THE LAST TEMPTATION

By Thanos Catsambas*

On May 10, 2010, the Executive Board of the IMF made a mistake that has been the subject of much commentary ever since: to justify a huge loan to Greece (the largest loan in the IMF's history in terms of a country's quota), the Board modified its own rules in a hasty and, some observers argued, "surreptitious" manner. Such a harsh criticism reflected the fact that the IMF rules were modified on the same day that the loan to Greece was approved, with little opportunity for the Board to deliberate the consequences of the new legal framework. Essentially, the loan was approved without sufficient guarantees that Greece's debt would be sustainable in the future—a condition that was a requirement, *inter alia*, for the approval of exceptionally large loans at the time. Within less than two years it became obvious that Greece's debt was indeed unsustainable, and in 2012 it received the largest haircut in world history—53% of its value was lost to creditors. But the delay in the debt restructuring cost the country valuable time in modernizing its economy, made the IMF appear subservient to Europe's wishes, and caused an upward debt spiral in the Greek economy that could be halted only with very high primary surpluses for extended periods of time. Thus, in achieving the required fiscal restraint, Greece's economy went into a deep recession, with GDP cumulatively declining by over a quarter and overall unemployment reaching 25 percent. The liquidity in the economy vanished, and the country has been subjected to capital controls since July 2015. In 2010, the premature IMF involvement in Greece's rescue (before a deep debt haircut) both made the organization look like an accomplice to the bailout of German and French banks and led to an insufferably long deterioration in Greece's standard of living.

While the 2010 modification of the IMF rules of engagement for an exceptionally large loan was reversed in 2016, the IMF is now facing a new dilemma: how to continue helping Greece while adhering to its own rules that are at odds with the position of Greece's major creditors, which are now the Eurozone governments. The circumstances mirror those of seven years ago: Greece needs both a fresh disbursement to be able to discharge its upcoming external obligations in July 2017, and another debt relief. The Eurozone governments have ruled out a new haircut, but are willing to grant a deep reprofiling through a combination of the standard parameters: extension of the repayment period, lower interest rates, and a longer grace period. The problem is that the debt relief, which is again necessary to render Greece's debt sustainable over the medium term and allow the IMF to re-enter the bailout program, will not be provided by the Eurozone creditors now; the relief may be announced in 2018 or even later, since the loans that would be subject to this restructuring are not due before 2022. This delay by the Eurozone governments reflects purely domestic political considerations and has caused much consternation at the IMF, which has resisted its participation in a new bailout arrangement for nearly two years. But Greece cannot make the July 2017 external repayments without financial assistance. The Eurozone governments are prepared to provide this financing, but only if the IMF is an active partner. This impasse reflects a classic Catch-22 situation: the IMF will not participate without assurances that the debt will become sustainable, and the Eurozone countries will not provide such assurances now; meanwhile, though, they must demonstrate to their parliaments that the IMF is an active partner.

Enter Sean Hagan, the IMF's General Counsel and, as on many other occasions, the *Deus Ex Machina*. He argues that the IMF can participate in the joint endeavor "in principle" through a Stand-by Arrangement (SBA) that would carry no disbursements unless and until the Europeans provide concrete steps for reducing Greece's debt burden. Then, and only then, would the *in-principle* SBA be converted to a regular SBA with access to IMF financing. This logic parallels similar cases from the 1980s, when some programs for African and Latin American countries were approved "in principle", because 12-month financing assurances (another important requirement for the approval of an arrangement by the IMF Executive Board) were lacking. The *in-principle* programs became "arrangements" once the financing assurances were confirmed.

The participation of the IMF "in principle" in a joint bailout effort for Greece was agreed between Germany and the IMF and presented to all participants at the May 22 meeting of the Eurogroup; it was a compromise to allow Eurozone countries to disburse the next loan installment in time for Greece's July repayments. But the Greek authorities rejected it, because it would shatter their long-promoted storyline that the new austerity measures, equivalent to 2.6 of GDP and recently passed by parliament, would have been accompanied by a generous debt relief, which in turn would have led to Greece's participation in the QE program of the ECB, which in turn would have allowed Greece to test the waters with capital markets. That was the political narrative of the Greek government, which reflected as much economic strategy as wishful thinking. The Greek authorities had painted themselves into a corner by linking the new measures with an imminent debt relief, which the May 22 meeting failed to approve.

It now appears that the same solution will be presented to Greece at the next Eurogroup meeting on June 15, and the country will have no choice but to accept the proposal so it can receive the financing that would help it get over the July repayment hump. But what would be the role of the IMF?

The IMF is facing its last temptation: should it bend again its rules for a substantive participation in the Greek bailout (approving an *in-principle* SBA not as time-dependent but as state-dependent, i.e. until the debt relief measures are clarified), or only provide a fig leaf to the Europeans for the disbursement of the July tranche, without a true intention to return? The latter approach would be another compromise to accommodate the wishes of Germany and other similarly minded countries, without an immediate solution to Greece's lingering debt problem. One counterargument to the current stalemate is that, since many of the recently legislated measures are not due for implementation before 2019, the delay in the parametrization of the debt relief would provide the Europeans with a lever to pressure the present and future Greek governments to honor their commitments. There is some truth to that, but given the highly charged political situation in the country (on May 25 a parcel bomb exploded in the hands of former PM Papademos as he was riding in his car), the delay will probably do more harm than good if it leads to a lukewarm implementation of the agreed measures and further postpones Greece's participation in the QE program. This is the dilemma that the IMF will have to face before the June 15 Eurogroup meeting, which will reveal if, and under what terms, the international organization would rejoin the bailout effort.

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