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Greece Faces Debt Restructuring or Default, Mundell, Hanke Say

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By Piotr Skolimowski

May 26 (Bloomberg) -- Nobel Prize winning economist Robert Mundell said debt restructuring may be “inevitable” in parts of the euro area and Steve Hanke, the architect of currency regimes from Argentina to Estonia, warned a Greek default may become unavoidable.

Mundell, who won the economics prize in 1999, predicted debt restructuring for “one or two” euro nations within five years. Hanke of Johns Hopkins University said Greece’s “death spiral” will end in default if debt obligations can’t be renegotiated.

Euro-area ministers agreed on May 2 to provide 110 billion euros ($135 billion) of aid to Greece as the country struggled to control a deficit that reached 13.6 percent of gross domestic product last year, more than four times the European Union limit. When that failed to stop the euro’s slide, the EU and International Monetary Fund offered a financial lifeline of almost $1 trillion to member states.

“Greece’s death spiral will end with debt restructuring or the outright default of its sovereign debt,” Hanke wrote in an article on the website of the Cato Institute in Washington D.C. dated yesterday. “While politicians and bureaucrats from the EU, IMF and Greece tell us that the bailout package will defuse Greece’s time bomb, don’t believe their ‘cheerful Charlie’ chant.”

Not ‘Deconstruction’

Mundell, whose Nobel Prize was for work on exchange rates and capital mobility, said at a conference in Warsaw today that “debt restructuring may be needed for one or two fiscally weak euro members. In five years it may be inevitable, but it doesn’t mean euro deconstruction, it just means debt restructuring.”

Europe needs greater fiscal centralization, including the creation of euro-area Treasury notes and bonds, Mundell said.

“The euro has done marvelously well in its 10 years of existence, but it is operating with one of its two hands tied behind its back,” Mundell said. “There is no area bill like a U.S. Treasury bill. A euro-area bill will greatly improve the ascent of the euro as the reserve currency along the dollar.”

Europe’s currency has dropped 14.2 percent against the dollar this year, the biggest loss among its 16 most-active counterparts, according to data compiled by Bloomberg. It traded at $1.2283 as of 6:20 a.m. in London, after dropping to a four- year low of $1.2144 on May 19.

Exit Possible

Nouriel Roubini, the New York University professor who predicted the global financial crisis, also warned today that financial markets aren’t “credibly” convinced Greece will control its budget deficit.

The euro will weaken further, and some countries may be forced to abandon the common currency, Roubini said at a conference in Bucharest, Romania today.

“I’m not predicting the breakup of euro zone, but the probability is not zero that some of weakest members of euro zone might decide to exit it,” he said.

There are also concerns Spain and Portugal as well as Greece lack the political will to cut spending, Roubini said. Greece pledged to implement austerity measures equal to almost 14 percent of GDP in exchange for the EU rescue funds.

“The markets are not credibly convinced Greece can do the fiscal adjustment it engaged to do,” Roubini said. There are “also questions whether, from a political point of view, there’s going to be support for budget consolidation in these countries -- Greece, Portugal and Spain.”

Double-Dip Risk

Without the option of currency devaluation, Greece needs to push through tax reform to improve its competitiveness, Hanke said. The country ranks 109th in an “ease of doing business” survey of 183 countries, according to the World Bank.

“Without growth, Greece is doomed,” said Hanke, who was an architect of currency policy in Indonesia, Venezuela, Estonia and Kazakhstan among other nations.

There are “serious economic difficulties in the euro zone,” Roubini said today. “There’s even a risk of a double- dip recession.”

The 16-member euro area emerged from its five-quarter recession in the three months through September. A double-dip recession would mean the region’s economy contracting again for at least two consecutive quarters.

The euro region economy will grow 0.9 percent this year after contracting 4.1 percent in 2009, the European Commission estimated May 5. Germany, the bloc’s biggest economy, will expand 1.2 percent in 2010 and 1.6 percent next year. Greece’s economy will contract 3 percent this year and a further 0.5 percent in 2011, the commission estimates.

Greece would benefit from scrapping employer contributions to payroll taxes and imposing a uniform value-added tax rate, Hanke said. Such measures would boost competitiveness “roughly” equivalent to a 40 percent to 45 percent currency devaluation, he said, citing research by Domingo Cavallo, Argentina’s former Economy Minister, and Joaquin Cottani, former Undersecretary of Economic Policy in Argentina.

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