Kenneth Rogoff writes: The International Monetary Fund's acknowledgement that Greece's debt is unsustainable could prove to be a watershed moment for the global financial system. Clearly, heterodox policies to deal with high debt burdens need to be taken more seriously, even in some advanced countries.

Ever since the onset of the Greek crisis, there have been basically three schools of thought. First, there is the view of the so-called troika (the European Commission, the European Central Bank, and the IMF), which holds that the eurozone's debt-distressed periphery (Greece, Ireland, Portugal, and Spain) requires strong policy discipline to prevent a short-term liquidity crisis from morphing into a long-term insolvency problem.

The orthodox policy prescription was to extend conventional bridge loans to these countries, thereby giving them time to fix their budget problems and undertake structural reforms aimed at enhancing their long-term growth potential. This approach has "worked" in Spain, Ireland, and Portugal, but at the cost of epic recessions. Moreover, there is a high risk of relapse in the event of a significant downturn in the global economy. The troika policy has, however, failed to stabilize, much less revive, Greece's economy.

A second school of thought also portrays the crisis as a pure liquidity problem, but views long-term insolvency as an outside risk at worst. The problem is not that the debt of countries on the eurozone's periphery is too high, but that it has not been allowed to rise nearly high enough.

This anti-austerity camp believes that even when private markets totally lost confidence in Europe's periphery, northern Europe could easily have solved the problem by co-signing periphery debt, perhaps under the umbrella of Eurobonds backed ultimately by all (especially German) eurozone taxpayers. The periphery countries should then have been permitted not only to roll over their debt, but also to engage in full-on countercyclical fiscal policy for as long as their national governments deemed necessary.

In other words, for "anti-austerians," the eurozone suffered a crisis of competence, not a crisis of confidence. Never mind that the eurozone has no centralized fiscal authority and only an incomplete banking union. Never mind moral-hazard problems or insolvency. And never mind growth-enhancing structural reforms. All of the debtors will be good for the money in the future, even if they have not always been reliable in the past. In any case, faster GDP growth will pay for everything, thanks to high fiscal multipliers. Europe passed up a free lunch.

This is a fully coherent viewpoint, but naive in its unqualified confidence (for example, in the polemical writings of the Nobel laureate economist Paul Krugman). As a result, the anti-austerian view masks strong assumptions and risks. In fact, piling loans atop already-high debt burdens in the eurozone's periphery entailed a significant gamble, particularly as the crisis erupted.

Political corruption, exemplified by the revolving door between Spain's government and financial sector, was endemic. Dual labor markets and product-market monopolies still hobble growth, and oligarchs have disproportionate power to protect their interests. In reality, Germany could not have underwritten all of the European periphery's debt without risking its own solvency and creditworthiness, particularly in the absence of a functioning system of eurozone-wide checks and balances. Expansive and open-ended guarantees might have worked, but if they didn't, the economic rot from the periphery could have spread to the center.

A third point of view is that, given the massive financial crisis, Europe's debt problem should have been diagnosed as an insolvency problem from the start, and treated with debt restructuring and forgiveness, aided by moderately elevated inflation and structural reform. This has been my viewpoint since the crisis began.

In Ireland and Spain, private bondholders, not Irish and Spanish taxpayers, should have taken the hit from bank failures. In Greece, there should have been faster and larger debt write-downs.

Of course, national governments would have had to use taxpayer funds to recapitalize northern European banks – especially in France and Germany – that lent too much to the periphery. And transfers would have been needed to recapitalize the periphery banks. But at least then the public would have understood the reality of the situation, while restructured and recapitalized banks would have been in a position to start lending again.

Unfortunately, too many policymakers in advanced economies allowed themselves to believe that such heterodox policies are only for emerging markets. In fact, advanced countries have resorted to heterodox policies to reduce debt overhangs on many occasions. Debt restructuring would have given Europe the reset it needed. Yes, there would have been risks, as IMF chief economist Olivier Blanchard has pointed out, but running those risks would have been well worth it.

So what is the way forward? Deeper European integration, stricter equity requirements for banks, and deeper but homegrown structural reforms are certainly key elements of any solution. Further aid to the European periphery is still badly needed.

But, beyond that, Europe's experience ought to spur a full rethink of the global system for administering sovereign bankruptcies. That could mean bringing back older IMF proposals for a sovereign bankruptcy mechanism, or finding ways to institutionalize the Fund's recent stance on Greek debt. There is no free lunch in Europe, and there never was; but there are much better ways to deal with unsustainable debt.