Greek crisis reveals new face of the IMF as supporter of debt relief (+video)

The International Monetary Fund's warnings that austerity plans for Greece are too harsh are a sign of the organization's own learning curve in an era of financial uncertainty.

By Mark Trumbull, Staff writer **JULY 16, 2015**

WASHINGTON — The mission of the International Monetary Fund is essentially to dole out a financial version of tough love for nations in economic trouble.

But the crisis in Greece is revealing a new face to the IMF, which this week called on Europe's creditor nations to take a softer tack toward Greece.

IMF officials have issued a blunt warning: The latest austerity plan for Greece won't put the nation on a sustainable path toward debt repayment or economic revival.Instead, the officials say, any viable Greek solution must involve creditor "haircuts" (forgiving some of the debt owed) or a grace period of three decades for the Greek economy to reform and recover from its current depression.

The IMF is not in the driver's seat in this situation, but it has influence as one of the key creditors alongside European nations – and as a widely recognized tracker of troubled economies.

Chastened by its own missteps and educated by how nations with different policies fared through the Great Recession, the IMF has evolved toward a more nuanced view of its role and capacities.

Not everyone is viewing the IMF as a hero with its call for more debt relief. Inside Europe, especially in hard-line creditor nations led by Germany, some disagree with the Fund's analysis.

Outside Europe, meanwhile, some wonder if the IMF makeover has gone far enough.

But many mainstream economists agree with the Fund's current assessment of the Greek situation – and say the stance reflects meaningful improvements at a long-controversial institution at the nexus of global economic policymaking.

"It is a very, very big change" that that has occurred, says Tu Packard, a senior economist at Moody's Analytics in West Chester, Pa. She says it's hard to know if the Fund's evolution will play out in its dealings with developing nations outside Europe, but "the IMF has become much more enlightened, compared to what it used to be."

The biggest example may be the latest one.

Even as the Greek Parliament was moving to approve major concessions to creditors, the IMF was pushing publicly for an amended bargain.

"Greece's debt can now only be made sustainable through debt relief measures that go far beyond what Europe has been willing to consider so far," said a Fund analysis made public Tuesday.

Its report outlines options including "grace periods of, say, 30 years on the entire stock of European debt," new annual transfers of aid to Athens, or "deep upfront haircuts," and then it says that the answer is "for Greece and its European partners to decide."

To many economists including Ms. Packard, this was a needed reality check. The so-called third bailout of Greece since 2009, by her reckoning, is likely to further shrink an economy already reeling from unemployment above 25 percent.

The deal includes economic reforms designed to foster growth for the Greek economy, but she predicts the austerity implied by tax hikes and interest payments would push up both unemployment and debt burdens (as a share of shrinking gross domestic product), even after factoring in financial support that's expected to flow to Greece from the creditors.

The IMF sees Greek debt rising to 200 percent of GDP under the new bargain with creditors, nearly twice the level it stood at when bond markets began to worry about Greece in 2009.

The IMF's warnings represent a turnabout from its own former stance – a sign of the organization's own learning curve in the current era of financial uncertainty.

Back in 2013, the Fund acknowledged flaws with the initial efforts to address Greek debts. Often initial recovery plans in such cases are "too sanguine," it said. The IMF accepted shared blame with other creditors for this costly mistake. The problem, as the world is seeing now, is that delaying needed restructuring can make problems worse for both debtor nations and their creditors.

But Robert Shapiro, a former US Commerce Department official who is now chairman of the consulting firm Sonecon, sees another explanation for the delayed day of reckoning on Greek debt: a rational desire by Europe and the IMF to mitigate "contagion" risks.

"Had this crisis occurred in 2011 or 2012 ... there was a real risk of contagion to the Italian and Spanish debt markets, and that contagion would have had very serious consequences for the European banking system," Mr. Shapiro says.

His point isn't a vindication for the precise form of the first Greek bailouts, but it explains why there was a focus on buying time. Since then, efforts by the European Central Bank and others have reduced the fear that a default on debt by Greece would amplify risks involving other high-debt nations in the currency union.

Changes in IMF thinking have been visible in ways that go beyond Greece.

- Economists at the Fund have revised their views on how changes in government spending or taxes affect GDP. "Fiscal multipliers" (the effect of policy changes on the overall economy) proved to be larger in the Great Recession and its aftermath than the Fund had expected. The implication: Although budget austerity may at times be unavoidable, it's important to factor in how big a squeeze it can put on GDP, especially during a recession. This view also implies more of a welcome mat for fiscal stimulus policies such as what the United States deployed in 2009.
- IMF economists have also been shifting toward the view that a high degree of income inequality may be a hindrance to economic growth, not a natural feature of economic development. "You do not have to be an altruist to support policies that lift the incomes of the poor and the middle class," IMF Managing Director Christine Lagarde said in a June speech. "Everybody will benefit from these policies, because they are essential to generate higher, more inclusive, and more sustainable growth."

- Looking at empirical evidence, the Fund has also reversed course on capital controls, saying that policies to regulate flows of money in and out of a country can be helpful, such as by mitigating the risk of asset bubbles and busts.

In all this, the Fund is adapting to changing economic theory and evidence, and to pressure from critics, including emerging-market nations that are IMF members.

“They’ve got a smart managing director,” Shapiro says. “They have a large and very competent professional staff.”

Will the IMF succeed in coaxing Europe to find a solution that keeps Greece in the currency union, and allows for economic recovery there?

That remains to be seen.

But in Shapiro’s view, the IMF is correct about the basic problem: If Greece is to pay off debts, the economy has to recover. And some major form of debt relief is needed to allow that to happen.