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Financial political power and the role of the Institute of International Finance in the Greek debt restructuring

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Abstract

Much has been written about Greece and the largest debt restructuring in history that occurred as part of the Eurozone crisis in 2012. Nevertheless, little attention has been paid to the precise role of the financial industry representative, the Institute of International Finance (IIF), throughout these restructuring negotiations. By most accounts the role of the IIF is either largely ignored (Porzecanski 2012) or else the organisation is portrayed as little more than a reflexive defender of financial interests (Zettelmeyer et al. 2012). I argue that this latter perspective is a greatly simplified interpretation of what was in fact, a sustained and highly complex political engagement on the part of the financial industry's leading private business association. On a theoretical level, the case of Greek debt restructuring actually highlights the tension between the automatic and impersonal forces of financial market sentiment, and the conscious and intentional engagement of financial sector elites on behalf of the general interests of the financial industry. EU authorities had resisted debt restructuring until the absolute final moment for fear of destabilising financial markets and setting off a chain reaction of capital flight across the Eurozone economy. Paradoxically, while major European banking institutions were a prime beneficiary of this structural power - allowing them to slowly offload approximately €100 billion of private debt exposures - they were also substantially threatened by these market forces which engendered the prospect of a disorderly default and a potentially cataclysmic Eurozone break-up and/or regional banking collapse. For this reason, the IIF was invited in by EU authorities to act as representative on behalf of the industry in order to facilitate concerted action by financial institutions and negotiate a voluntary write-down that would be acceptable to the majority of Greek creditors. The IIF proved highly successful in securing agreement on a substantial creditor write-down - offset in part by a range of generous creditor-friendly inducements - but also agreeing to coercive legal action by the Greek government in order to side-line a minority of 'rogue' financial actors that could scupper the deal. The case thus provides evidence of significant divisions between regulated (i.e. major banks) and non-regulated (i.e. 'vulture' hedge funds) elements of the financial industry and their competing prerogatives over the long term stability of financial markets.

Keywords

Financial political power; debt restructuring;

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Introduction

This paper examines the exercise of financial political power throughout the Greek debt crisis and in particular, focuses on the central role played by the Institute of International Finance (IIF). By most accounts the role of the IIF is either largely ignored (Porzecanski 2012) or else the organisation is assumed to be little more than a reflexive defender of financial interests (Zettelmeyer et al. 2012). I show that this latter perspective is a simplified interpretation of what was in fact a highly complex political engagement by financial firms leading private business association to function on behalf of the long term interests of the industry. As the structural power of financial markets engendered the prospect of a Greek disorderly default and a catastrophic Eurozone break-up and/or regional banking collapse, the IIF was invited in by EU authorities to assist in securing agreement on a debt restructuring deal. While major European banking institutions were a prime beneficiary of this structural power - allowing them to slowly offload approximately €100 billion of private debt exposures - their long term viability was simultaneously threatened by a destabilised and uncertain market environment. As such, the IIF had strong incentives to act in the industry's far-sighted interest by facilitating a substantial voluntary writedown. By contrast, short-sighted 'vulture' funds that had entered the Greek market to capitalise on profitable bond yields had little interest in long term stability and as such, posed a collective action problem for the IIF to overcome in negotiating the restructuring deal. Despite the failure to achieve a substantial writedown at the first attempt in 2011, renewed political and economic turmoil throughout the Eurozone area brought the EU and IIF back to the negotiating table with a sense of urgency. At the second attempt, the IIF and EU authorities agreed to coercive legal action by the Greek government in order to side-line a minority of 'rogue' financial actors that could scupper the deal. The IIF eventually proved successful in securing agreement on a substantial creditor write-down which was offset in part by a range of generous creditor-friendly inducements. The case provides evidence of significant divisions between regulated (i.e. major banks) and non-regulated (i.e. 'vulture' hedge funds) elements of the financial industry and their competing prerogatives over the long term stability of financial markets. Importantly, it also provides evidence of a sophisticated political role played by the IIF to mediate structural market forces and operate on behalf of the 'enlightened' general interest of the wider financial industry.

The paper proceeds in four parts. In the first section I explain the fateful decision by EU authorities to forgo the option of immediate debt restructuring in Greece due to the fear of spreading financial market panic throughout the entire European banking system. As such, the structural power of bond markets held enormous sway over EU decision-making and facilitated the gradual offsetting of privately-held Greek government debt onto public balance sheets. In the second section, I show how this policy of avoiding debt restructuring was eventually recognised to be untenable and as such, the IIF was invited in to negotiate a voluntary writedown on behalf of the financial industry. The IIF was conferred this salient political role on the basis of their embedded position with senior EU officials. However, the first attempt at debt restructuring failed because of a failure to appreciate the level of writedown that would be necessary to satisfy financial market unease over the trajectory of Greek debt. The third section explains IIF efforts to negotiate a larger and more credible voluntary writedown which would be enabled by narrowing the negotiation process to a much smaller group of experienced debt restructuring insiders. The fourth section unpacks the specific details of the final restructuring deal which was skewed towards the interests of long term focused bondholders over and above the interests of short term investors. The paper concludes with a brief summary of the operation of financial political power throughout the Greek debt crisis.

Section 1: The Euro design flaw and the structural power of finance

Design flaws in the political-economic construction of the Eurozone facilitated an exceptionally high degree of structural power of financial actors over other political and social concerns, and rendered Eurozone member-states powerless in the face of a severe external shock. In the absence of fiscal union and the inability of peripheral member states to devalue their currency/monetise their debt, the only option left to them is to pursue harsh internal devaluation as a way of regaining debt sustainability. Shackled to a deflationary recovery policy, the yawning budget deficit of Greece aroused severe investor doubts about the nation's ability to finance maturing bonds on an on-going basis. Under normal circumstances, the sovereign's central bank would provide a 'lender of last resort' guarantee of payment by providing the necessary liquidity required to honour maturing loans. However, Greece was unable to rely upon a lender of last resort because the ECB would provide no *explicit* guarantee to financial markets that it would act to support sovereign borrowing. As DeGrauwe puts it:

> "The absence of [a lender of last resort] guarantee makes the sovereign bond markets in a monetary union prone to liquidity crises and contagion—very much like banking systems were before central banks backstopped them as lenders of last resort." (2011)

Taking the place of more traditional speculative attacks on currencies and falling exchange rates, falling bonds prices indicated adverse market sentiment towards the sustainability of Greek government debt (Lapavitsas et al. 2010: 325). Ironically, access to extremely cheap cash in an environment of low interest rates incentivised the financial sector to search for higher yields in the bonds of struggling governments. Reinforced pressure upon Greek and other periphery bonds was thus a direct result of the ECB's skewed mandate to maintain bank liquidity but not member state liquidity.

The unlikelihood of a Greek recovery of financial health through austerity and internal devaluation was widely recognised and, as such, the option of a default/debt restructuring/creditor write-down was brought up at the outset by a range of high profile commentators (Roubini and Das 2010; Wolf 2010)[1]. Nevertheless, the Troika (the IMF, the ECB, and the European Commission) made the decision in May 2010 to move ahead with a €110 billion bailout package. The most contentious aspect of this package was that it eschewed the prospect of debt restructuring, instead dispensing the money to Greece so that it would be able to pay off existing and maturing bondholders up front in return for a commitment to fiscal retrenchment and a supervised structural adjustment programme. In 2013, an official IMF retrospective report into this bailout provides a remarkable (and politically controversial) insight into the thinking behind the process. Regarding the issue of a potential debt restructuring, the report notes:

> "One way to make the debt outlook more sustainable would have been to attempt to restructure the debt from the beginning. However, PSI [private sector involvement] was not part of the original programme. This was in contrast with the Fund programme in Uruguay in 2002 and Jamaica in 2011 where PSI was announced upfront. In Iceland in 2008, foreign creditors (albeit private bank depositors) were

[1] As the Greek debt deepened the chorus became louder, including for instance, Robert Mundell - a leading figure of OCA theory and 'intellectual father' of the Euro (Skolimowski and Ummelas 2010).

> bailed in ex ante via capital controls, …Yet in Greece, on the eve of the programme, the authorities dismissed debt restructuring as a "red herring" that was off the table for the Greek government…In fact, *debt restructuring had been considered by the parties to the negotiations but had been ruled out by the euro area* [my Italics]" (2013: 27)

We will come to the precise reasons why European authorities ruled out debt restructuring further below. However, important to understand is the distributional effect of a strategy that in fact broke precedent with previous official sector efforts to deal with such a severe national debt crises (Bucheit and Gulati 2013: 55[2]). In essence, the bailout programme simply postponed the inevitable, yet allowed crucial time for private creditors to gradually wind down their exposures. Continuing, the IMF report suggests that:

> "The delay provided a window for private creditors to reduce exposures and shift debt into official hands. This shift occurred on a significant scale and left the official sector on the hook…An upfront debt restructuring would have been better for Greece although this was not acceptable to the euro partners" (2013: 28-33)

Thus, the European authorities were in fact guaranteeing financial participants of timely and upfront payments, while at the same time undermining the prospect a Greek recovery. In total, roughly €100bn of Greek government debt progressively migrated from the private to official sector (see table 1); an occurrence that would have important strategic implications for the sustainability of Greek structural adjustment further down the road - even with an eventual 50% principal write-down of private debt in 2012.

Table 1: Composition of holdings in Greek Government Debt (billions of Euros)

	May 2010 (First bailout)	July 2011 (Failed first restructuring attempt)	February 2012 (Pre-restructuring)	April 2012 (Post-restructuring)	December 2012 (Post official sector buyback)
Private Sector	303	213	206	71	35
Official sector	n/a	50	60	189	228
Total Greek	320	345	365	280	304

[2]The authors note that in the Latin American Debt crises, official sector authorities explicitly refused to lend out money for the full repayment of maturing loans until some form of restructuring had been agreed between debtor nations and creditors – a key difference with the handling of the Eurozone sovereign debt crisis.

debt					
Private creditor % of Greek debt	94%	62%	56%	25%	11.5%

Source: Authors calculations from Eurostat; Financial Times; Jones 2012.

Continuously rising bond prices acted as a weathervane for the likelihood of a Greek default and in turn, the markets correctly perceived the need for the country to restructure its debt The announcement in May 2010 of the first bailout plan eased fears for a matter of weeks before a downgrade in June resurrected the upward trend, climbing steadily until early 2012. However, at the same time – crucially - it is also true that bond markets signals regarding the threat of a Greek default had *a double edged character* to them: namely, that financial movements were also reflecting bond market fears of being 'bailed in' to any potential restructuring deal. Ultimately, the Eurozone was in a catch-22 as to how to deal with a prominent tension in bond market fluctuations: on the one hand, reflecting an acute necessity for restructuring to enable a viable Greek debt trajectory, and on the other, a fear that authorities would begin imposing losses on private creditors.

Given the dilemma, the decision to postpone restructuring during the period between 2010 until 2012 entailed a critical risk-trade-off calculation on the part of policymakers, largely framed by the anticipated reaction of financial market participants. In this regard, several interrelated considerations on the part of Eurozone officials require further scrutiny. A primary concern was the threat of contagion to other parts of the Eurozone area, particularly to other periphery economies in the crosshairs of financial markets. Eurozone officials feared that a creditor bail-in of Greece would trigger a "Lehman-type event" resulting in banking runs and rising borrowing yields for already embattled Eurozone economies (IMF 2013: 27). The level of financial market exposure to these nations was enormous, with a calculation by Jacques Cailloux – Chief economist at the Royal Bank of Scotland – of approximately €2 trillion of public and private exposure to Spain, Portugal and Greece by all foreign institutions (Ishmael 2010). Furthermore, rising debt yields would also depress the price of corporate bonds, thereby hindering investment and growth, and turning liquidity pressures into solvency pressures even faster. The ultimate threat on the horizon of course was the breakup of the entire Eurozone which constituted a calamitous economic cost not just to Europe but the entire global economy (UBS 2011). Accordingly, the strategy decided upon by Eurozone officials would be to forego any kind of Greek debt restructuring, thus buying enough time to erect more substantial firewalls around other vulnerable economies – what the IMF review referred to as “a holding operation” (IMF 2013: 28). However, this strategy seemed to engender those very consequences that officials were trying to avoid, as market turmoil throughout the middle and end of 2011 pushed the currency block to the brink of collapse, only to be rescued by emergency Securities Markets Programme (SMP) purchases by the ECB.

However, the most salient reason behind the resistance by Eurozone officials to an initial Greek debt restructuring relates to the massive levels of exposure that other *systemically important* European banks had to Greek government debt: this included in particular, BNP Paribas, Credit Agricole, Societe Generale, Groupe BPCE, Deutsche Bank, Commertzbank, UBS, Credit Suisse, ING, HSBC, RBS, Unicredit, and Dexia. Unsurprisingly, domestic banks in Greece also held a significant portion of Greek debt, especially Alpha Bank, Piraeus Bank, Eurobank ERG, and National Bank of Greece. As such, it was clear that any creditor losses would inflict significant damage upon core European banking systems, already struggling in the aftermath of the global financial crisis of 2008 (See table 2).

Table 2: National banking system’s exposure to Greek Government Debt in early-2010

Country	Amount (Dollars)	% of total exposure
France	75.7 billion	25%
Switzerland	64.4 billion	21%
Germany	43.2 billion	14%
United States	16.4 billion	5%
United Kingdom	12.3 billion	4%
Netherlands	11.8 billion	4%
Others (incl. Greece)	79.4 billion	26%
Total	303.2 billion	

Source: Der Spiegel (Based upon BIS calculations)[3]

[3] Chart available at: http://www.spiegel.de/images/image-57832-galleryV9-gxwr.jpg [accessed August 30th 2013]

This consideration was intrinsically connected to Eurozone officials worry about contagion, except this time from the perspective of member's states private financial firms. Unquestionably, losses to Greek creditors would have inflicted damage upon the wider European financial sector. Nevertheless, given the scale of the European financial sector, in and of itself, the losses were likely manageable. However, Greek restructuring would have sent a clear signal about the strategy for dealing with broader European sovereign debt troubles, thus putting bond investors on notice for future bail-ins in Spain, Portugal, Ireland and Italy. Fallout from exposures to these nations collectively was *decidedly unmanageable*.

In summary, the threat of Eurozone contagion - and the response by financial markets - was the most prominent concern to policymakers in their deliberations on a potential Greek restructuring and private sector haircuts. Ultimately then, the €110 billion bailout of Greece in May 2010 became a bailout-by-proxy of core European banking firms and other financial institutions. Two important analytical points can be made on this basis. Firstly, as has been argued throughout, the predominant concern of European policymakers related to the structural power of financial markets and the potentially damaging impact that financial sector losses would have over the entire Eurozone – indeed global – economy. This fear trumped all others, as the potential impacts were numerous, including: further taxpayer bailouts, higher government debt levels, higher financing costs for large and small business, lower lending rates, liquidity concerns, and on-going contagion problems both regionally and globally. Secondly, the distributional impact of delayed Greek debt restructuring illustrates the limitation inherent in viewing the Eurozone crisis from a strict nation-state perspective. Certainly, European governments from the core were primarily concerned with protecting their own national banking systems – however, the net effect of the Greek bailout meant that core European taxpayers were providing funds to governments in periphery member states, so that they could repay in full and on time the outstanding loans of private financial firms based in both the core and periphery. Furthermore, the ultimate cost would of course be borne by citizens of periphery nations through austerity and deep structural adjustment programmes. As such, these decisions – adopted by political elites and favourable to financial actors - had a substantial class character to them. Such a perspective offers a more multi-layered and precise assessment of the impact of such contentious decision-making. Nevertheless, as it transpired, the 'holding operation' policy adopted by the Troika would prove to have a limited life-span.

Section 2: The growing involvement of the Institute of International Finance

From approximately the end of 2010 to eventual debt restructuring in March 2012 the financial sector largest business association, the IIF, came to play a key role in the handling of the Greek crisis. The motivation for the IIF to engage as a representative in the crisis ran in both directions from the public and private sector. From the IIF point of view, the organisation became anxious that continuing Eurozone instability would tempt public officials to begin a "more dictated top-down process" in dealings with creditors (IIF 2011a: 9). From the point of view of Eurozone officials, the IIF could provide a conduit for policy communication to the broader financial sector, allowing them to directly transmit positive signals regarding Eurozone policymaking to the financial sector, and thus, attempt to gain some form of control over structural forces causing such instability and contagion - in a sense, similar to how the concept of 'forward guidance' works for central banks. Additionally, on a practical level, the IIF provided a central institutional platform through which the Eurozone could negotiate with such a diverse array of creditors holding peripheral government debt, while also providing substantial technical expertise throughout the restructuring process.

However, as important as these mutual interests in collaboration were, they were not the only factor in IIF involvement. There were also a plethora of professional and informal elite linkages between Eurozone officials and individuals from the IIF which would serve to encourage dialogue based upon pre-established lines of trust and on-going working relationships. Reference to the two institutional IIF bodies that deal with debt management – the Principles Group of Trustees (GoT) and the Principles Consultative Group (PCG)[4] – illustrates the close private-public interconnections that made the IIF a predictable go-to forum for Eurozone officials. Jean Claude Trichet's role as co-chairman of the GoT provided an explicit avenue of professional engagement[5]. However, from the public sector, the GoT also included Deputy Governor of the Bank of Italy, Fabrizio Saccomanni and German State secretary Jorg Asmussen from the ministry of finance. Asmussen would later play a key negotiating role in the final Greek restructuring deal, as he was promoted to the powerful position as member of the executive board of the ECB in January 2012. Equally important

[4] The 'Principles' is the name given to an IIF informal code of conduct for dealing with voluntary sovereign debt negotiations between creditors and debtors.

[5] Trichet would eventually be replaced as Co-chair of the IIF GoT by Christian Noyer, current Bank of France governor and chairman of the board of directors for the BIS, as well as former ECB Vice President. Noyer would also be involved in the eventual Greek debt restructuring negotiations.

were the connections of financial market actors with a role in either the GoT or the PCG who would have direct access to their national political counterparts, particularly in Germany and France. Chief among these were Josef Ackermann and Caio Koch-Weser of Deutsche Bank, Klaus Peter Muller of Commertzbank, and Jacque de Larosiere and Jean Lemierre as advisors to BNP Paribas. Jean Lemierre, in particular, had been president of the European Bank for Reconstruction and Development from 2000 to 2008, and as such, the IIF's choice for him to act as the leading negotiator of the Greek private creditors committee in 2011 and 2012 was not surprising. De Larosiere was well known within political circles and had been tasked with conducting the EU supervisory overhaul in the wake of the crisis[6]. Thus, IIF access to Eurozone consultations was not simply procured on a functional and practical basis, but on the basis of longstanding professional relationships which conferred to the organisation an 'insider' political status.

As the first bailout programme proceeded, it became clear that Greece could not survive for that long without some form of additional debt relief, and so, by the summer of 2011 Eurozone leaders had agreed to tie a second Greek bailout plan to the attainment of a *voluntary* Private Sector Involvement (PSI). The IMF was also an important force behind this policy shift, arguing in its periodic structural adjustment review that it would be unable to commit further funds to the Greek programme in the absence of some form of creditor contribution, and stressing that PSI should be voluntary in order to avoid the occurrence of a "credit event" (IMF 2011a: 27). These considerations had prompted the debt swap proposal of French banks, discussed above as too favourable to creditors. Such circumstances lent themselves to the involvement of the IIF, as the organisation had the institutional capacity to easily communicate with a wide range of creditors in an effort to craft voluntary proposals. Furthermore, by positioning themselves as an "honest broker" (IIF 2012a: 44) between the private sector and the Eurozone, the IIF appeared more likely to produce a credible proposal that offered Greece meaningful debt relief and strike a balance in the long run interests of financial stability. Accordingly, in mid-June the Eurogroup Working Group (EWG) – primarily involving member-state finance officials, and representatives from the EU commission, the European Financial Stability Facility (EFSF), the ECB, and the IMF – tasked the IIF with getting Greek creditors to collaborate and agree upon the correct "form and volume" of PSI, with the aim having an appropriate creditor contribution in place for the

[6] These individuals represent just a selection of professional and informal crossovers between the IIF GoT/ PCG and the Eurozone. For a complete list of GoT/PCG members, see IIF 2011a (41-44).

upcoming Euro summit in July (IIF 2012a: 44). The IIF swiftly arranged an ad-hoc Task Force for Greece composed primarily of firms that were major holders of Greek government bonds

In a highly co-ordinated arrangement, a new bailout deal for Greece involving voluntary PSI was due to be announced at the Euro Summit of July 2011, widely heralded to be the first serious step that Eurozone officials had taken to definitively put an end to the turmoil gripping the Eurozone area (by then even threatening to spread as far as the French bond market). Negotiations in the run-up to the summit took place within an incredibly complex political milieu primarily involving the competing interests of Germany, France, Greece, private creditors, the European commission, the IMF, and the ECB. The governments of Germany and Greece had become eager for a substantial private sector contribution - partially to correct the Greek debt trajectory, partially to assuage popular domestic anger opposed to on-going bailout costs. Furthermore, it was seen as an essential step towards a realistic recovery by the IMF and high profile economic observers. France was considerably more hesitant due to their banks extensive exposure to Greek debt. As such, they proposed the idea of a Eurozone bank tax that would raise funds towards a Greek write down - in effect, mutualising the cost of debt reduction across core Eurozone countries and thus evading the disproportionate effect that PSI would have on the French banking system (Spiegel and Peel 2011). The ECB remained committed against the notion of imposing any creditor losses and threw into question the acceptance of Greek securities as valid collateral if any form of default occurred. For his part, Manuel Barosso of the EU commission berated all sides in an illustrative depiction of each party’s respective concerns: Germany for resisting the idea of utilising EFSF bonds to support a Greek write-down (shifting further costs upon German taxpayers), France for stalling significant PSI to protect their national banks, and the ECB for threatening the liquidity status of the Greek government (Waterfield 2011).

In the event, Germany emerged the most victorious with the July 21st deal involving a renewed €109 billion euro programme for Greece, and incorporating a headline 21% net present value loss for private investors with no mention of a bank tax. The deal also involved an extended role for EFSF bonds which would facilitate lower interest rates and extended maturities to ease the Greek debt burden and stretch out repayment times. In order to get the ECB (and France) on board, the EFSF was also given the capacity to buy up peripheral Eurozone bonds in the secondary market in order to maintain the integrity of the ECB balance sheet, and be used for recapitalisation of ailing financial institutions. The agreement also came with explicit commitments that the PSI was a once-off deal, undertaken due to the "exceptional and unique" situation that Greece found itself in (European Council 2011).

The IIF negotiating team was headed by both the managing director Charles Dallara and chairman Joseph Ackerman – the latter who would facilitate close interactions with Angela Merkel and the German goal of a 21% write-down for creditors. Interestingly, Dallara played a key role in convincing the Greek government of the wisdom of restructuring. As reported by the New York Times:

> "Paradoxically, it was a representative of the banking industry, perhaps more in tune with the realities of the marketplace, who finally insisted that Greece could not borrow and cut its way out of the crisis without restructuring its debt. ''There was shock and surprise on their faces,'' Mr. Dallara recalled. ''They could not believe it.'' Even though work proceeded on a haircut plan, the Greeks were reluctant to participate. ''They were being passive,'' Mr. Dallara said. ''I think they felt this was being driven by the European governments and they were not sure how to grab hold of the issue.''"
>
> (Thomas and Castle 2011)

Provided the target of 21% was met, the IIF had substantial scope in shaping the precise mechanics behind the write-downs. Thus, the details of the plan itself provided a range of options for private investors to choose from, coaxing them into accepting the deal by selecting a write-down exit that would be most preferable in terms of their investment strategy. The options – four in total – included:

- A 30-year par bond exchange with coupon rates between 4 to 5%
- A 30-year par bond rollover on maturity, with coupon rates between 4-5%
- A 20% discounted bond into a new 30 year bond with coupon rates between 6 to 7%
- A 20% discounted bond into a new 15 year bond with coupon rate of 5.9%

The latter two options implied an up-front debt reduction for Greece, whilst the first two options stretched the bonds involved[7] over a much longer period of time, thus easing the load on more immediate Greek repayments. All options however - according to the IIF - represented a common 21% reduction in net present value premised upon an assumed average discount rate for the current bonds of 9%. Furthermore, provided the exchange secured a 90% participation rate, the IIF argued that this would result in PSI of roughly €130

[7] Note that only those Greek bonds maturing between 2011 and 2020 were targeted for restructuring in the July 21st deal, unlike the successful restructuring in February 2012.

billion of financing – a large portion of which would be frontloaded over the next 3 years (IIF 2011b). Finally, the exchanges would be complemented by a Greek debt-buyback programme involving the Euro-area countries (who would provide €20 billion in financing) and potentially other government contributions (through IMF co-financing) in order to "kick-start" the process of Greek debt sustainability (IIF 2011b).

On the face of things, the July 21st proposed bailout deal seemed like a bold move in order to resolve the crisis in Greek public debt levels and by proxy instil confidence in the adjustment prospects of the entire Eurozone periphery. Eurozone authorities had unveiled an array of new powers for the EFSF, utilised a variety of novel funding arrangements, and broken the taboo of implementing a creditor write-down without sparking any immediate market panic. Nevertheless, despite impressive headline figures, the IIF calculations were quickly called into question. In particular, it did not seem appropriate for the IIF to compare the value of the newly exchanged bonds with the full face value of the old bonds (reflecting a 21% NPV decrease at a presumed 9% discount) especially when market valuations of these bonds were sporting a highly vulnerable 'C' level grading by rating agencies. As such, the level of creditor write-down was in fact closer to half the proposed 21%, perhaps less depending on discount assumptions (Zettelmeyer et al 2013: 7-8). Crucially, the implications for Greek debt relief and budget sustainability were perceived by market analysts as extremely modest: according to Morgan Stanley's European market research, while the deal would certainly improve the short run liquidity of Greece, it did little to address longer-term insolvency. Based upon their projection, while debt to GDP would peak at a lower level in 2013 at 155% (compared to 162% without the deal), by the medium term of 2017 the debt ratio would still remain at an intolerable 143%[8] - just 13% lower as a result of the bailout plan (Morgan Stanley 2011: 9). Thus, the threat of a more severe Greek default was still deemed to be very likely, particularly after 2013 – a situation which did not bode well for the price of medium to long-term bonds. Furthermore, 'recovery value' – that which would be recovered in the case of a hard restructuring – was still judged to be at a 45-50% mark. Compounding the issue was the fact that writedowns to Greek banks involved in the debt exchange would also have the effect of increasing Greek funding requirements by an estimate of 3% of GDP (Morgan Stanley 2011). As such, after digesting the details, the first attempt at the second Greek

[8] While the report acknowledged there was no "hard and fast rule" on a sustainable debt levels, it calculated that markets would have confidence in a trajectory reaching 90%-100% in the event of a 'hard restructuring' (2011: 5)

bailout was deemed to be insufficient by financial markets. Thus, after an almost imperceptibly brief drop in yields, the real implications of the deal became clear throughout financial markets and bond rates resumed their incline upwards as a faster pace than had previously seen. This initiated perhaps the most serious phase of the entire Eurozone crisis as yields jumped significantly for all peripheral economies over the next six months with Greek yields soaring into the high thirties on the back of very real Eurozone exit fears. At root, this rise was a rational market response to the absence of credible plan for Greek debt, as the inevitability of a much more severe restructuring dawned upon Eurozone officials in the coming weeks and months.

What were the key factors behind the failure of Eurozone officials, in conjunction with the IIF, to deliver an initial proposal that would have been judged as satisfactory by the structural forces of bond markets? Several elements serve as an explanation. For one, Eurozone officials were simply out of their depth when it came to the process of facilitating a write-down, unlike private financial institutions and in particular, the IIF, which had developed an institutional sophistication with the intricacies of debt restructuring over several decades. According to a number of participants in the negotiations, deliberations had become "chaotic" and "confusing" as the public sector had "little grasp...of the technical issues involved" (Jenkins and Murphy 2011). Little wonder that the July deal produced a generous menu of options for investors, in stark contrast to the more simplified take it or leave it deal produced the following February. Also peculiar was the buyback mechanism - strongly advocated by IIF negotiators and supported by public funds - which raised an obvious question about why this avenue of debt reduction would be chosen over simply pursuing a larger private creditor write-down. Thus, it seems that while Eurozone officials were primarily concerned with overcoming the legion of contrasting policy goals among different member states and institutional bodies – a task which won much applause within European political circles - private creditors were delegated far too much autonomy to craft a proposal on their own terms, providing it attained a 21% write-down. Relatedly, a second element which explains the failure of a viable deal was the pre-agreement upon a 21% write-down. As pointed out by Ardagna and Caselli, the rigid specification of a write-down amount precluded the possibility of Greece haggling for a better deal on debt relief, as creditors were fully aware of the dictated target. As such, the bargaining inherent in standard restructuring agreements was completely sidestepped (2012: 13). Quite likely, this was precisely the intention of Eurozone leaders who were so preoccupied with the potential damage that a write-down could inflict upon the broader European banking system. This view was not without justification, as the collapse of Dexia due to crystallising Greek losses later in the year painfully illustrated. Nevertheless, lack of manoeuvrability for the Greek government contrasted with the character of more formal debt restructuring negotiations in 2012 whereby - armed with a team of experienced advisors and lawyers - Greek politicians had significantly stronger cards to play against creditors. Thirdly, the IIF at this point of the crisis, did not necessarily have the strongest hand to play in terms of convincing private bondholders that it was in their best interest to participate in the restructuring. As appealing as the deal seemed from a creditor perspective, it struggled to reach the proposed target of 90% voluntary participation. Partially, this was unwillingness by some bondholders to crystallise losses at a particularly severe point in the crisis (Financial Times 2011). It was also partially a result of simply not having a clear idea at the time of who precisely owned the private sector bonds, as many offshore hedge funds had entered the Greek bond market in recent months (Saltmarsh 2011). Most of these funds were non-IIF members and were not as amenable as regular banking institutions to restructuring negotiations. In fact, many of these institutions had entered the Greek bonds market precisely for the purpose of buying securities at low prices and holding out in the event of restructuring. This division between regulated, well-known institutions of finance and the more shadowy 'vulture' hedge funds would persist into the February 2012 negotiations discussed further below.

Ultimately, the IIF failed in their first attempt to 'mediate' the structural financial market forces on behalf of the Eurozone authorities – unable to bridge the tension between the short term commercial interests of their members and the more longer terms 'enlightened interest' of market stability. From a purely self-interested point of view, their biggest achievement was in convincing Eurozone authorities to commit to utilising much larger amounts of public money (primarily through the EFSF) while the larger private creditors progressively migrated out of Greek government bonds. European officials tolerated such a circumstance as most of these larger creditors were core European banks. Nevertheless, the first bailout deal would never be implemented as structural market forces condemned the agreement as insufficient. During the course the next six months – October to March 2012 – the IIF and Eurozone authorities would receive one final chance to placate financial markets.

Section 3: Renewed restructuring negotiations

With financial markets throwing off the viability of the first IIF restructuring agreement, the Eurozone entered its most severe stage of crisis in mid to late 2011 as popular unrest throughout the region prompted the IMF to warn in September of a dangerous new "political phase" to the crisis. In a key paragraph from their biannual *Global Stability Report*, the report stressed that;

> "Markets perceive major political economy difficulties as policymakers struggle to raise support for painful adjustment measures selected from a rapidly shrinking set of feasible choices. Policymakers have only limited time to reinforce credibility and build defences against potential systemic shocks" (IMF 2011b: 44)

In the context of the Eurozone crisis, "systemic shock" referred to the distinct possibility of a 'Grexit' – a Greek withdrawal/dismissal from the Eurozone currency bloc - which became a key consideration throughout the course of restructuring negotiations in February 2012[9]. In effect, time was running out and the unravelling of the Euro project posed a severe threat to the entire global economy by triggering a European 'Lehman moment'. In the specific case of Greece, IMF fears over the implementation of structural adjustments were fully justified as popular discontent translated into missed targets and subsequently fudged compliance assessments in order to keep the Greek state (and banking system) liquid. As a result, the IMF – and indeed, countries such as the US - were pushing hard for EU officials commit to a much larger write down for Greek creditors in conjunction with flexible monetary tools and fiscal firepower[10] that would stem contagion channels and ring-fence other banking systems across the Euro area. The collapse of Dexia in early October, as a result of recognising losses on Greek bonds, punctuated the failure of the Eurozone/IMF 'holding strategy' which was now recognised to be spreading – as opposed to containing – financial panic[11].

Renewed negotiations leading to the successful debt restructuring in early 2012 took on a much more 'closed' character and thus resembled the plethora of defaults that had taken place in emerging markets over the previous three decades. The knock on effect of this was that

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[9]Both the political and economic costs of a Grexit were neither fully known nor desired to be contemplated. For an excellent survey of the potential fallout see 'Beware of falling masonry', *The Economist* (2011).

[10] By now, the IMF was targeting precisely those design flaws that enabled financial markets to wreak havoc on Eurozone policymaking.

[11] Nevertheless, the paradox remained: although resisting creditor write-downs was indeed fostering panic, the recognition of losses threatened the stability of core banks and contagion to the periphery. Financial markets bristled at each end of these poles, buttressing the persistent IMF argument that creditor losses needed to be recognised *in conjunction with* core banking recapitalisation and ECB lender of last resort action.

those involved would be able to rely on a range of precedents – in terms of personnel, organisation, legal arrangements, strategic approach, etc. – which would heavily influence the final outcome. As such, the IIF immediately scrapped the original taskforce and set up an official Creditor Committee, which in turn, voted upon an even smaller steering committee that would facilitate in-depth negotiations on behalf of the wider investor community. This core steering committee consisted of 13 members (see table 3), 10 of which were regulated financial institutions from Greece, Germany or France whose governments spearheaded the negotiations.

Table 3: Steering Committee of IIF Private Creditor Committee for Greece

Institution	Home country	Core market
Allianz	France	Insurance
Alpha Bank	Greece	Banking
AXA Group	France	Insurance
BNP Paribas	France	Banking
CNP Assurances	France	Insurance
Commerzbank	Germany	Banking
Deutsche Bank	Germany	Banking
Eurobank EFG	Greek	Banking
Greylock Capital Management	U.S	Investment Banking
ING	Netherlands	Banking
Intesa San Paolo	Italy	Banking
Landesbank B. Württemberg	Germany	Banking
National Bank of Greece	Greece	Banking
Co-chairs of Committee	-	-
Charles Dallara	-	-
Jean Lemierre	-	-

Source: *Institute of International Finance (2012a)*

Such an organisational composition meant that representation of creditor interests became even more highly concentrated, and specifically geared towards the prerogatives of creditors who were (a) officially regulated (b) close to European governments, and (c) had an intimate stake in the overall continuation of the Euro project. Such factors served to delineate a clear distinction between those investors - like the steering committee - who had much to lose from a disorderly default, and those investors - such as hedge funds or short-term speculative holders - with less incentive for constructive deal-making. At the helm of this steering committee was IIF managing director Charles Dallara, and Jean Lemierre, then senior advisor to the chairman of BNP Paribas (a firm that was still one of the largest individual holders of Greek bonds worth roughly €5 billion). Between them, the IIF provided two representatives that had a wealth of experience in restructuring negotiations - crucially, from the perspective of the official sector. Dallara was a veteran of the 1980's Latin American debt crisis, while Jean Lemierre was a former chairman of the Paris Club group of creditors. Lemierre in particular – drafted in after the breakdown of first debt deal - had held key position positions within European circles, including former head of the French Treasury and President of the European Bank for Reconstruction and Development. He was thus well positioned to facilitate compromise with European leaders. Noticeable was the fact that Josef Ackerman, the most intractable in terms of re-negotiating the July deal[12], was not included in the negotiating committee. Neither, for that matter was Vega Asset Management: one of the largest hedge fund holders of Greek public debt and an IIF member that had originally been present in the Greek creditor task force. Signalling the growing split that was beginning to occur between 'long and short' financial interests, Vega had resigned in protest of the new 50% restructuring negotiations, threatening legal action if the deal was to proceed (Spiegel and Mackintosh 2011).

The IIF then, had clearly assembled a team that was most amenable to securing a larger deal, yet it would not be an easy task considering the unwieldy assortment of figures across the table. Key interlocutors from the official sector included Merkel, Schauble, Sarkozy and Baroin from Germany and France, and Jan Kees de Jager from the Netherlands. Also present was IMF lead negotiator Poul Thomson, the ECB's Jorg Asmussen (member of the IIF Group of Trustees for the IIF Principles) along with representatives from the European Commission and the EFSF. Finally, the Greek negotiating team was headed by unity government leader Lucas Papademos and finance minister Evangelos Venizelos. However, perhaps the most important negotiators besides the IIF were the team of lawyers and financial advisors recruited by Greece. Chief among this group was Lee Bucheit from the law firm Cleary, Gottlieb, Steen and Hamilton, who was well known as the 'dean of debt

[12] According to Ackermann himself, Dallara had convinced him of the wisdom of a voluntary deal. Furthermore, Ackermann had loudly protested against reopening write-down negotiation (Beattie and Braithwaite: 2011).

restructuring' due to his work over the course of three decades in practically every major debt crisis on the side of debtor nations. Greece had also recruited the financial advisory services of Lazard, a firm that had been officially advising Greece on its public finances since 2010 and retained the services of Bucheit's former business partner Mark Walker – also a veteran of sovereign debt negotiations. Another key figure from Lazard was Michele Lamarche who had previously worked on high profile debt restructurings in Iraq, Ivory Coast and Argentina, and whose acumen for intelligent deal making proved pivotal for bringing the restructuring to a successful conclusion. Indeed, as early as December 2011, Lamarche had sat down in private with Jean Lemierre and came up with the plan of 'co-financing': an inducement for Greek creditors to accept the restructuring provided the official sector could be convinced that new creditor bonds issued under the exchange would be on a *payment-priority par* with EFSF bonds (one of several inducements central to achieving creditor agreement, discussed in further detail below). Perceptively, in searching for a deal Lamarche later declared that her goal was to "identify the bondholders that are constructive and will be able to apply pressure on their more aggressive peers" – a critical divide and conquer strategy that would serve to put even more distance between the steering committee/other regulated financial peers vis-à-vis more short-term orientated financial institutions that would threaten hold-out, legal action and 'free-rider' non-participation (Chassany and Westbrook 2012).

Due to their involvement with emerging market debt, not only were participants on both sides of the negotiations well known to each other but they were also *well versed in the standard procedures of debt negotiations*. In a telling interview after the debt restructuring, the CEO of Greylock Management – one of the few hedge funds predisposed towards a deal and thus part of the steering committee - chief executive officer Hans Humes conveyed the underlying dynamic of the February/March deal:

> "We're trained, we understood, we've been there before. What's going on in Europe is not unfamiliar to anybody who's been involved in what's now considered to be the emerging markets. What it's telling us is that financial and legal advisers to Greece are also the financial and legal advisers to the Ivory Coast, to Ecuador, to Argentina…when you get a country that has too much debt and it can't afford to pay it, you have to go back to the precedents, and it is the usual gang of suspects who understand what the playing field is" (Humes 2012)

In sum, those directly involved in negotiations drew upon experience which had been prefigured through previous processes of elite interaction and cultivated particular norms of behaviour and expectations. Thus, insulated from broader popular involvement, and in an effort to mediate the disruptive workings of impersonal structural market forces, a handful of senior private creditors, European officials and legal/financial advisors set about crafting a resolution to Greece's private debt burden.

Section 4: The successful debt restructuring of February/March 2012

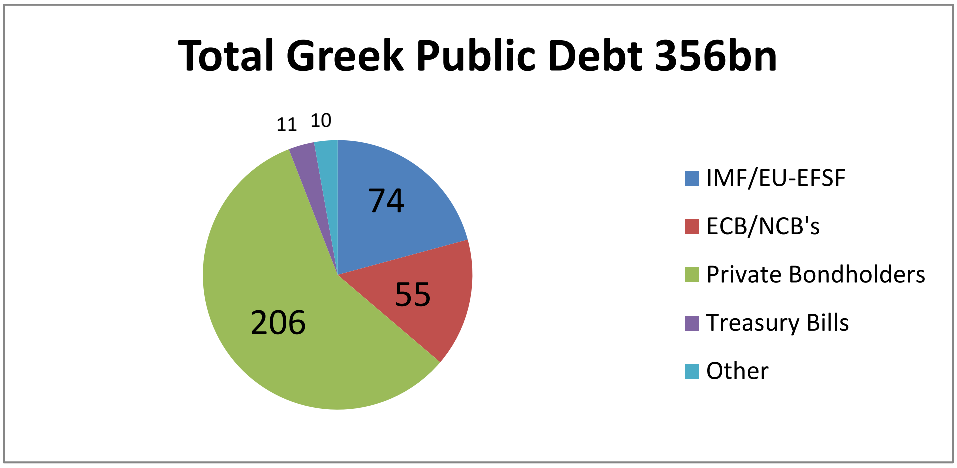
The final deal was 'successful' in so far as it was agreed upon by all those involved in formal negotiations and swiftly implemented without modifications thereafter. This effectively resolved the issue of outstanding private debt and the contagion threat this posed to balance sheets of core financial institutions within the Eurozone. Furthermore, the resolution did not stoke further financial market panic in the aftermath – thus avoiding the fate of rendering the deal redundant as had occurred with so many previous attempts described in this chapter. How particular political-economic issues faced during negotiations were tackled and resolved illustrates much about the power of financial actors, and the IIF in particular. A key aim of negotiators was to assiduously avoid giving the impression to financial markets that private creditors were being forced against their will, and without autonomous input, into the restructuring of Greek bond holdings. Of course, to the extent that any debt restructuring is coercive, it signals the power of debtors over creditors to impose losses, which must generally be weighed against the threat of a loss of credibility in a defaulter's subsequent issuance of securities. Within the Eurozone, the threat of contagion across the periphery as a result of a loss of market confidence in debtor's willingness to honour outstanding debt was a primary factor driving a co-operative approach towards restructuring: Eurozone officials desire to avoid a disorderly default and secure a significantly voluntary process, gave the private sector – as represented by the IIF – important leverage. To frame the issue in terms of a voluntary vs. a coercive participation is ultimately a fiction: in reality, all restructurings are a balancing act between the imposition of a necessary write-down, while providing enough inducements to convince creditors – and by proxy, wider financial markets - that the new deal is in the best interest of all parties concerned *in the long run*. The Greek deal was no exception. With reference to Humes again;

> "I think we had a choice…it's difficult to say 'voluntary, involuntary' -- I don't think anybody wants to walk away from as much debt as we have, but the alternative is just a total default by Greece, and I think that that might actually end up being worse for everybody" (2012)

Total Greek debt at the time of negotiations was approximately €356bn. However, significant proportions of this debt was accounted for by loans from the ECB and other EU central banks, IMF/EU-EFSF bailout funds, and short-term Treasury bills which were to be excluded from restructuring negotiations (see figure 1). While it was understandable that bailout loans were given a protected seniority status, the exemption of ECB and other central bank bonds holdings was a contentious issue. Without publicly demanding so[13], it was clear that both the IIF and the IMF favoured central bank restructuring involvement which would further lighten the load on Greek debt repayments and potentially reduce the private sector contribution. Indeed, ECB fear of this possibility led a European Parliament report to conclude that it was "difficult to refute claims that being a creditor to Greece may have shaped the ECB policy relative to the PSI" (Belke 2011: 14). Thus, with a view towards maintaining both its balance sheet and monetary policy credibility, the ECB was permitted to swap its bond holdings for brand new Greek bonds under exactly the same payment terms, yet excluded from a potential debt write-down. What remained was €206bn worth of private debt (approximately 60% of overall Greek public debt) which was to be targeted for restructuring - significantly more expansive than the failed July 21st agreement which only targeted bonds maturing between 2011 and 2020. Out of this €206bn, €184.3bn (90%) worth of bonds had been issued under Greek law, while €21.3bn (10%) was composed of foreign law bonds[14]. Within these amounts was €9.8bn of Greek guaranteed debt issued by three publicly owned domestic institutions under both Greek and foreign law: Athens Urban Transport Organisation, Hellenic railway Organisation, and Hellenic Defence Systems (Credit Suisse 2012) (see figure 2). Based upon industry estimates, roughly €135bn of overall private bonds were owned by banks and insurance firms mostly comprised of IIF members or under government regulation, and hence, most amenable to restructuring agreement. The wildcard resided primarily with the €70bn remaining worth of bonds in the hands of hedge funds and other independent minority bondholders, most of which (approximately €50bn or 24% of debt held by investors) were outside the purview of the IIF (see figure 3). In an effort to strengthen their hand, several hedge funds had pre-committed to rejecting any offers of restructuring (Jones 2012).

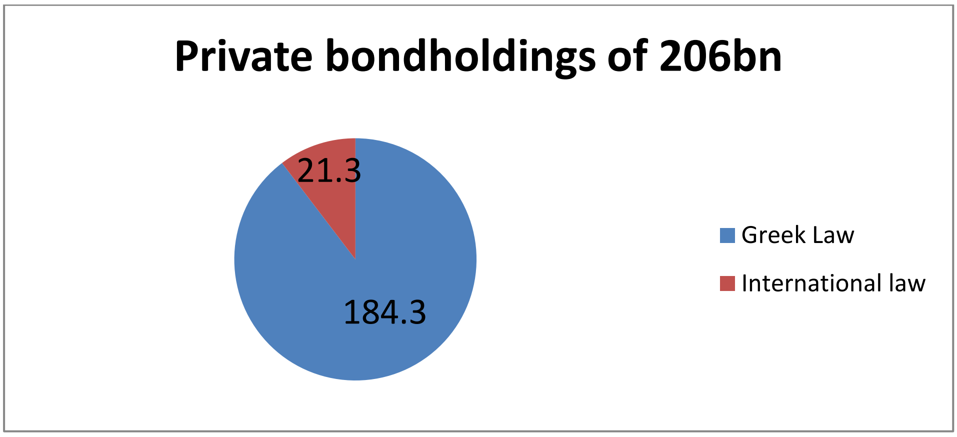
[13] After the restructuring deal, the IIF publicly flagged the issue of private bond holders subordination to ECB purchases and eventually secured guarantee's that future Outright Monetary Transactions (OMT's) would be '*pari passu'* terms - i.e. at the same seniority level – as private investors (IIF 2012a: 49).
[14]Most of these bonds were issued under English law, but also included a minority of Japanese, Italian, Swiss and other International law bonds.

Figure 1: Composition of Greek public debt in February 2012



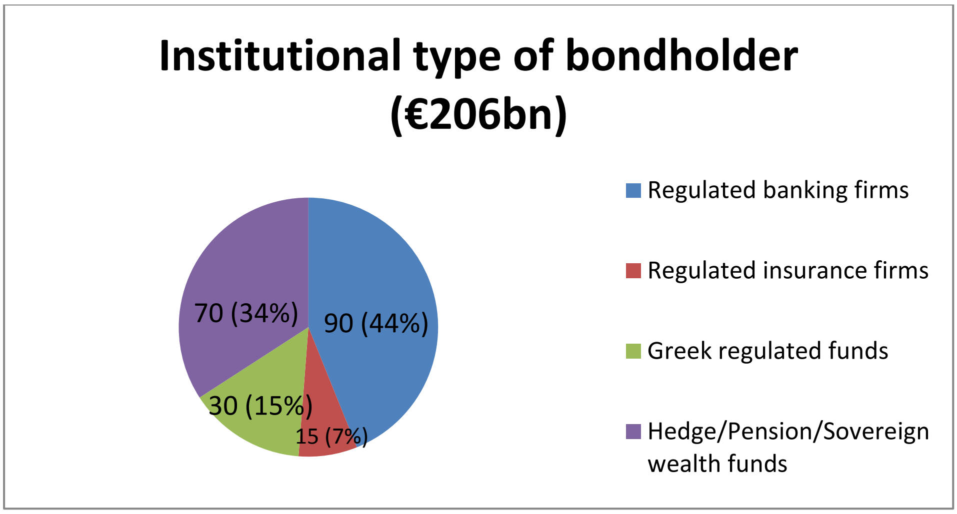
Source: Calculations based upon Credit Suisse 2012; Porzecanski 2012

Figure 2: Legal composition of privately held bonds



Source: Credit Suisse 2012

Figure 3: Composition of private bondholders



Source: Calculations based upon Jones 2012

In a move to overcome the obstacle of potential holdouts, Greece was highly fortuitous that the vast majority of its public debt was governed by Greek law. Seizing upon this fact, Greece's legal advisor, Lee Bucheit - along with law professor Mitu Gulati – had controversially proposed in 2010 that Greece could amend the legal terms of these bonds through local legislation in order to retrospectively insert Collective Action Clauses (CAC's) that would apply across all holdings of Greek law bonds[15] (Bucheit and Gulati 2010). Thus, if Greece could secure voting from at least 50% of Greek-law principal holders, and two thirds of those voted favoured the exchange deal (figures that could be met quite easily through IIF-member agreement) then the problem of minority bondholders blocking the restructuring could be side-stepped and resolved (Credit Suisse 2012: 4-5). In the event, the Greek Bondholder Act 4050/12 did precisely this. By taking such aggressive action, the Greek government and Eurozone officials essentially killed two birds with the one stone: as they had committed to a 90% minimum participation rate in order to go ahead with the overall debt exchange, the fact that Greek law bonds represented 86% of all bond holdings (excluding Greek guaranteed bonds which were dealt with individually), the 90% target would be comfortably reached even with minimal participation in relation to international law bonds and sovereign guaranteed bonds. Importantly, the local law amendment also expedited the restructuring process enormously, and guaranteed that the bond exchange would occur before the deadline of March 20th, when an extremely large notional value bond

[15] The authors referred to this as a 'mopping up law' which would bind any dissident minority to the decision of the majority.

(approximately €10bn) was due to be repaid in full[16]. The remaining 14% of non-Greek law bonds were subsequently dealt with on a bond by bond basis and still garnered a 70% agreement rate (IIF 2012a) – largely due to the willingness of IIF members once again. Overall, this meant that the total participation rate would be just shy of 97% (or approximately €200/206bn) leaving roughly €6bn escaping write-down– a phenomenally low holdout figure given the scale of the restructuring.

An obvious question arises on the back of the Greek law amendment: if it was possible to insert CAC's clauses through local legislation, why not simply enforce the restructuring on bondholders without negotiation or voluntary participation? The answer is contained in Bucheit and Gulati's original proposal;

> "A dramatic change in local law by one country might allow a worm of doubt to slip into the heads of capital market investors in other similarly-situated countries, driving up borrowing costs around the board. The official sector supporters of the debtor country will presumably balk at any action of this kind that could unleash the forces of contagion and instability upon other countries whose debt stocks also contain predominantly local law-governed instruments. The more dramatic or confiscatory the effect of the change of law, the higher the likelihood that it would be subject to a successful legal challenge" (2010: 11)

In sum, Greece was setting a precedent for the handling unsustainable debt, which would be inserted into financial market calculations about other peripheral economies debt. With reference to the balancing act nature of debt restructurings referred to previously, Greece and its Eurozone partners were hugely sensitive about the level of coercion they would utilise in order to facilitate successful restructuring. This concern even extended as far as Greece actually honouring the payments of holdouts maturing later in 2012, despite warnings before the restructuring deal that these debts could not be fulfilled[17]. Thus, while the Greek law amendment represented a decidedly aggressive element of coercion, this needed to be tempered by considerable counteracting elements of a voluntary character in the deal. This was required specifically in the practical sense of achieving consensus with IIF members in order to activate the newly inserted CAC's – but also, to facilitate the overarching aim of

[16] Bond GR0110021236 (Credit Suisse 2012: 36).

[17] It is likely that Greece will continue to repay the full €6bn to holdouts in an effort to avoid legal challenges and uphold the message of voluntary participation.

convincing markets that the Eurozone, Greece, and other peripheral nations were open for business and serious about their commitment to repaying outstanding debts.

The voluntary process of the restructuring was achieved by providing a deal which was interspersed with a range of inducements and market-friendly concessions that, under the circumstances of such devalued bondholdings (and given the alternatives[18]), added up to a relatively lenient fallout for private creditors (Roubini 2012). The formal deal involved three basic components:

1. A principle write-down of 53.5% of all bonds subject to exchange.
2. A swap of 15% of bonds for AAA EFSF securities maturing between 1 and 2 years.
3. A swap of the remaining 31.5% of bond for new 30 year bonds with incremental coupon payments (2% to 2014; 3% from 2014 to 2020; 3.65% from 2020 to 2021, and 4.3% from 2021 onwards until maturity).

There was no question that the acceptance of a headline figure 53.5% principle write-down represented a substantial loss for creditors. According to independent estimates the deal resulted in a net present value loss of around 60% - lower than Argentina in 2005, but on the upper end of net present value writedowns in historical comparison (Zettelmeyer et al. 2013: 19-20). Nevertheless, the EFSF bond swap – essentially, a direct cash pay-out worth €30billion and financed by an EU-contribution – entailed a huge sweetener that was without historical precedent. Given that some of this money could have been used to provide Greece with further debt relief as opposed to buying investor goodwill, this represented an extraordinary concession to private creditors. Furthermore, the new 30 years bonds came with a significant upgrade in terms of their legal status: they would be issued under English law and replete with a range of investor protections not found in previously held Greek law bonds. The skewed distribution of the coupon value towards the long end of these new bonds also favoured longer-term investors, i.e. most likely IIF members as opposed to short-term hedge fund holders. Finally, the co-financing agreement referenced previously, struck between the IIF's Jean Lemierre and Lazard representative Michele Lamarche, was also signed off on by Eurozone officials. This tied Greek repayments to bond holders with Greek loan repayments to the EFSF, thus providing extra safety guarantees for restructured

[18] In a final bid to round up participation of all creditors, the IIF itself - in a leaked memo just days before the acceptance of the Greek exchange - warned of the catastrophic consequences of a disorderly default: a European Lehman-style event which would cost more that €1trillion in the fallout and wreak havoc on the European banking. For reporting on this see Oakley (2012).

holders[19]. As such, even a significant portion of non-IIF/non-regulated institutions signed up for the debt exchange on a voluntary basis. Discounting the activation of CAC's into Greek law bond, the voluntary participation rate for the entire deal was 83.5%, which signified the active agreement of a substantial number of potential free-riders (IIF 2012b: 13).

The inducements and participation rates outlined demonstrate that the deal was not voluntary-in-name-only. Particularly in the context of the €30 billion EU contribution it illustrated that in fact, inducing creditors and insulating the rest of the Eurozone from private exposures was the primary motivation from the point of view of EU officials, even superseding the ostensible goal of restoring Greek public debt sustainability. This is because in spite of the write-down, Greece's debt trajectory remained on a very questionable path. The second bailout plan envisaged an ambitious structural adjustment target of a 120% debt to GDP ratio by 2020[20] – still a dubious level in the eyes of financial markets. According to Morgan Stanley assessments, Greece's "economic outlook remain[ed] very uncertain" as the adjustment programme was based upon a number of critical assumptions (growth, privatisation receipts, political stability, etc.) which could not be taken for granted (Morgan Stanley 2012: 3-4). Thus, while the restructuring deal successfully secured an effective exit from Greece for the vast majority of creditors, a buyback scheme launched late in 2012 to provide additional debt relief[21] illustrated that official creditors were aware of deficiencies vis-à-vis Greek debt sustainability in the second bailout programme. As such, the official sector essentially contributed to further Greek debt relief *in place* of private creditors. As argued, the deal was also not coercive-in-name-only. In fact, much to the chagrin of Eurozone officials, Greece was officially downgraded to 'selective default' as a result of the CAC insertion through legislation, albeit it for just a short period of time. While achieving the primary aim of avoiding a full-blown disorderly default, the downgrade was enough to trigger a previously untested mechanism within European financial markets: credit default swaps (CDS) for the sovereign bond market. Throughout the Greek crisis, Eurozone officials had anxiously wondered if such a 'credit event' relating to CDS pay-outs could potentially spread further contagion across the European banking system, despite the fact that the market

[19] For full technical details on inducements and concessions see Zettelmayer et. al (2013) and Morgan Stanley (2012)
[20] Although Italy had, at this time (February/March 2012), a debt to GDP ratio of 120%
[21] This write-down did not involve any headline grabbing principle reduction, but rather a simple stretching out of maturities to ease Greek payment schedules. Thus, it was an easier plan for core governments to sell to their domestic audience.

constituted a tiny fraction (roughly €2.5bn in early 2012) of European exposures (Whelan 2013). Nevertheless, the irrationality that a potential ‘CDS event’ provoked was representative of the broader structural fear that officials had in the face of unruly financial markets. That very same ‘fear of financial markets’ accounted for the extensive engagement of the IIF, the strained efforts to execute a (semi-)voluntary restructuring deal, and why the entire struggle to contain the Greek debt problem took so long to resolve. From early 2010 through to just before the agreement on debt restructuring in early 2012, private creditor exposures had been reduced by almost €100bn (see table 1). If a similar restructuring had occurred at the outset, this amount would have provided enormous debt relief for Greece and quite possibly would have stemmed Eurozone contagion immediately. As it was, that debt migrated from private creditors to official creditor’s balance sheet.

Conclusion

The case of the Greek debt crisis vividly demonstrates the complex and multifaceted operation of financial political power and highlights the tension that can arise between the automatic and impersonal forces of financial markets, and the conscious and intentional engagement of financial sector elites on behalf of the industry. Undoubtedly, the structural power of financial markets was the overriding concern of policymakers throughout the entire period, as ECB inaction allowed bond markets to route peripheral member-states and the Eurozone architecture constrained Greece to deflationary re-adjustment. This scenario initially benefited creditors greatly, as the May 2010 bailout allowed them to offload approximately €100 billion of Greek debt while being paid in full and on-time through the use of public funds - essentially socialising the risk to the European taxpayer and acutely demonstrating the class-character political outcome of the EU/IMF ‘holding operation’. Nevertheless, this power was very much a Janus-faced phenomenon as it simultaneously destabilised the entire European banking system and threatened a calamitous breakup of the Eurozone through contagion effects. The market panic which drove the Troika ‘holding operation’ policy undermined the policy results. The dynamic was as such: market panic > bailouts and austerity > downward spiral of growth and unemployment > unsustainable public debt > loss of political legitimacy and popular unrest > further market panic. Thus, a tension arose: financial markets did not want to see creditor losses imposed but they also did not want to see unsustainable government debt as a result of bailouts and austerity. Put another way, structural power benefitted immediate financial interests but undermined them in the long run. In this context, the political mobilisation of the IIF was pivotal and can be understood in terms of elite-led efforts to 'mediate' the uncontrolled forces of financial markets and co-ordinate financial sector activity in pursuit of their long-term (or general) interests.

The IIF was by no means flawless in this pursuit and it is important to not overstate the capacity of the IIF to succeed in this role. As the first debt restructuring attempt revealed, the IIF constructed a deal that was heavily skewed towards the interests of their members and, along with EU authorities, agreed upon a write-down that was much too low to be credible in the eyes of financial investors. However, despite this misstep, heightened political troubles and growing market instability sharpened the focus of all the major players involved. Working closely with EU authorities, the IIF ultimately facilitated the deal by enclosing off negotiations to experts well-versed in the process of debt restructuring negotiations, and created a sharp dividing line between regulated banks and more 'unruly' elements of the non-regulated financial sector. In this context, major financial institutions voluntarily accepted a genuinely large creditor write-down - nominally, the largest ever conducted and historically very high in terms of net present value losses. At the same time, significant inducements were won by the IIF to ameliorate the deal for their members, while the coercive legal action of the Greek government side-lined minority actors that could scupper the agreement. Although the restructuring deal did not solve the entire Eurozone crisis, it did mark a considerable turning point by effectively cordoning Greece off as a contagion threat to the European banking system and dramatically reducing private creditor exposures.

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