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A E D B F

SOVEREIGN DEBT

CONFERENCE

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The discussion and analysis of the topics of this conference by our distinguished speakers enlightened the various facets of the sovereign debt crisis in a most lucid and pertinent manner.

I would remind you that efforts to institutionalize through a Convention sovereign debt restructuring mechanisms stopped approximately 8 years ago. Perhaps one could suggest that we needed the global financial crisis and, even more, its devastating effects on Eurozone member states to make us face and try to manage sovereign debt issues again.

This time sovereign debt problems are more acute and complex than ever before, because the sovereign debt crisis concerns states belonging to the Eurozone. Sovereign debt restructurings to date have been the province of developing countries and have become quite standardised. The problems in the Euro-zone have changed this reality.

When the euro was first conceived and designed, the concerns about crisis management were not institutionally addressed.

Nor was a remedy for a possible euro pathology envisaged in the Treaty establishing the common currency. As a result, when troubles appeared, credibility was the first victim, due to the very lack of legal certainty and predictability.

So we found ourselves unprepared to tackle what is arguably the biggest sovereign debt crisis of modern times. Not of course because of the size of Greece, but because of the perplexing circumstances.

Greece, as a member of the eurozone, was simply too complex to fail. New and diverse exogenous parameters appeared, complicating the situation.

As a matter of fact and for the first time, sovereign creditors now hold credit default swaps on their sovereign debtors' debt, so these creditors will probably have an incentive not to cooperate in any restructuring.

Furthermore, a disorderly debt restructuring of Greece is impractical, not for economic, but mainly for institutional reasons, relating to the reasonable fear that the problem would spread to the banking sector and create systemic risk in Europe.

For the first time regulatory bodies are arguing for bail-ins, a process by which bondholders and other commercial creditors are forced, by law or contractually, to accept potentially heavy discounts on the debt they hold.

With great reluctance and after much hesitation, the EU and the IMF intervened through a financing scheme and almost a year later decided on a form of orderly restructuring through the PSI, tackling in parallel the moral hazard issue.

In that respect, it was not the holdout problem, as such a classical collective action issue, that was crucial. A quite satisfactory solution to that problem can be found contractually, through the retroactive institutionalization of the CACs in the Greek law on the basis of a voluntary restructuring (voluntary does not require a unanimous decision where the law provides for a majority or supermajority decision).

It was and is the funding problem, far more, that causes headaches. Without funding, a sovereign debt crisis would trigger larger systemic collapse, starting with and emanating from a banking crisis in the Eurozone.

First the non-bail out clause of the European Treaty put into question the whole financing scheme. Then the conditions under which such funding could be granted created an unsustainable uncertainty for the markets and this has aggravated the situation.

Legal uncertainty surrounding a possible currency change and its possible effects on deposits with banks established in Greece, made capital outflows an everyday reality.

That created an increased need for liquidity in the banking sector in Greece, which was now depending more than ever on financing through the ECB.

And since the collateral given for such financing was primarily domestic government bonds, enough parameters for the creation of a vicious circle were already there, exposing the terrifying interdependence between the public and private sectors, and thus the systemic risk at a European level.

A disorderly Greek default would render Greek Government bonds non eligible for Eurosystem operations. And a credit event would trigger CDSs' payouts. Both, potentially devastating developments.

The need arose to encapsulate terms of art, such as selective default, into traditional legal terms; and legal engineering was recruited to tackle this prima facie oxymoron.

It is like a fight against Lernaean Hydra, the many-headed beast.

The competent European bodies failed to provide a timely market-driven and adequate response to the sovereign debt crisis within the Eurozone. Bureaucracy, narrow-mindedness and lack of adaptability deprived Europe of the perspective of an efficient use of market instruments to tackle the problems, which could have a less costly and more promising solution.

One shall not oversee that the financial crisis in Greece has been caused due to integral structural deficiencies that need to be dealt with brave internal reforms. However, the sovereign debt problem in the Eurozone is for sure not a Greek one. Gaps, inconsistencies and contradictions in the European legal arsenal could turn the fates of European nations into those of the protagonists of a Greek tragedy.

The European Union has gained – even after great delays – a better, more comprehensive perception of the diversified dimensions of sovereign debt, allowing it to adopt better crisis management tools.

It finally turned its back on the obsession for a moral-driven punishment. Such initially prevailing view not only cost valuable time, but also contributed to the development of a climate of increasing doubt about European anti-crisis policy, a risk not only to Greece but the Eurozone itself.

In March 2011 the European Council took its first steps to institutionally face sovereign debt problems through the European Stability Mechanism. However, the attempts to date to stabilise the Euro have had no obvious successful outcome. No current proposals, focusing mainly on austerity and fiscal discipline, are likely to return the ailing peripheral economies to the growth levels required to service their debts. The fundamental changes in Europe's sovereign debt markets are what elevates Europe's problems from those requiring tough economic adjustments to problems giving rise to the very real threat of a major global financial collapse.

All in all, recent history has shown that monetary union is not enough. And it also proved that innovative development of genuine market driven instruments could reduce costs and promote at least the hope and possibility of a resolution of many sovereign debt issues.

A thorough empirical analysis and the political courage to act are needed to find and apply efficient holistic solutions providing not only measures for fiscal discipline but also action to enhance competitiveness and economic growth.