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BOLD RESTRUCTURING OF GREEK DEBT NEEDED FOR COUNTRY'S ECONOMY TO START GROWING AGAIN, NEW LEVY INSTITUTE REPORT SAYS

Broader Agenda Needed to Address Structural Imbalances in Eurozone

ANNANDALE-ON-HUDSON, N.Y.— Despite European Union finance ministers reaching a deal with Greece to extend the country's bailout by four months, the restructuring of Greece's debt and addressing structural imbalances in the eurozone remain urgent policy issues. In a Policy Note from the Levy Economics Institute of Bard College, *The Greek Public Debt Problem,* Levy Institute Research Scholar Michalis Nikiforos, President Dimitri B. Papadimitriou, and Research Scholar Gennaro Zezza argue that Greece's public debt is unsustainable, and that a significant restructuring of this debt is needed in order for the Greek economy to start growing again. The scholars suggest that the sweeping cancellation of Germany's debts after World War II—as part of the wider plan for the economic and political reconstruction of Germany and Europe—provides useful insights moving forward with a broader agenda to address Greece's domestic economic malaise, as well as the structural problems of the eurozone.

"The extension of current policies that target high fiscal surpluses in the name of debt sustainability will lead to a deepening of the recession—or a prolonged period of stagnation—with all its attendant consequences for the Greek society," write Nikiforos, Papadimitriou, and Zezza, stressing that, because the unsustainability of the debt is obvious to everyone except the official sector of the eurozone, the debt overhang creates uncertainty that prohibits a recovery in private investment activity. "Finally, precious resources that could be used to put an end to the recession of the last five years and lead to a recovery are sacrificed for the servicing of this clearly unsustainable stock of debt."

In their policy note, the Levy scholars call International Monetary Fund medium-term forecasts for vigorous rebound in growth, exports, and investment in Greece "wildly implausible" in the face of the country's high public surpluses. "Given the recent performance of the Greek economy and the condition of the European and global economies, it is also hard to see where the rebound in investment and net exports will come from," they write. "The growth rate of gross fixed capital formation in Greece recorded double-digit negative numbers until recently, while the most recent data show a (negative) growth rate of -3.3 percent in the first three quarters of 2014 against the same period the previous year. At the same time, the improvement in net exports over the last five years has been the result of the recession, mostly through a decrease in imports rather than a significant improvement in exports."

The authors contend that maintaining the current policy stance is not justifiable on either pragmatic or moral grounds, that Greece's debt cannot be repaid under any plausible circumstances, and that the Greek fiscal problem is to a large extent the result of the structural problems of the eurozone. "The policies that were put into place after the signing of the Maastricht Treaty in 1992 and the adoption of the euro in 2001 exerted a large negative impact on the foreign sector of the Greek economy and led to a gradual increase in the current account deficit," they write. "The fiscal deficits of this period reflect the worsening of Greece's external position as the government attempted to stabilize the economy."

The authors point out the historical irony that Germany, which staunchly opposes any effort to restructure the Greek public debt, was the beneficiary of the largest debt restructuring deal in history, in the aftermath of World War II—an essential factor behind the "German economic miracle" of the postwar period. Furthermore, the sweeping cancellation of its public and foreign debt was part of a wider plan for the reconstruction of Europe that included the establishment of several institutions, such as the Organisation of European Economic Co-operation, or OEEC (precursor to the Organisation for Economic Co-operation and Development), that promoted cooperation among European countries. "In this sense, the postwar German economic miracle and the robust development of the rest of the European economies was not the result of abstract market forces," they write. "Instead, they were based on very specific and detailed planning."

While stressing the need to be careful drawing historical analogies, the Levy scholars conclude that postwar reconstruction of Europe, specifically the forgiveness of German debt, offers a template for the current crisis in Greece and Europe. "Greece needs a bold cancellation of its public debt," they write. "The post–World War II developments also show that debt restructuring is a necessary but definitely not sufficient condition for the solution of the crisis in Greece and the rest of Europe. As happened in the early postwar period, the restructuring needs to be part of a wider plan to deal with the malaise of the Greek economy and, most important, with the structural problems of the eurozone as a whole."

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Policy Note 2015/2: *The Greek Public Debt Problem*

To read the full text of this policy paper or to learn more about the Levy Economics Institute of Bard College, please visit http://www.levyinstitute.org/publications/the-greek-public-debt-problem.

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