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Greece Isn't Lost, Yet

Other debt-ridden countries have also managed to dig themselves out of similar fiscal crises.

By MICHAEL HEISE

Conventional wisdom increasingly has it that the €110 billion European Union/IMF bailout for Greece will only delay a debt restructuring. The Greek economy, so the argument goes, could not possibly pull off the required austerity program.

But back-of-the envelope calculations supposedly showing Greece's inevitable fiscal death are somewhat exaggerated. The slashing of the Greek budget deficit (13.6% of GDP last year) is actually proceeding faster than planned. The consolidation program agreed with the EU and the IMF projects for this year a deficit of 8.1%. In light of the progress in the first five months of this year, Greece might even manage to undershoot this target.

That's partly because the government had already started to curb its spending—particularly on the investment front—before the EU and IMF imposed the current savings program. And if Greece implements the measures in full, more substantial savings will come in the second half of the year. Even if we factor in the blow that a "stabilization recession" could potentially deal to the deficit-to-GDP-ratio (the economy is expected to contract 4% this year and 2% next) the deficit could be cut roughly in half this year to between 6% and 7% of GDP. This should help restore some of the trust that the capital markets have lost in Greek fiscal policy.

For 2011, the new borrowing target is 7.6% of GDP. This is not ambitious enough. There is no sense in spreading out the pain of the consolidation process over several years. An acute confidence crisis on the capital markets can only be overcome with swift and stringent budget cuts. I believe that this is within Greece's grasp, not least as new legislation enables the government to pursue tax debtors more successfully.

It is not true that Greece is destined to suffocate under the enormous public sector interest burden. Historically, those interest rates are still relatively modest. Last year, the country was paying an average interest rate of around 4.4% on its outstanding government debt. This year, the interest rate is likely to climb to 4.8%, rising to 5% by 2014, according to European Commission data. But this would still be much lower than the 7% Greece had to pay in 2000, immediately before joining the euro. Seen from this perspective, the consolidation efforts would certainly not appear to be doomed to fail, even if the debt level does climb further.

True, at around 5% to 5.5% of GDP in the 2009-2010 period, Greek government interest payments make up a relatively large share of the economy by international standards. And that ratio looks set to rise even further in the coming quarters. Nevertheless, there are other countries, such as Italy and Brazil, that manage to get by with interest burdens on this scale. The South American country has more than once been on the brink of insolvency, but has managed to turn things around in the past 10 years by focusing on fiscal stability and debt reduction. Despite an interest burden hovering around the 6% mark in recent years, nobody is calling Brazil's solvency into question.

There are plenty of other examples of debt-ridden countries that have managed to dig their way out of their fiscal crisis within a reasonable period of time. Between 1987 and 2002, Ireland cut its debt ratio by around 80 percentage points to less than 40% from approximately 120%. Belgium cut its debt level around 50 percentage points between 1993-2007. And between 1996 and 2007, Spain managed to lower its debt ratio by more than 30 percentage points.

In Belgium's case the fiscal indicators, such as interest expenditures and debt-to-GDP ratio, were substantially worse than Greece's today, and still the country managed to emerge from the quagmire within a few years. Moreover, none of the countries mentioned were faced with the massive international political pressure that is coming down on Greece. And, in most cases, exchange-rate adjustments—which euro-zone member Greece cannot use—were only minor.

Greece's predicament is anything but a lost cause. It does not make sense to rashly evoke an unprecedented sovereign default in the euro area, which would have unforeseeable consequences for other member states and the standing of the euro as an investment currency.

Driving the campaign for debt restructuring is often the desire to ensure that private investors foot some of the bill. But debt waivers would automatically also drag in EU taxpayers, who'd be left with at least a partial write-down on the loans their governments had granted to Greece.

The best solution for Europe's taxpayers is if the situation in Greece is stabilized so that it can pay back its debt with interest. This is exactly what the Greek government has pledged to do. Let's not try to prove Athens wrong.

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