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FIVE QUESTIONS TO DOROTHEA SCHÄFER

»The ECB's Policy of Low Interest Rates Is Indispensable for Now«

1. Prof. Schäfer, Europe is still suffering from the debt crisis. Is the ECB's low base interest rate a cure or a symptom of the euro crisis? While the low base interest rate is certainly due to the euro crisis, it also helps countries manage their debt. A persistently low interest rate has the effect of reducing countries' interest burdens. This can be demonstrated empirically. The average interest rate on government debt has declined continuously over the past few years. The ECB's policy of low interest rates is indispensable for now in order to cope with the debts and make them more bearable.

2. You have compared the current situation in Europe with historical examples from the US (1953) and Sweden (1990). What can Europe learn from them? The US debt level dropped from 120 percent to 70 percent of GDP within seven years after World War II, which is a relatively brief period of time for that to happen. It was achieved through low interest rates, a heightened inflation rate, and ultimately also by increasing economic growth, among other things. These factors contributed to the debt level dropping. In Sweden, the situation was somewhat different. There, economic growth increased sharply after the financial crisis had been overcome. At the same time, the Swedish government exercised strict budgetary discipline, which resulted in an annual surplus in the fiscal budget. These two conditions were also conducive to the debt level coming down quickly. There are simply several paths to reducing the debt level. If economic growth is strong, then countries can grow their way out of high debt levels, so to speak. If that is not the case, like at present, then other instruments must be used, for example, a policy of low interest rates, which helps first of all to bear the mountains of debt and then to reduce them in the long term.

3. What about budgetary discipline in Europe? The budgetary discipline of the debt-ridden countries has improved within the aid packages. These countries are developing toward a positive primary balance, and this is definitely a positive development. The entire debt situation is also eased by the fact that the average interest rate on existing liabilities is dropping, with the effect that the hurdle that needs to be taken to reach a positive overall balance has become smaller because of declining average interest rates.

4. What about the increase in the individual euro countries' gross debt? The only exception is Greece because the haircut enabled the country to reduce its gross debt by more than 110 billion euros. Interestingly, Greece's gross debt actually reflects only half of that amount, since the Greek government also took compensatory measures for some of the losses that the bondholders had to accept because of the haircut. Because of this, only about 50 billion euros of the 110 billion euros can be proven to be a reduction in the debt level. But in the other countries, gross debt is still continuing to grow.

5. That's not necessarily a good sign, is it? It always depends on the other factors. If nominal economic growth, which is always determined by the inflation rate and the real growth rate, increases sharply at the same time, then rising gross debt can certainly be compatible with declining debt levels. In other words, growth of gross debt is not in itself an indication of whether debt ratios are increasing. It's always a combination of several factors, including interest burdens and economic growth.

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