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# Greece's new debt deal may appease creditors but it won't help the economy

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Yanis Varoufakis, is hoping to appease creditors and voters with his new plan. EPA/Simela Pantartzzi

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Greece's new coalition government was elected with a mandate to write off most of the €310 billion sovereign debt, with or without the consent of its creditors. In less than a week in power, this position has already shifted from attaining a debt "haircut" to arranging a debt swap.

Last week, the new Greek premier Alexis Tsipras said that his government would refrain from any unilateral action on debt. And this week the debt haircut was denounced altogether by the Greek finance minister Yanis Varoufakis.

Instead, he has proposed a debt swap. As I have explained elsewhere, apart from the political bickering, the debt write-off is not in Greece's best economic interest. The new proposal is not any better, even if it is accepted by the other eurozone countries, which hold most of Greece's debt.

## Swapping Greek debt

Varoufakis made the new proposal after his visits to Paris and London. He proposes to swap Greece's outstanding debt for bonds linked to growth, promising, as many Greek finance ministers have before him, that he will continue with Greece's commitment of primary budget surpluses and chasing wealthy tax evaders.

This new suggestion was made to appease Greece's eurozone creditors. Since Syriza came to power, all – Germany and France in particular – have made it very clear that a “haircut” would not be acceptable to them. As they put it, Greece owes money not to banks, but to their taxpayers. And they have their own democratic mandate not to write off Greece's debt.

So, Varoufakis has proposed a two-tier scheme to tackle the problem of Greece's debt. First, European loans to Greece will be replaced by bonds, which will be linked to nominal economic growth. Second, the Greek bonds held by the European Central Bank will be replaced by a “perpetual bond”, implying that interest will be paid on the debt forever. If the other eurozone countries accept it, then the Greek government can claim that they have technically achieved a debt haircut for their citizens, since there will be no need to pay for any principal but only interest.

The first proposal is tricky. Greece's nominal economic growth is expected to be below its real economic growth because of deflation. Thus, even if Greece had positive real economic growth this year, as it did in 2014, the nominal growth would be negative.

According to Eurostat, in 2014 Greece's real GDP grew by 0.6%. The nominal GDP decreased by 0.9%. If Greece had such an agreement in 2014, it would not have paid any interest on its debt. It is hard to believe eurozone countries would accept such an arrangement. This would have allowed the Greek government to save about €7.5 billion in interest payments and be used to finance Syriza's pre-election promises without violating its balanced budget promise.

## Perpetual bonds

The perpetual bond scheme depends very much on the interest rate. Suppose €120 billion of Greece's debt becomes a perpetual bond at a rate which is equal to the average of the eurozone's rate in 2014 of 3%. In 100 years, Greeks would have to pay in interest payments €360 billion. If instead Greece continues with the current arrangement, in 100 years the whole debt of €120 billion will be written off with a total payment (interest and principal) of €317 billion.

The annual payments of the current arrangement would be slightly lower than with the perpetual bond, €3.12 billion instead of €3.6 billion per year. With a perpetual bond, the interest payments would have continued to be paid even after the 100 years.

## Austerity measures and tax evasion

The Greek premier reassured his eurozone partners that not only would they balance the government budget but they will generate a small surplus and they will do this by putting an end to austerity. But this doesn't add up.

By definition austerity exists when in times of economic recession (GDP growth less than 2%), the government follows a restrictive fiscal policy. In other words, the government balances the budget. This is exactly what Syriza promises to do.

The Greek government is desperately looking for money. Combating tax evasion is not a short-term solution to money shortage and has a high political and financial cost. Greece cannot afford this at the moment – its new government has already requested an additional €10 billion in treasury bills from the European Commission to finance its current expenditures.

The new Greek government must realise that its pre-election promises cannot be implemented. The desire for an international conference on debt and the debt haircut have been rejected by all concerned partners – namely, the eurozone countries that hold Greek debt.

There is an easy way out of this which is to accept the current debt arrangement and work hard on the great opportunities opened up by the ECB's recent quantitative easing announcement and the investment package announced last year by the president of the European Commission, Jean-Claude Juncker.

But Syriza is tied by the promises of its populist election campaign to implement its impractical program. Unfortunately, this will be a serious setback for the Greek economy.



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