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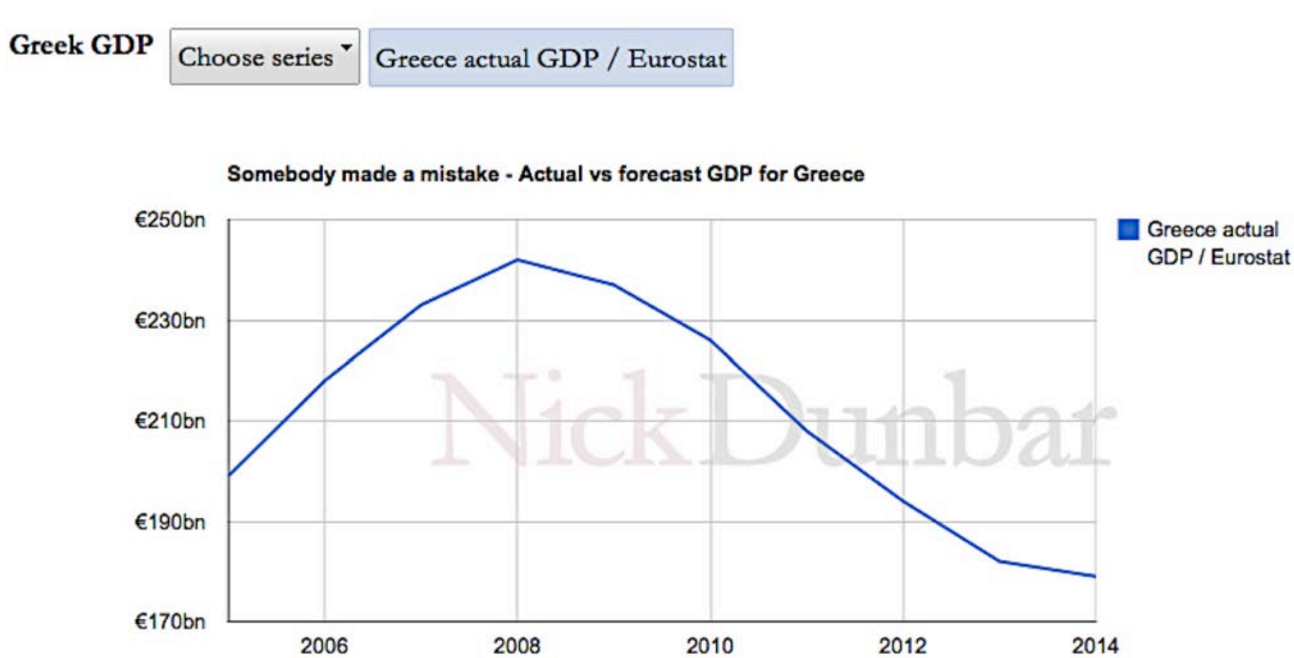
The eternal Greece of the financial engineer's mind

Exactly 12 years ago I wrote about a Greek disappearing act: how in 2001 the country concocted a swap deal with Goldman Sachs to conceal almost €3 billion of debt from its national accounts, to help meet Maastricht ratios. This story refuses to die: a former Goldman banker recently suggested that Greece sue the bank to recover the profits it made on the deal.

Last week I found myself in Munich as part of a discussion whether Greece could shrink its debt again – this time by hundreds of billions of euros. Instead of a secret derivatives deal, the method would be a more transparent bookkeeping adjustment that would bring the country in line with modern national accounting standards. I will return to Goldman in a moment, but let's first consider Greece's present predicament.



In the Munich conference which was hosted by Germany's IFO institute, the driving force was US investor Paul Kazarian, who is believed to be the largest holder of Greek government bonds. In front of an audience of economists, accounting experts and lawyers, Kazarian argued passionately for his idea: if you valued Greek debt on a market value or accrual basis, all the relief measures taken since 2010 would add up to a €200 billion haircut. If you then subtracted Greece's net financial assets of €90 billion from that (this is a Eurostat 2013 figure) then you get to a net debt position of €33 billion, or 18 per cent of GDP.

Although economists at the conference quibbled about some of the numbers (the assets for example), the point is that when compared with the equivalent numbers for Ireland, Portugal or Spain, this looks like a far from unsustainable burden. It doesn't require any new debt relief programme, but merely a recognition in accounting terms of what has already taken place.

Kazarian may have some heavyweight accountants backing his numbers, but the political realities left him sounding exasperated.

On one hand, the Eurogroup, led by Germany's finance minister, refuses to budge from the official €315 billion figure, because it doesn't want to acknowledge the transfer that has already taken place. On the other hand, it suits Greece's Syriza government to say it owes €315 billion because it sounds crippling and gives more negotiating leverage.

In other words, it's OK to say that Greece has had debt relief but not to recognise it in the accounts. Consider the European Stability Mechanism's 2014 annual report which lists the various steps taken since 2010 – repeated debt maturity extensions and interest rate reductions, amounting to an "economic reduction" of 49 per cent of 2013 GDP. Yet when it comes to the balance sheet reporting of Greece's debt, the ESM insists these measures "do not entail any financial loss or writedown".

Instead, current suggestions involve an element of financial engineering: for example, professor Mitu Gulati's proposal at the conference that Greek debt be tranched like a securitisation, with official sector lenders taking the most subordinated, junior tranche. Gulati suggested that this would encourage private sector lenders to invest in Greek debt, but it also amounts to a haircut in all but name. (Gulati was involved with lawyer Lee Buchheit in advising Greece on its 2012 private sector debt restructuring).

Well-intentioned as these proposals are, it's hard not to be reminded of deals like the Goldman swap. Twelve years ago, it was about making the debt appear smaller with Eurostat's tacit agreement. Now it is about keeping it large. With Greece, the theme is always the same: financial engineering deployed to maintain a politically driven illusion.

Since the ultimate collateral for Greece to repay its debt is future growth, we find that this is also fertile territory for the financial engineer's imagination. Back in the time of Greece's entry to the euro, the country busily securitised any future stream of cash flows it could find to raise cash and reduce its debt burden. All of this was a diversion from the real challenge, which was to make Greece competitive within the Eurozone.

Knowing how badly Greece and its creditors failed at that challenge, it's all the more pathetic to see the succession of U-shaped recession-recovery curves that the creditors used to justify the bailouts from 2010 onwards. None of these bailouts could reverse the downward path of GDP, hastened on its way by austerity. Most tragic of all was the fleeting recovery in 2014 (when Greece was fleetingly able to borrow in the private markets once more) now erased in favour of a further downward GDP plunge.

For such an illusion to persist in the minds of intelligent human beings against the repeated contradictory evidence can only mean that rationality is being displaced by an article of faith. And we know what it is: Greece's membership of euro currency itself, something Greece's leaders and its creditor organisations both cling to.

So bad is the pain that one can't be surprised that the Greeks have a heightened sense of victimhood, even though many Greeks acknowledge that the problem starts at home with a culture that make them unable to reform. And it isn't really a surprise that the idea of suing Goldman over that infamous swap deal is now being suggested.

The idea is tempting, because Goldman gouged its client, making over €600 million in a single day as I reported for Bloomberg in 2012. While legal, the deal was wrong and remains a stain on the bank's reputation. However, if I was the Greeks I would be wary about starting a lawsuit.

Not just because success in a London court would be elusive. After all there is plenty of evidence that the Greek government was far from a victim but a "willing sinner" in the words of its former debt chief Christoforos Sardelis. More to the point, by suing Goldman, Greece would risk putting itself on a parallel with Libya, a country far richer than Greece on paper but one that has become a failed state. And even if such a case was winnable, Greece would be once more distracting itself from its real task at hand: reforming itself so that it is capable of attracting investors and repaying them like a normal country.

Until Greeks grasp that nettle they are doomed to remain in a hall of mirrors, trapped in the dreams of financial engineers.

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