Greece Gets More Time to Get It Right

Jacob Funk Kirkegaard explains the complex interplay of European politics behind the move to give Greece more time to reform and straighten out its budget—and why the International Monetary Fund is withholding its blessings.

Steve Weisman: The European finance ministers have given Greece a little bit more time to get its act together. But their decision has opened up an unusual rift with the International Monetary Fund. Jacob Kirkegaard of the Peterson Institute for International Economics is here to assess the latest developments with me, Steve Weisman. Jacob, what did the finance ministers do?

Jacob Kirkegaard: They acknowledged and offered a lot of praise for the recent decisions by the Greek government and the Greek Parliament [which passed] a package of structural reforms and a further austerity budget for next year and the year after that. So they basically acknowledged the progress on the ground in Greece and then they set in motion the policy process that will ultimately lead to the release of the next tranche of Troika funding.

But in doing so, they also opened up this surprisingly public rift with the IMF. One of the issues that needs to be addressed in order for the next payment to Greece to be made is that it needs to be established whether or not Greece is actually a sustainable country in terms of debt or not. On that issue the euro area finance ministers and the IMF disagree.

Steve Weisman: You mentioned the Troika earlier. Let's just make sure to explain that you mean the European Union, which in this case is the finance ministers, the European Central Bank, and the IMF.

Jacob Kirkegaard: It's actually the European Commission, the ECB, and the IMF. The issue here and what I think everybody is working towards is a situation where Greek is once again a sustainable country defined as a country that can raise finances in the private financial market.

Steve Weisman: But that target seems to recede. What's the target now?

Jacob Kirkegaard: No one really knows. In March, quite arbitrarily, it was determined that debt sustainability for the purposes of IMF lending meant Greece achieving 120 percent of debt to GDP by 2020. Even if that were successful, would Greece be able to borrow money at sustainable rates in the markets with that amount of debt? I think it's highly questionable. The trick is that the IMF has a legal requirement that it can only lend money to a country that is defined as being sustainable. It's always in the eye of the beholder, what does sustainable mean? There is a very public disagreement between the European finance ministers who said, "Maybe we can define debt sustainability as 120 percent of debt to GDP – but not in 2020, but in 2022."

Steve Weisman: That raised eyebrows with Christine Lagarde of the IMF.

Jacob Kirkegaard: Yes. This made Christine Lagarde's state publicly that we at the IMF have a different opinion. But everything is on the table and we now have until the next euro group meeting on November 20 to come up with an agreement about this issue.

Steve Weisman: But Madame Lagarde's concerns were a mask for the IMF's real concerns here, which is that they want some sort of debt restructuring for Greece to help make it sustainable?

Jacob Kirkegaard: Yes. The rules for the IMF that they can only lend money to sustainable countries reflect the need to protect the IMF as a creditor, meaning that you don't throw good money after bad money.

Steve Weisman: Sure.

Jacob Kirkegaard: That's why the IMF basically wants the euro area to restructure and write down the total value of Greek debt now or up front.

Steve Weisman: Who owns that debt that she wants restructured?

Jacob Kirkegaard: Overwhelmingly, the euro area governments. The vast majority of Greek debt now is held by or is owed to other euro area governments. Some of it is owned by the ECB, some of it is owned by the IMF, but a relatively small amount is owned by private investors, because they had their holdings restructured earlier this year.

Steve Weisman: Governments are answerable to voters and don't want to do this?

Jacob Kirkegaard: From the perspective of the euro area governments, they don't want to do this now for several reasons. First of all, it has to do with German politics. You don't want to do this before the German elections next year.

And second, the euro area governments are also afraid that if they give Greece a debt restructuring now, meaning a sizeable debt write-down, it's going to lower their leverage over the Greek government to continue to implement all these structural reforms that they have put in place.

The euro area is basically pushing for time, saying essentially to the IMF, "Look, don't worry; we will not allow Greece to go bankrupt again. We will make the numbers work; somehow you've got to trust us." And the IMF is saying, "No, no, no, that political commitment is not enough. We need to see money on the table right now. Those are our rules and we need to stick by them."

Steve Weisman: The IMF may even trust the European authorities, but they have their own concerns about countries down the road demanding the same terms.

Jacob Kirkegaard: Yes, absolutely. This is the institutional integrity part of the concerns from the IMF. There's no doubt that Greece is as bad as it gets in the euro area, whereas for the IMF, which is an organization that intervenes globally, you can easily mandate that the next time the IMF has to intervene in an emerging market country somewhere, this country's government is going to say, "Hey, guys, I want the same cozy deal that Greece got."

Steve Weisman: Is this going to be resolved by mid-November?

Jacob Kirkegaard: I think that it will be ultimately resolved and I think we will see the euro area governments agree to further restructure their own holdings of Greek debt. But they [will] restructure it in a way that does not involve outright debt relief, meaning that they do not write down the principal value of the debt.

They don't give Greece a haircut, but they do give them reductions in the net present value of the debt. That can be done by lowering interest rates to zero or giving them an interest rate moratorium or further extending the duration of these loans so that it's a sort of down payment for the IMF to see that the euro area is actually serious and it also allows for the IMF debt sustainability analysis to be tweaked in such a way that it actually shows the politically magic number of 120 percent debt to GDP by 2020 under the baseline policy scenario.

There are a number of levers here that you can play back and forth. But ultimately, I expect a compromise to be made, but a compromise that allows the euro area governments, particularly in Germany, to not have to go back to their voters and say, "Oh, we just gave Greece a fiscal transfer, we just gave them a haircut."

That's not in the cards yet. It will have to happen in the future because there is no way that Greece will ever be able to return to the financial market and private market financing unless its total debt burden is substantially reduced.

Steve Weisman: Thank you, Jacob.

Jacob Kirkegaard: Pleasure.