other concessions, the package cuts the value of Greece's 206 billion euros in private debt by more than 70%, he said. The rest of Greece's debt,

Most Popular

Stories
Canceled credit card debts come back to...
Why some investors worry about Dow 13,000
AOL is 8th advertiser to pull Rush Limbaugh...
Pepper Jack sales soar as buyers say spicy...
Judge: Mets owe up to $83M to Madoff...

Videos
Lava Claims Last Home in Hawaiian Community
New Mexico Crews try to reach child's body
Death toll rises from violent storms

Photos
Cars in the News
Test Drive
Concept vehicles by Chrysler

144 billion euros owed to public entities such as the European Central Bank, is not affected by this deal.

The deal still has to be approved by some European parliaments, and Greece's legislature must pass implementing legislation, Vogl said. Enough private-sector investors also must agree to the bond swap. The IMF said it will decide how much it will contribute to the package after those steps are completed.

"It's a huge reduction of their debt burden and a huge boost to Greece's cash flow," Vogl said. "The program is very tough. Hopefully, their sacrifices will be worthwhile."

Why it might not work

Yet the deal contains few provisions to stimulate Greece's major export sectors or boost tourism, another area where Greece gets foreign exchange, said Eswar Prasad, an economist at Cornell University.

To make its private sector more competitive, Greece needs to break down cartels in industries such as trucking, cut wages broadly and improve tax collection from rich, self-employed Greeks so tax rates for middle-class workers can be kept manageable, Prasad said. Greece posted a 21-billion-euro trade deficit last year, according to official statistics.

"The only way Greece comes back is by exporting," Prasad said. "If you make lodging cheaper, and if you make food cheaper, Greece becomes a more attractive tourist destination. But there is no obvious hope that at the end Greece becomes a strong, prosperous economy."

Lessons for the rest of Europe

The deal should warn other troubled nations such as Italy and Portugal to make themselves more competitive, including by cutting wages, to boost exports before their situations become as dire as Greece's and to demand more radical cuts, Iscaro said. IHS expects Italy's economy to shrink 1.6% this year, and Portugal's to shrink 3.7%.

"The political situation in Italy has become much more stable," as a result of the replacement of former Prime Minister Silcio Berlusconi by Mario Monti, Iscaro said. "But Italy's situation is still risky. Growth there has been non-existent."

Posted 2/21/2012 8:14 PM | Updated 2/21/2012 8:30 PM