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.
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.
For other CEPS publications on the Greek economy by the same author, see the list of titles below.

Why Greece is different
22 May 2015

Greece and the IMF
24 March 2010

Greece’s Soft Budgets in Hard Times
07 March 2012

Who can save Greece?
15 April 2010

What makes Greece special?
19 March 2014

Why Greece declined a euro holiday
06 August 2015

Can Greece ‘grow solvent’?
with Thomas Barnebeck Andersen and Mikkel Barslund 08 September 2011

Greece and Portugal: Similar fundamentals but different outcomes?
17 February 2012

Where is the credit crunch in Greece?
06 October 2015

Puerto Rico and Greece: A tale of two defaults in a monetary union
30 June 2015

Financial Stability beyond Greece: On the need for a European Financial Stability Fund
and Thomas Mayer
11 May 2010

A Greek way out?
05 February 2015

Grexit 2015: A primer
22 January 2015

The Greek Austerity Myth
10 February 2015

TRAC: A market-based tax on capital flight as an alternative to Grexit
07 May 2015

Narratives matter
16 July 2015

Privatisation is no salvation
23 June 2011

IMF Go Home
10 June 2016

The Fiscal Economics of a Greek Exit
01 June 2012

The Greek Fiscal Adjustment Programme: An evaluation
27 April 2010

History repeating itself: From the Argentine default to the Greek tragedy?
with Cinzia Alcidi and Alessandro Giovannini 01 July 2011

Cleaning up the mess: Bank resolution in a systemic crisis
with Dirk Schoenmaker 07 June 2012

Learning from small countries? Contemporary Nordic sagas
06 February 2013

Adjustment Difficulties in the GIPSY Club
05 March 2010

‘Grexit’: Who would pay for it?
with Cinzia Alcidi and Alessandro Giovannini 23 May 2012

The Greek elections and the third bailout programme: Why it could work this time round with Cinzia Alcidi
21 September 2015
A tale of two defaults  
12 July 2011

The end of fiscal waterboarding?  
23 February 2015

Greek burdens ensure some Pigs won't fly  
01 February 2010

The Greek economy is unlikely to benefit from further devaluation  
With Cinzia Alcidi 03 July 2015

Why is the Greek economy collapsing? A simple tale of high multipliers and low exports  
With Cinzia Alcidi 21 December 2012

Can the Greek state pay for itself?  
05 June 2015

Sovereign Debt vs Foreign Debt in the Eurozone  
12 May 2011

From pain to gain on the EU frontier  
08 August 2011

Restructuring the Greek banking sector with an empty purse  
with Willem Pieter De Groen 13 July 2015

Addressing the immediate needs of the Greek banks  
with Willem Pieter De Groen 31 July 2015