Can debt writeoffs help the eurozone avoid a default? [1]

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Above is a stylized diagram showing the interconnectedness of the EU's web of debt. [Click for full-size images.] The domino-like situation is clear ? if one country goes, it may take down others as well. Thus far, the "solution" within the eurozone has been successive bailouts, which appear unlikely to solve the problems facing the EU. Indeed, considering the fact that the bailouts will have to be paid off, they may be making the situation even worse for the countries forced to accept them.

A new report by two professors at the ESCB Europe Business School offers an alternative to this web: bilateral debt forgiveness. The Great EU Debt Writeoff [4], as they call it, would see countries that owe each other money excuse the debts, reducing interconnectedness. Their simulation results in the web above transforming into something far simpler:

[5]

According to the people behind the plan, the results would be revolutionary:

- The countries can reduce their total debt by 64% through cross cancellation of interlinked debt, taking total debt from 40.47% of GDP to 14.58%
- Six countries ? Ireland, Italy, Spain, Britain, France and Germany ? can write off more than 50% of their outstanding debt
- Three countries - Ireland, Italy, and Germany ? can reduce their obligations such that they owe more than €1bn to only 2 other countries
- Ireland can reduce its debt from almost 130% of GDP to under 20% of GDP
- France can virtually eliminate its debt ? reducing it to just 0.06% of GDP

Whether or not this plan would work is uncertain. But, as with the banking crisis, the problem with the eurozone is not that states are "too big to fail", it is that they are too interconnected to fail. Reducing these interconnections, so that countries can either crawl their way back to fiscal stability or default in an orderly way that doesn't knock the rest of the European dominoes down in the process, would be a big step away

from catastrophe. The full paper is available to read here [6].

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