Greece, Sovereign Default and the Concept of Solvency

The investment world is replete with opinions and scenarios of a Greek sovereign default. Many commentators speak of Greece being insolvent, but what does this mean in the strictly technical sense of the word.

It is difficult to envisage the insolvency of a sovereign. Default, however, is another matter which is related to solvency but neither necessarily follows from the other incontrovertibly.

The issue is explored in an earlier article on Hedged.biz entitled: Sovereign Debt Investing: A Distress Investing Approach

In that article, a sovereign default was considered highly improbable to impossible in the currency of the sovereign. Being written before May 2010, it did not consider the case of a Eurozone sovereign defaulting.

The consequences and implications of a Greek default have now been discussed ad nauseum by many credit experts. The question that remains is not the consequences or implications for the market, for financial systems, fairly dire would be a good approximation, or “good enough for government work” as the Americans say, but what is the nature of the claim held by a sovereign bond holder? In a corporate, the seniority of claim is usually clear. The assets are (hopefully) well defined, as are the liabilities. What are the assets of the sovereign? Apart from the definable assets of the sovereign, such as land, property, licenses, gold, resources, financial assets, operating businesses, foreign reserves, one of the largest assets of the sovereign are tax revenues, appropriately capitalized. This begs the questions what is the meaning of properly capitalized? Can these assets be transferred? Can they be securitized? What claim can possibly be attached to these assets or cash flows?

If these issues are scrutinized and analysed, innovative solutions might be found to the Greek debt problem.