SYRIZA, The IMF And The EU: Gambling With The Future Of Greece

by Costas Lapavitsas and Daniel Munevar on 8 April 2016 [http://www.socialeurope.eu]

The latest flare up regarding Greece has followed publication by Wikileaks of illegally taped discussions among IMF officials. To analyse the significance of this event it is vital to bear one point in mind: Greece cannot meet the terms of the bailout agreement struck on July 2015 by Prime Minister, Alexis Tsipras. The agreement is effectively dead and all parties involved are aware of that, even if they are not openly admitting it.

An impossible agreement

To establish this point there is no need to engage either in Debt Sustainability Analysis, or in macroeconomic projections of output. Suffice to mention that the agreement requires Greece to ensure a primary surplus of 3.5% of GDP in 2018. The Greek economy actually returned to recession in the last quarter of 2015 and the available indicators since the end of 2015 have ranged from bad to appalling: industrial turnover in December was down 13.5%, retail turnover in January down 3.8%, unemployment in the last quarter of 2015 up to 24.4%, job vacancies for the whole of the economy in the last quarter of 2015 stood at a pitiful 3119, and the banking system currently has perhaps €115bn of non-performing exposure, roughly 50% of its loan book.

Once the austerity measures of the bailout agreement kick in, substantially reducing aggregate demand for 2016-17 via tax increases and lower pensions, the recession will become deeper. There is no way that this ruined economy could generate a 3.5% primary surplus in 2018. The problems thereby created for all parties to this disastrous bailout are legion.

The problem of the Greek government

In the worst position is the Greek government, which signed up to the bailout in direct contravention of everything that it had promised to do in 2015. As the reality of its deception and the harshness of the squeeze have begun to sink in, electoral support for Tsipras has vanished.

All competent polls show the opposition New Democracy – with a new leader – comfortably ahead. The outlook has become even worse for SYRIZA via the refugee wave, which has turned Greece into a kind of EU repository for refugees and migrants. For the time being the country has avoided a major crisis, but the situation remains extremely fraught as the deportation of migrants to Turkey has just started.

In this context, the last thing that the Tsipras government would like to do is to impose further pressure on wage earners, or tax payers in an attempt to meet the impossible target of 3.5%. On the contrary, it is extremely keen to complete the first review of the bailout programme on a nod and a wink, pretending that current measures are sufficient to hit the bailout targets. It then hopes to receive a tranche of bailout money that will give it breathing space for a few months. The government's further hope is that investment will pick up by the end of 2016, possibly through foreign capital inflows, thus allowing the economy to recover somewhat.

The question of what will happen in 2017 and 2018, and whether the bailout will prove viable in the medium term, is very low on the government's list of priorities. It is, of course, a measure of its desperation and naïveté that it is banking on a spurt of private investment, the least predictable factor of aggregate demand. But such has been the trajectory of SYRIZA in power from the beginning.

The problem of the IMF and the EU

For the IMF the problem is of a smaller, if still significant, order of magnitude. The Fund has been badly caught out by the Greek disaster, having masterminded two failed bailouts in 2010 and 2012. Its projections of growth have been wrong, its assessment of the multipliers was notoriously mistaken, its judgment of how Greece is positioned relative to world markets has been poor. On any dispassionate assessment of the situation, the role of the Fund has been disastrous. The loss of credibility has been substantial, the exposure to Greece remains large, and the internal ruction caused by continuing with failed policies are far from negligible. Given the hopeless nature of the third bailout, the IMF is again in danger of being proven calamitously wrong.

In this context, the Fund has been calling for major debt relief for Greece to generate some feasible targets for 2018. After all, the reason why the country faces the impossible target of 3.5% is the need to service its enormous and unsustainable public debt. Not only this, but since the Fund's Debt Sustainability Assessment shows that under current conditions the bailout terms do not add up, it faces strong internal opposition to approving the review of the Greek programme. IMF staff and non-European members of the Executive Board are resisting continued involvement with what is becoming the biggest programme failure in the Fund's history.

Thus, the IMF, without changing its basic approach, has been pushing for significant debt relief to give the bailout agreement a chance of succeeding. For the Fund this must go hand-in-hand with credible, and tougher, short-term measures that would allow Greece credibly to achieve a primary surplus target of 1.5% of GDP. Even though its position does not represent a departure from austerity policies, the difference between earlier and new targets does imply a significant relaxation of the Greek fiscal position over time. Furthermore, the debt relief that would be required to ensure consistency between the lower fiscal targets and debt sustainability would be quite substantial. According to the assessment conducted by the IMF in July 2015, any scenario in which the primary surplus for Greece was allowed to drop below 2.5% of GDP would require stretching debt repayments decades into the future as well as "a significant haircut of debt".

And this is where the EU and the German government come in. For the Commission it is vital to appear as if the Greek problem is under control, the bailout is a success and no significant debt relief measures need to be contemplated. It is well-known that Commission projections and forecasts have an optimistic bias, very much in line with its institutional role. In the Greek case, the Commission's formal assessment of the third bailout is more positive than the IMF's, which means that the Commission is generally amenable to completing the review and releasing the bailout money.

This, of course, perfectly suits the short-term aims of the Greek government. From the perspective of Tsipras – who has always been primarily concerned with political expediency – it would be desirable for the IMF to leave the programme and for the Commission to have the decisive role.

The trouble is that, for the German government – the true power behind the bailout – the Commission does not have sufficient gravitas to guarantee the credibility of the Greek programme. The presence of the IMF acts as a guarantee for the Bundestag, which contains a sizeable contingent that is fervently opposed to bailouts in general, and to the Greek bailout in particular. Yet, at the same time, the Bundestag is strongly opposed to any substantial debt relief for Greece, particularly if that would involve a debt write off. It's far from clear how Berlin will square this circle.

Is there an IMF plot to create a Greek crisis?

The importance of the leaked discussions and the reasons for the attack on the IMF by the Greek government can be better understood in this context. The transcripts show that in exchange for supporting the lowering of fiscal targets and the provision of debt relief, the IMF is demanding an additional current fiscal adjustment amounting to 2.5% of GDP. This would include tax increases and pension cuts going way beyond the latest bailout agreement. Thus even though the IMF is now proposing what SYRIZA has demanded all along, i.e., lower fiscal targets and some debt relief, the immediate price to achieve it is quite harsh and somewhat hard to justify. Indeed, what the IMF is doing is effectively to move the goal posts in order to rescue a failed agreement that it designed in the first place.

Still, the bitter complaints of IMF officials about their Troika partners are underpinned by frustration about the politics of the Greek bailout. Poul Thomsen and Delia Velculescu (top IMF officials in Athens) claim that the Commission and the Eurogroup are well aware of what is required to keep the IMF within the Greek programme. However, European politicians will do whatever they can to delay recognition of the hopelessness of the agreement. In IMF eyes, the Commission is giving the Greek government an easy pass on the programme review to ensure continued disbursement of funds. The Eurogroup, meanwhile, keeps playing for time. Unable to accept the fiscal targets proposed by the IMF and their implications, it keeps sending technical teams to Athens to find more measures to achieve the impossible target of 3.5%. An entirely pointless exercise.

Thomsen and Velculescu insist that European leaders have to make a choice. Either they will continue kicking the can down the road on the basis of make-believe projections, implying that the IMF would be out of the programme. Or, they will accept their conditions for fiscal targets and debt relief, keeping the Fund in it. Such a choice implies a crisis somewhere down the line.

It is stating the obvious that every single important decision relating to Greece has always involved last-minute agreements after marathon sessions and dramatic events. The accusation by the Greek government that the IMF is actively plotting a crisis to bring Greece to heel is not supported by the transcripts. The IMF functionaries are merely stating what is well-known about the politics of the Greek bailout. They are breathtakingly cynical in doing so, and they do not acknowledge the Fund’s many faults, but they are not plotting a crisis.

What is likely to happen?

It is clear that the outcome of the current negotiations hinges on yet another political gamble made by Tsipras. Implicit in his government’s attack on the IMF is the consideration that, for all its power, the Fund is still junior to the European lenders. Thus, even if Greece would deliver on the tougher measures requested by the IMF, the promise of debt relief would remain uncertain. After all, the IMF could do no more than threaten to abandon the programme in order to force a haircut.

From the perspective of Tsipras, when the unavoidable showdown with the European lenders comes, it is conceivable that Germany would keep Greece in the Eurozone, leaving the IMF behind. Inevitably this would take the issue of significant debt relief off the table. Greece would continue to receive bailout funds keeping it afloat, while pretending to follow the prescriptions coming from Brussels. The SYRIZA government would gain some more time. The Greek people, meanwhile, will continue subsisting in a netherworld of stagnation and poverty.

But it is also conceivable that Angela Merkel will find it politically impossible to exclude the IMF from the programme. In that case all should stand prepared for yet another Eurozone crisis. The Tsipras government will have a knife put to its throat to accept tougher terms in the short run, while some measure of debt relief will be put on the agenda to make the third bailout workable. The outcome of such a confrontation would be unpredictable, but it is unlikely that there would be a fourth bailout for the country. After the dramatic events of July 2015 and in view of the emerging failure of the third bailout, it would be practically impossible for either Germany or the IMF to muster enough political capital to justify yet another misadventure in Greece.