COMMENTARY
Thinking ahead for Europe

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Debt forgiveness is not the solution for Greece

Daniel Gros

A superficially plausible narrative to the continuing problems besetting Greece is that it cannot recover because of a crushing debt burden. However, this narrative overlooks some basic facts and cannot explain why all the other peripheral countries that needed official support (Portugal, Ireland, Spain and Cyprus) are recovering.

The key to understanding Greece's debt situation is that most of it is owed to the European institutions, which have already extended the maturity to over 30 years and are charging very low interest rates. Expenditure on interest now amounts to 3.2% of GDP, which is much less than what the Greek government had to spend on interest before the crisis and before the Troika! Interest expenditure is also lower for Greece than for Italy (3.9% of GDP) and much less than for Portugal (4.2% of GDP). Even the US government has to spend more on interest (3.8% of GDP) than the Greek government. But nobody argues that these countries need debt forgiveness to be able to grow.

An implicit conclusion from the fact that interest is not an important cost item despite high debt is that debt forgiveness makes little difference at low interest rates. Let us assume that the official European lenders were to forgive Greece €100 billion, undeniably a huge sum. What would this change? This huge concession would save the Greek government a little over €1 billion in interest payments each year, which represents less than 1% of the country's GDP. Savings of this order of magnitude are unlikely to make much of a difference.

In order to make debt forgiveness important, one would need to argue that business will become much more willing to invest in the country because 30 to 40 years down the road there will be €100 billion less to be repaid (or refinanced). But this is not realistic. Very few investments have such a long time horizon. Both Greek and foreign investors are reluctant to commit their capital to Greece because they fear the regulatory environment and the continuing political instability of today, not because the country has to pay some large sums two generations into the future.

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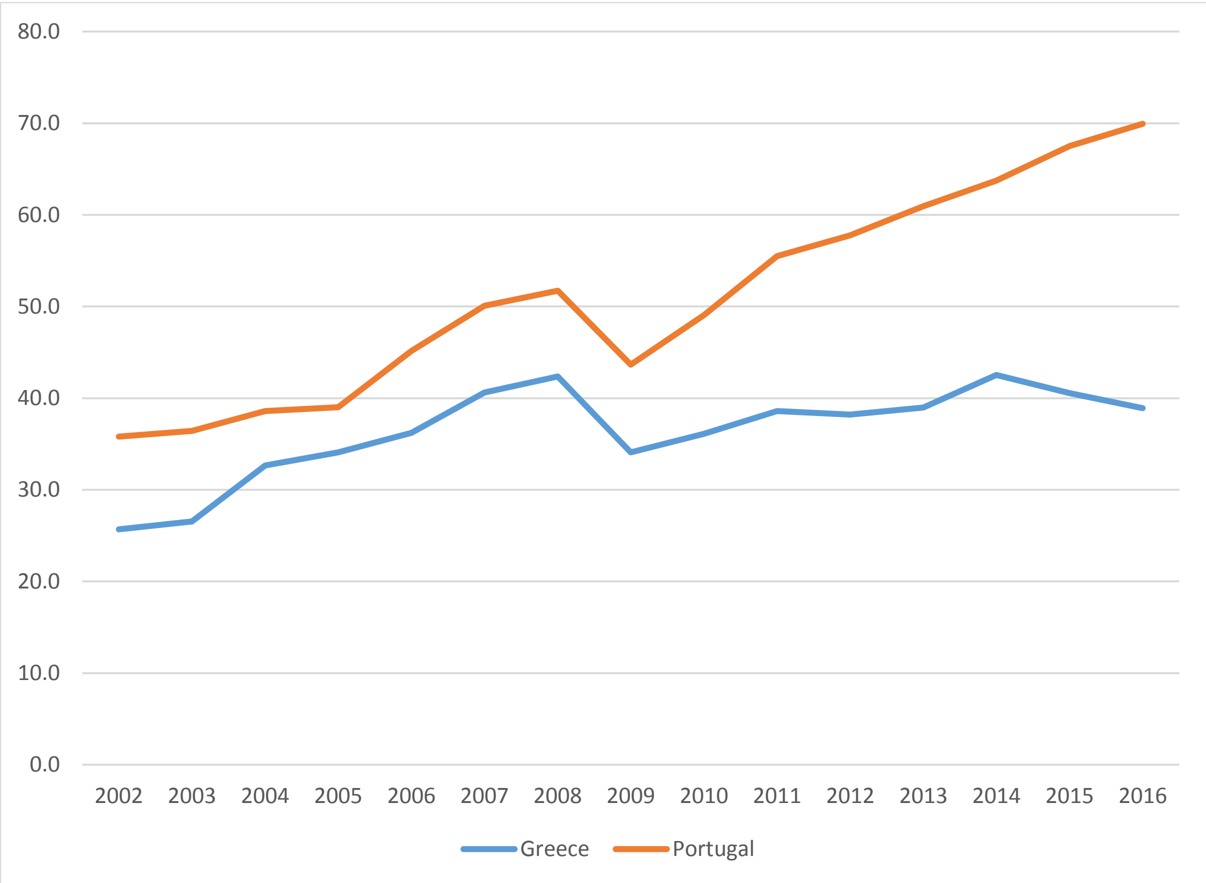
The discussion about debt forgiveness is a dangerous distraction from the real problem, which is that Greek exports are continuing to stagnate, as shown in the figure below (blue line). With wages having fallen by over 20%, Greek exporters should be experiencing a boom. The other peripheral countries are recovering because their exports are growing, which allows their entire economies to grow without the need for new capital from abroad. Portugal is a case in point. Its starting point was very similar to that of Greece: double-digit fiscal and external deficits followed by a tight austerity programme. The Portuguese economy, however, has recovered because the negative impact of the fiscal adjustment has been offset over time by a strong expansion in exports. Figure 1 below shows that the exports of both countries were growing at similar rates before the crisis. But today, almost a decade later, the exports of Portugal have increased by one-half, compared to the temporary peak of 2008, while those of Greece have fallen slightly.

The Greek economy can grow again on a sustainable basis only if its exports grow. Debt forgiveness will do nothing to solve this key problem.

Figure 1. Greek vs Portuguese exports, 2002-16 (€ bn)



Note: Exports exclude all oil and include transport services only in the net export position.

Source: Author's own calculations based on data from Eurostat and the Central Bank of Greece.

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