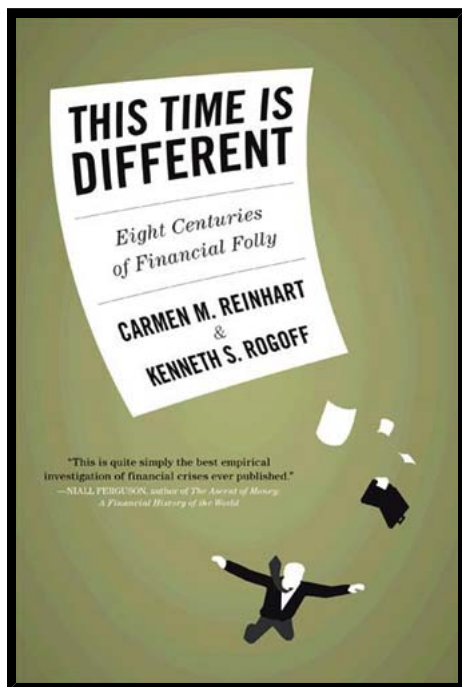





Harvard's Rogoff Says EU's Bazooka Won't Prevent Defaults

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Review by James Pressley



May 19 (Bloomberg) -- **Kenneth Rogoff** says Europe's unprecedented aid package, worth roughly \$1 trillion, won't be enough to prevent sovereign debt defaults. What's needed, the Harvard University economist says, is a mechanism to allow countries such as Greece to walk away from the euro.

"It would be positively healthy if the European Union found a way to let countries that need to restructure to temporarily exit the euro and later re-enter," he says.

When Rogoff talks about sovereign debt, people pay attention. He and **Carmen Reinhart** of the University of Maryland are the authors of "This Time Is Different," a landmark study of eight centuries of financial crises. He talked in a phone interview about shocked Germans, bazookas and the curious case of how Newfoundland lost its sovereignty.

Pressley: Your book with Carmen Reinhart shows that it usually takes decades for countries to graduate from a history of serial defaults on sovereign debt. Were Greece, Ireland, Portugal and Spain ready for the euro?

Rogoff: No. Greece and Portugal, in particular, were allowed into the euro prematurely. It would have been better for everyone had they been given a longer transition period. In any event, the entire euro area played too loose with the Maastricht Treaty debt limits and now they are paying the price.

Sustainable Debt?

Pressley: What does your research tell us about the sustainability of the debt levels of these countries?

Rogoff: Reinhart and I find that most emerging markets get in trouble when their external debt -- public plus private -- reaches 60 percent of gross domestic product, although there are country-specific factors that can affect this limit. A history of serial default, for example, is all too common and tends to make countries vulnerable at lower debt levels.

For advanced countries, we don't have a benchmark because those data have been kept by the International Monetary Fund only since 2000. If you treat Greece, Ireland, Portugal and Spain as emerging markets, their current debt is extremely high. Greece's total external debt to GDP is more than 170 percent. Ireland's tops 300 percent.

Pressley: The EU now has its own "bazooka," as **Hank Paulson** might have called it -- a stabilization package of about \$1 trillion. Will it be enough to prevent defaults?

Rogoff: Clearly not. First of all, remember that some of the money is coming from the same southern countries that are in trouble. The main issue is whether those countries will be able to sustain fiscal tightening over the period required to improve their debt ratios. They're all either in recession or teetering on recession. So their debt is going to grow.

Keeping Resolutions

Look at the Greek program, which is extreme. They are supposed to go through recession for two more years. At the end of it, they will have a government **debt-to-GDP ratio** of 150 percent, up from about 120 percent. In all likelihood, they're going to end up in default again. It's one thing to make a New Year's resolution; it's another thing to keep it.

Pressley: Does the stabilization package just add more debt to a crisis that began with **too much debt**?

Rogoff: There are two core questions. Will the southern countries find it in their interest to sustain austerity? And how will the German people react? They're going to end up paying a lot of it. The package was meant to give the market shock and awe, but people are saying that it was really German taxpayers who are in shock and awe. Germany has to decide whether it really wants to do this. That's by no means a foregone conclusion.

German Backlash

Pressley: Especially when the Germans see the **European Central Bank** buying up the debt of southern countries.

Rogoff: If inflation emerges from this at some point, it would be very destabilizing politically for Germany. The German people were told that the euro is just as solid as the old deutsche mark it replaces. If they learn differently, there is going to be tremendous anger and resentment.

Pressley: You have found that countries rarely default because they can't afford to pay.

Rogoff: There are very few cases of country defaults where the ability to pay is the ultimate question. It's almost always the willingness to pay. It's not obvious that it's in Greece's interest to pay. Why go through a brutal recession for two or three years and restructure anyway?

Pressley: When Newfoundland defaulted on its external debt in the 1930s, it lost its sovereignty. Will we ever see that kind of resolution again?

Rogoff: Not so extreme, but Europe needs much deeper fiscal integration if it wants to keep monetary union moving forward. Member states may need to surrender a significant degree of fiscal sovereignty.

"This Time Is Different" is from **Princeton** (463 pages, \$35, 19.95 pounds). To buy this book in North America, click [here](#).

(**James Pressley** writes for Muse, the arts and leisure section of Bloomberg News. The opinions expressed are his own. This interview was condensed from a longer conversation.)

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Last Updated: May 18, 2010 19:00 EDT

