The Wall Street Journal

OPINION

http://www.wsj.com/articles/greeces-achilles-heel-1428536815

Greece's Achilles' Heel

The banks are bleeding billions in deposits while the Greek government stonewalls its creditors.

By **WILLIAM R. RHODES**

April 8, 2015 7:46 p.m. ET

In 1980, when Nicaragua's Sandinista government confronted major sovereign-debt and economic difficulties, I had a meeting in Managua with Fidel Castro, a close ally of the country's leader, Daniel Ortega. I was Citibank's senior vice president in charge of operations for Latin America at the time and Cuba's leader bet me that I could not conclude a restructuring deal in the near future. I won the bet, and Fidel sent me a box of cigars.

That was the good news. The bad news was that Nicaragua did not comply with the signed agreement. The result was that it could not return to the capital markets for many years and the economy continued to suffer.

The lessons from those events are relevant today. Syriza, Greece's left-wing party, like Nicaragua's Sandinistas, came to power determined to confront the country's foreign creditors.

Alexis Tsipras, Greece's prime minister

PHOTO:YORGOS KARAHALIS/BLOOMBERG

The Greek government has promised to make a crucial, €450 million (about $492 million) debt repayment to the International Monetary Fund due on Thursday. But it has yet to start negotiating seriously about a long-term solution to its debt crisis. The government needs to understand that creditors have long memories and want assurances that it will live up to the terms of whatever deal is struck.

Over the past 35 years I've helped negotiate solutions to sovereign-debt crises across Latin America, Asia and Europe. The pressure to negotiate in earnest often came from the financial markets, notably rising levels of capital flight. In this regard the banking system is Greece's Achilles' heel. Greek banks have lost more than 15% of their total deposits

since November, with outflows of €20.4 billion ($21.9 billion) in the first two months of this year. Capital flight is usually stimulated by devaluation fears. In Greece's case, given that its citizens hold euros, the prime cause is fear of a banking crisis like the one in Cyprus in 2012.

The European Central Bank cannot continually increase funding to Greek banks without undermining its own credibility. Capital controls would at best provide the banks with some short-term relief, but they would not deal with Greece's core problems. Moreover, past crises have shown that there is never a white knight able to ride to the rescue—despite rumors that the Greeks may turn to Moscow and Beijing for aid.

In 2012, Greece restructured about €206 billion of government bonds, which were mostly held by private foreign creditors. But it failed to implement changes that would put its economy on a growth path. Meanwhile, Greece increased its debt to foreign public creditors—and Greek debt now amounts to around 175% of its gross domestic product.

This debt, held by foreign governments and central banks, has to be restructured—at a minimum the maturities need to be lengthened and the restart of debt-service payments postponed. Creditors in almost all past debt crises agreed to take losses, and this crisis should be no different.

But a deal must also involve tough economic policy conditions, including budget discipline, privatization, pension and labor reforms, deregulation to encourage investment, and effective tax collection. The negotiations need to be hammered out behind closed doors with participants being warned not to speak to the press. There were never television cameras around during crucial debt negotiations for countries such as Brazil, Mexico and South Korea.

The short-term goal of the sovereign-debt negotiations in which I participated was to end with a statement that would calm financial markets, provide citizens of the debtor country with some confidence of future economic growth, and offer a path by which the debtor nation could once again have access to credit in international capital markets. These are the objectives that the Greeks and their creditors should focus on.

Sovereign-debt deals have the best chance of succeeding if they are not seen as being imposed by the creditors, but rather owned and authored by the debtor country's government. This would give the Greeks a greater chance of creating domestic political support for necessary, but inevitably painful, economic changes that will return the country to sustained growth.

Mr. Rhodes is president and CEO of William R. Rhodes Global Advisors and author of "Banker to the World: Leadership Lessons From the Front Lines of Global Finance" (McGraw Hill, 2011).