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COMMON CENTS

Last week, as everything was hitting the proverbial fan in Greece, I read any number of articles about how Greece had forgiven the debt Germany owed it after World War II, so turnabout should be fair play. I had not known this, but the majority of articles I read on the subject didn't really go into just how much Greece forgave and the circumstances behind the forgiveness; only that Greece had done so at something call the London Agreement on German External Debt in 1953.

This piqued my curiosity, so I delved into the issue a little further to come up with some hard numbers. After I did so, I started wondering whether the reporters writing on the story were either financially illiterate or knowingly obfuscating the issue. Regardless, the story itself got a lot of tongues wagging on message boards, most of it anti-German and pro-Greek.

That the Germans were brutal to the Greeks during World War II is not open for debate; they were, and then some, as they were to just about everyone not deemed pure Aryan. Also not open for debate was a 476 million Reichsmark loan the Germans extracted from the Greek central bank at 0% interest. This was overwhelmingly the largest claim Athens had against Germany come 1953, and, at first blush, this sounds like a lot of money, and I suppose it is.

However, what most reporters failed to mention was the US arm-twisted the signers of the London Agreement to forgive their German claims in order to: 1) have West Germany as a bulwark against the USSR, and; 2) continue to receive aid or get aid through the Truman Doctrine and the Marshall Plan.

By 1953, the Greeks had already received at least roughly \$300 million in military and economic assistance from the US in 1947 (AMAG), and an additional \$396 million (AMAG) in 1949. This apparently doesn't include Marshall Plan money which was an additional \$376 million from 1948-1951.

In essence, the US had given the Greeks a lot of aid and a lot of loans, and told them to either forgive or postpone their German claims, which, unsurprisingly, they did. Now, much of that aid went to fighting a civil war, and some of it had some pretty stupid stipulations on it. However, make no mistake about it, the Greeks didn't forgive German External Debt in 1953 out of humanitarian purposes; neither did anyone else.

Why this matters is simple: just how much was, say, 500 million Reichsmarks in 1953? Well, by that point, Germany had replaced that currency with the German Mark, and the accepted conversion rate was around 4.2 German Marks per \$1. So, 500 million Marks in 1953 would have been worth, drum roll please, right at around \$119 million.

At 0% interest for 62 years (1953-2015), that works out to, um, \$119 million. However, Berlin made a 115 million Mark "official payment" in 1960, which Athens gladly accepted. The accepted conversion rate at that time was 4.17 per \$1, so that works out to be \$27.6 million, meaning the total remaining balance would have been around \$91.4 million had Greece not have forgiven it back in 1953.

Even at 3% interest for 62 years, 500 million Reichsmarks in 1953 would be worth around \$744 million....which is significantly less what the Greeks received from the US to forgive it. If you factor in

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When dealing with people, remember you are not dealing with creatures of logic, but creatures of emotion.

Dale Carnegie

Something to Think About Cont.

the 115 Mark payment in 1960, the amount would be worth \$603 million....fun with compound interest, huh? By comparison, currently, Greece directly owes Germany around €56 billion, which works out to be around \$62 billion at today's conversion rate.

Then, you have to remember Greece owes everybody else, at least other countries directly, another €187 billion. Should these other countries forgive Greece's debt as well? If not, Germany certainly should, right? I mean, it could swallow that \$603 million figure, let alone the \$91.4 million one without missing a beat.

Now, this has a point.

My heart tells me the Germans should forgive some amount of Greek debt, if not the \$603 million, then at least the \$94 million number. If nothing else, it would put this argument to bed, and idealist reporters would have one less thing with which to mislead the reading public. Further, it would be a grand symbolic gesture, and sometimes that sort of thing is important.

However, my head tells me otherwise, for a lot of practical reasons. First, what would happen if the Germans were to repay the external debt to the Greeks the 1953 London Agreement wiped out, for all intents and practical purposes? Do you think perhaps the French, Dutch, and others get in line to collect their due? In essence, it opens up a huge can of worms, just huge, which would have very long tentacles.

That aside, as much as the court of public opinion and the heart might not like it, there is something called the rule of law. It has to be blind and sometimes heartless to be effective. This is one of those times.

Various Greek governments have agreed to various terms and bailout packages, and Greece now finds itself in hock to Germany, directly, to the tune of about \$62 billion. That works out to be roughly \$769 for every German man, woman, and child...who didn't really have a say so in the matter. So, ask yourself: if someone came and took \$3,076 from your family of four and lent it to someone else, would you expect your money back? Would you be a little peeved if that same person who took your \$3,076 made a deal with the borrower where they only had to pay you back, say, \$3,000? Would you be beside yourself if they told the borrower they only had to pay back \$2,000 or \$1,000 or even \$0?

You might be different, but I wouldn't like it very much. Oh, the \$3,076 might not make or break your finances, but would it be fair to you nonetheless? Particularly if you didn't have a voice in the matter? Therein lies the rub.

If the Greeks get to hold referendums on the terms of their debt, so should the Germans, French, Dutch, Slovenes, Italians, Slovaks, Maltese, Cypriots, Spaniards, Finns, Irish, Austrians, Belgians, Portuguese, Latvians, Lithuanians, Estonians, and Luxembourgers....on the terms of Greek debt. Do you want to know what I think the results would be? The majority of Eurozone members would probably vote that, yes, Germany has to forgive a vast chunk of its holdings of Greek debt, but, and this is a big one, their country shouldn't have to do so.

As we all well know, it is far easier to be altruistic and bend contract terms/law with someone else's money and contracts than it is your own. That is why the rule of law, and dispassionately applying it, is so important....not just in this instance, but every single time.

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Something to Think About Cont.

Frankly, the strong adherence to the established rule of law is a cornerstone, if not the entire building, of a nation's economic success.

Consider the following table, which ranks the countries with the strongest rule of law, as defined by The World Justice Project (2015), and their nominal GDP per capita (2014), as defined by the IMF:

1	Denmark	\$ 60,564
2	Norway	\$ 97,013
3	Sweden	\$ 58,491
4	Finland	\$ 49,497
5	Netherlands	\$ 51,373
6	New Zealand	\$ 43,837
7	Austria	\$ 51,307
8	Germany	\$ 47,590
9	Singapore	\$ 56,319
10	Australia	\$ 61,219
	World Average	@ \$10,600
33	Greece	\$ 21,653
50	Belarus	\$ 8,042
75	Russia	\$ 12,926
101	Afghanistan	\$ 649

Make no mistake about it: there is a very strong positive correlation between the rule of law and per capita GDP. In fact, all of the top 10 in terms of rule of law are in the Top 20 in terms of per capita GDP, with the exception of New Zealand at 21. What's more, countries like Luxembourg and Switzerland weren't included in the World Justice Report, for whatever reason.

Trust me, this isn't just happenstance. The adherence to the rule of law, as opposed to giving into emotion or the zeitgeist of the moment, leads to higher living standards, which is arguably more important than momentarily feeling pleased with yourself.

Of course, laws can and do change. However, the fundamentals of contract law ordinarily don't. This is why it is important to put aside ancillary stories about German external debt following World War II to focus on the situation at hand.

Of course, the Germans and Greeks can always readdress the issue in a separate deal, but it can't be part of this one. As crazy as it might sound, that is in the Greeks best interests. Why?

Well, what happens if Greece's creditors significantly forgive the outstanding debt at this point? What if the Greeks fail to abide by whatever terms they hash out this go around? Will that help or hurt their ability to borrow money in the future? Understanding there isn't really another lifeline available to them outside of maybe Russia or even China moving forward?

That is right; their ability to finance future deficits would be detrimentally impacted. Well, maybe they could borrow money in the capital markets, but it would be at pretty high interest rates, of that you can be sure. To that end, Argentina, who has played any number of games with creditors over the last decade or so, can borrow money for 2 years at around 17-17.50%. Conversely, Ireland, which took its bailout lumps and staggered through the financial crisis like a bloodied prize-

fighter, can borrow at, get this, 0.05% for 2 years...according to Bloomberg on July 10, 2015.

As it stands, because of their shenanigans, the Greeks have seen their 2-year borrowing costs go from around 14% at the start of the year to, again get this, about 57% as of yesterday. Two weeks ago, on June 26, it was 21%. Thanks to Tsipras' recent somewhat hat in hand approach since the referendum, which I discussed in a private email to clients, Greek 2-year borrowing rates have fallen 24% today alone, to 30.5%. It is amazing what playing by the rules can get you.

Oh yeah, in case you were wondering, Denmark (#1 in the rule of law) can borrow money for 2 years at -0.48%, at least that is what Bloomberg is reporting today. You read that right; investors pay Copenhagen 0.48% to lend it money. That is beyond absurd. Of course, some of that has to do with ECB monetary policy and economic prospects, but it is still quite a spread to Greece.

In the end, I don't when business columns shifted away from actual business to emotion. Heck, maybe it has always been this way. However, I sure seem to be reading more and more articles in the business section which don't make a lot of business sense, at first blush. When you do the math and research, it is even worse. So be careful out there....people are trying to make up your mind for you through your heart as opposed to your brain.

Oh yeah...please don't throw yours truly into that lot. Ha.