MacKay ON MONEY

BY AUTHORISED FINANCIAL ADVISER CHRIS MACKAY

"It is a slow day in a little Greek Village. The rain is beating down and the streets are deserted. Times are tough, everybody is in debt, and everybody lives on credit. On this particular day a rich German tourist is driving through the village, stops at the local hotel and lays a €100 note on the desk, telling the hotel owner he wants to inspect the rooms upstairs in order to pick one in which to spend the night.

The owners gives him some keys and, as soon as the visitor has walked upstairs, the hotelier grabs the €100 note and runs next door to pay his debt to the butcher.

The butcher takes the €100 note and runs down the street to repay his debt to the pig farmer.

The pig farmer takes the €100 note and heads off to pay his bill at the supplier of feed and fuel.

The guy at the Farmers' Co-op takes the €100 note and runs to pay his drinks bill at the tavern.

The publican slips the money along to the local hooker drinking at the bar, who has also been facing hard times and has had to offer him "services" on credit.

The hooker then rushes to the hotel and pays off her room bill to the hotel owner with the €100 note.

The hotel proprietor then places the €100 note back on the counter so the rich traveller will not suspect anything. At that moment the traveller comes down the stairs, picks up the €100 note, states the rooms are not satisfactory, pockets the money, and leaves town.

No one produced anything. No one earned anything. However, the whole village is now out of debt and looking to the future with a lot more optimism.

And that, Ladies and Gentlemen, is how the Greeks will pay off their Eurozone debts."

There's a few holes in that fictional story, emailed to me recently, but it's a bit of fun.

In a semi related but this time true tale, back in 1970, there was a six-and-a-half month strike of all banks in Ireland. Apparently with the absence of cash, people started writing cheques and IOUs in payment for goods and services which then started recirculating and ending up morphing into the new "currency" and the economy ticked over quite well.

Continued on page 8…

…continued from page 7

Common sense dictated who you would accept an IOU from. If punters had been let down in the past by some ratbag, chances are their cheque or IOU wouldn't be accepted.

For the vast majority of honest people, the expectation was when the banks were no longer striking, all transactions would be reconciled and tidied up. And that's exactly what happened. But life had gone on in the meantime.

It's probably a bit simplistic 45 years on and may only work in small towns, but hey, who knows?

By the time this article is published, Greece may well be old news, but if you're into a bit of history, here goes.

Greece has around €323 billion in debt. In comparison, the total US national debt is around 50 times this. Greece makes up about 0.3 per cent of the world GDP so is very small. (In 2013 USA made up 19.31 per cent, China 15.40 per cent, Japan 5.40 per cent and NZ was 0.16 per cent.) However €323 billion translates into 175 per cent of Greece's GDP which is pretty huge.

They were meant to (but didn't) make a €1.6 billion payment to the International Monetary Fund (IMF) on June 30, as part of a bailout package agreed back in 2009 and negotiated several times since. They also were meant to pay the European Central Bank (ECB) €3.5 billion on July 20.

When I wrote this, some deal had been agreed upon based on Greece accepting some tough austerity measures.

The Guardian had an article about this on May 7. The guts of it was that tax evasion in Greece is rife. I've heard some stories suggesting there's only seven people in the whole country declaring income of over €1 million. This is out of a population of about 11 million.

One headline I researched from 2011 said "Greece has more registered Porsches than tax payers earning over $50k".

Another reported in 2013, just 233,087 Greek citizens declared incomes higher than €44,021 while 548,581 taxpayers declared an income of €2,934 or less and 944,365 declared an income of €5,869 or less. The article deduced 1,542,946 families live on €16 per day. And that's a yeah right moment.

In 2011, a mere 5,000 Greeks declared incomes of more than €100,000.

By comparison in NZ with a population of about 4.4 million, projected figures from Budget 2010 estimated 141,000 Kiwis would pay tax on incomes of over NZ$100,000 and 52,000 on over NZ$150,000 for the year ended March 2011.

"No one produced anything. No one earned anything. However, the whole village is now out of debt and looking to the future with a lot more optimism."

Projected figures for March 2016 are for 240,000 Kiwis to earn over $100,000 and 85,000 over $150,000.

Why would the Greek figures be so low? Why indeed?

Now I'm not quite sure how sophisticated the Greek tax man is. In 1958 NZ went to the PAYE (Pay As You Earn) tax system where the employer deducts tax from the employee and sends – or is meant to send – the money off to the IRD once or twice a month.

The Poms went the PAYE way during the war in 1944.

Tax collection always has required a huge amount of voluntary compliance – ever since extracting money from a reluctant populace was in its infancy.

According to Paul Goldsmith in "We Won, You Lost, Eat That – A political history of tax in New Zealand since 1840", a new tax was introduced to young New Zealand in 1844 by Governor Robert Fitzroy. "The first quarterly return yielding a pittance, £958 6s 4d, mainly because evasion, by failing to report income, was so easy and so enthusiastically adopted by the majority of settlers. People simply didn't send in a return and The Southern Cross reported with horror that from a population of 9,000 in the southern settlements only 600 returns had been received on the 1 March 1845 due date."

My take on this extraordinary criminal activity is a lot of early immigrants had enjoyed a free passage from London to Botany Bay en route to God's own.

Mind you this trans tasman and deeply imbedded convict influence cannot explain NZ Treasury Secretary, Bernard Ashwin's 1945 memo to Finance Minister Walter Nash "The evasion of tax is widespread at present and with the removal of patriotic incentives engendered by the war, evasion is likely to spread, perhaps to such an extent that the system of income tax would virtually break down. It is not possible to check up everybody's accounts and income tax fundamentally rests on the honesty of the average taxpayer."

Seventy years later and NZ has a sophisticated would class system of collecting revenue.

I'm not so sure about Greece's!

The Guardian article of 2010 reckoned there were around one million Greeks employed in the wider public sector with the vast majority holding jobs from which constitutionally they can never be fired.

The article quoted author Nikos Dimou who said "Until now the only dream of nearly every Greek has been to get a State job. Because they knew that it was not only a job for life but involved little work."

The article went on to say most civil servants reasoned that with average monthly salaries being no more than €1,000, the cushiness of State posts also allowed them to hold second jobs (policemen working for security firms, tax inspectors working as accountants, department heads running boutiques) which they invariably never declared. Such jobs the article opined, account for Greece's huge black economy conservatively estimated at over 30 per cent.

We were in Cambodia a few years back and one chap we met had a great job with a Government department but spent most of his working week as a guide, so moonlighting and "sunlighting" isn't peculiar to Greece.

We've got more than a few firemen in NZ who have second careers too. I'm sure these guys pay tax on their other income though.

Here are some other stories I've heard. Whether they are true, I'm not sure.

"Greece has the highest population in the world of people reporting an age of 110 years. The deaths are often not registered and pensions continue to be received. The European Union had found there are families receiving four – five monthly pensions which they are not supposed to get. There were still pensions paid to persons who died in 1953, 60+ years ago. A total of 40,000 girls received a monthly life pension of 1,000 Euros for the simple fact they were unmarried daughters of deceased civil servants. Now they will receive pensions only up to the age of 18. In Greece, many workers have benefited from early retirement, set at 50 years for women and 55 for men who belong to one of the 600 job categories identified as particularly painful which included:

- Hairdressers (because of dyes that may be considered harmful)
- The musicians of wind instruments (blowing into a flute is exhausting)
- TV presenters (the microphones are supposed to cause damage to health)

There are thousands of ridiculous 'tricks' departments and unnecessary institutions, from which many Greeks live off. For example, The Institute for the Protection of Kopais Lake, a dry lake since 1930."

These next bits are factual. The first recorded default in Greek history occurred in the fourth century B.C. when 13 Greek city states borrowed funds from the Temple of Delos. Most of the borrowers never made good on the loans and the Temple took an 80 per cent haircut.

Greece has defaulted on its external sovereign debt obligations at least five previous times since 1821 when the Greek War of Independence began (1826, 1843, 1860, 1893/94 and 1932). The 1932 default on repayment of its foreign debt triggered by the Great Depression lasted until 1964.

Economists and authors of "This Time it's Different", Carmen Reinhart and Kenneth Rogoff calculate Greece has been in default (and not repaying its loans) for 50 per cent of the years between 1800 and 2008. Greek's default in 1826 shut it out of international capital markets for 53 consecutive years they say. Mind you apparently Honduras and Ecuador have worse records.

Why would anyone lend money to these guys? With a well-documented track record of recidivism, you would have to wonder?

As at April 2015, most of the Greek debt appears to be held by other European Governments versus by the private sector. I went to a seminar fronted by Pathfinder Asset Management recently. Paul Brownsey, one of the Directors, reckons over the past few years, the Europeans have done a fantastic job of transferring Greek risk (loans) from bank shareholders to northern European taxpayers – effectively the Governments.

As at December 2014, German, British and US banks held just over €30b in loans, which is far less than in 2012. So Greece exiting the Eurozone for example wouldn't be as harmful to the banking system as it would have been back then.

Why would anyone lend money to these guys? With a well-documented track record of recidivism, you would have to wonder?

Whatever happened or will happen is not the end of the world. None of the fund managers or KiwiSaver schemes we deal with have any direct exposure to Greek shares or bonds as far as I am aware. I did see Australian banks may have lent them €10m as at December 2014. About the same figure as an Aussie bank's CEO's annual package. Peanuts! (In 2014 Michael Smith from the ANZ got $10.4m, slightly behind Gail Kelly at Westpac on $10.9m.)

And if a local fund manager did happen to have some minute exposure via some index fund, it would be exactly that – minute.

The consensus seems to be whatever happens in Greece is not going to affect markets dramatically and most bad news has already been factored in to the markets.

So in summary – for those of us not living in Greece – and in the words of Lance Corporal Jones – **"Don't panic Mr Mainwaring!"**

These are generalised comments only and should not be taken as personalised advice. Disclosure Statements are available on request and free of charge.