The Great Greek Bank Robbery

ATHENS – Since 2008, bank bailouts have entailed a significant transfer of private losses to taxpayers in Europe and the United States. The latest Greek bank bailout constitutes a cautionary tale about how politics – in this case, Europe's – is geared toward maximizing public losses for questionable private benefits.

In 2012, the insolvent Greek state borrowed €41 billion ($45 billion, or 22% of Greece's shrinking national income) from European taxpayers to recapitalize the country's insolvent commercial banks. For an economy in the clutches of unsustainable debt, and the associated debt-deflation spiral, the new loan and the stringent austerity on which it was conditioned were a ball and chain. At least, Greeks were promised, this bailout would secure the country's banks once and for all.

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In 2013, once that tranche of funds had been transferred by the European Financial Stability Facility (EFSF), the eurozone's bailout fund, to its Greek franchise, the Hellenic Financial Stability Facility, the HFSF pumped approximately €40 billion into the four "systemic" banks in exchange for non-voting shares.

A few months later, in the autumn of 2013, a second recapitalization was orchestrated, with a new share issue. To make the new shares attractive to private investors, Greece's "troika" of official creditors (the International Monetary Fund, European Central Bank, and the European Commission) approved offering them at a remarkable 80% discount on the prices that the HFSF, on behalf of European taxpayers, had paid a few months earlier. Crucially, the HFSF was prevented from participating, imposing upon taxpayers a massive dilution of their equity stake.

Sensing potential gains at taxpayers' expense, foreign hedge funds rushed in to take advantage. As if to prove that it understood the impropriety involved, the Troika compelled Greece's government to immunize the HFSF board members from criminal prosecution for not participating in the new share offer and for the resulting disappearance of half of the taxpayers' €41 billion capital injection.

The Troika celebrated the hedge funds' interest as evidence that its bank bailout had inspired private-sector confidence. But the absence of long-term investors revealed that the capital inflow was purely speculative. Serious investors understood that the banks remained in serious trouble, despite the large injection of public funds. After all, Greece's Great Depression had caused the share of non-performing loans (NPLs) to rise to 40%.

In February 2014, months after the second recapitalization, the asset management company Blackrock reported that the burgeoning volume of NPLs necessitated a substantial third recapitalization. By June 2014, the IMF was leaking reports that more than €15 billion was needed to restore the banks' capital – a great deal more money than was left in Greece's second bailout package.

By the end of 2014, with Greece's second bailout running out of time and cash, and the government nursing another €22 billion of unfunded debt repayments for 2015, Troika officials were in no doubt. To maintain the pretense that the Greek "program" was on track, a third bailout was required.

The problem with pushing through a third bailout was twofold. First, the Troika-friendly Greek government had staked its political survival on the pledge that the country's second bailout would be completed by December 2014 and would be its last. Several eurozone governments had secured their parliaments' agreement by making the same pledge. The fallout was that the government collapsed and, in January 2015, our Syriza government was elected with a mandate to challenge the very logic of these “bailouts.”

As the new government’s finance minister, I was determined that any new bank recapitalization should avoid the pitfalls of the first two. New loans should be secured only after Greece’s debt had been rendered viable, and no new public funds should be injected into the commercial banks unless and until a special-purpose institution – a “bad bank” – was established to deal with their NPLs.

Unfortunately, the Troika was not interested in a rational solution. Its aim was to crush a government that dared challenge it. And crush us it did by engineering a six-month-long bank run, shutting down the Greek banks in June, and causing Prime Minister Alexis Tsipras’s capitulation to the Troika’s third bailout loan in July.

The first significant move was a third recapitalization of the banks in November. Taxpayers contributed another €6 billion, through the HFSF, but were again prevented from purchasing the shares offered to private investors.

As a result, despite capital injections of approximately €47 billion (€41 billion in 2013 and another €6 billion in 2015), the taxpayer’s equity share dropped from more than 65% to less than 26%, while hedge funds and foreign investors (for example, John Paulson, Brookfield, Fairfax, Wellington, and Highfields) grabbed 74% of the banks’ equity for a mere €5.1 billion investment. Although hedge funds had lost money since 2013, the opportunity to taking over Greece’s entire banking system for such a paltry sum proved irresistibly tempting.

The result is a banking system still awash in NPLs and buffeted by continuing recession. And with the latest round of recapitalization, the cost of the Troika’s determination to stick to the practice of extend-and-pretend bailout loans just got higher. Never before have taxpayers contributed so much to so few for so little.