The IMF and Greece
(post Blanchard Blog and post Euro-Greek deal)

Yesterday's Euro-Greek "deal" leaves a bitter after-taste. Whatever its ultimate fate, hopefully the uneasy sense of "what have we done?" that already pervades will prompt deeper introspection about how we all got to such a point.

Defensive briefings are already out, including that from Blanchard last week on the IMF role in Greece. But in the wake of the deal, it is clearer than ever that his blog evades the issues, and that those issues badly compromise prospects for the deal.

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IMF on Track

But start with four of his points which are basically correct, though on the first and last of these, he is unduly understated.

He notes that possible systemic risks motivated the IMF decision to lend to Greece in 2010. However, he is agnostic about them himself, saying only that firewalls were absent and that the risks could be argued "either way" and, simply, that it "*was*" decided they were to high restructure. In contrast, among others, two of his former colleagues who led the Irish program—Chopra (from m35) and Mody (citing Otto Pöhl)—both said recently, after leaving the IMF, that systemic risks were exaggerated; in 2010, they now say, all bondholders should have been bailed in.

Had subsequent events in the Eurozone been fairly plain-sailing, such ex-post agnosticism or assertion of systemic robustness in 2010 would have heft.

But if the system was so strong in 2010 as to have made a Greek and/or Irish defaults at that time systemic-non-events, it is nigh impossible to explain subsequent actual Euro strains—including continued market mayhem in 2010 even after the Greek program began, and again in 2012. And nor does it account for grounded concerns with systemic effects of Grexit even now. In that light, it is unclear how, in real time, it would have been responsible for the IMF to take the chance in 2010.

My view at the time, and in light of that subsequent Euro history, is that had outright Greek and/or Irish default occurred in 2010, the Euro would already be long and catastrophically dead. Despite the cynicism of self-interested parties in the judgement, I see little basis for agnosticism or for saying that policymakers should have taken a punt on systemic risk in 2010.

That said, those concerns do *not* justify what the IMF actually did—neither the infamous systemic exemption, nor the utterly incoherent macro projections and corresponding conditionality in the 2010 (and 2012) programs—nor what the ECB did in that context either. There were other better if politically less convenient options even at the time. But Blanchard's blog does not even consider the possibility of other options or what is to be learned from how the IMF chose among them.

Blanchard is on firmer ground on three other points.

First, that alongside an easing of official credit terms, private sector creditors took a hit in the 2012 restructuring, including—though he omits this key and very troubling detail—the Cypriot banks.

Second, that Greece's output falls reflected factors in addition to fiscal consolidation—including an above-potential starting point, and multiple deep structural failings in the economy.

Indeed, if, as he does, one starts the clock for analysis at end-2009, the outlook for Greece and its creditors was indeed very bad, whatever policy options on the Euro and Greece were applied from that point on. But that does not mean that the appropriate options—those at least cost to global order—were chosen by the IMF.

Last, Blanchard is right that the latest IMF DSA, though only released days ago, is too "optimistic" and that more debt relief than noted there is needed. But that reassessment has little to do, as he suggests, with the referendum—the DSA was over-optimistic regardless. And it is truly remarkable, as he records, that it was long-shared with the creditors but not, until publication, with the Greek government. There could hardly be a clearer sign than this concerning who the IMF works for!

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IMF off Track

Beyond these acknowledgements of his case, the defense of the IMF falls badly short. And the failings he overlooks are reflected in key shortcomings in the new Euro-Greek deal—as will be noted point by point and then drawn together below.

To see this, note that he uses the device of choosing which critiques to respond to as a means of sidestepping much more damning critiques than those he addresses.

So, for example, he does not even raise the question of the IMF's role in the antecedents to the 2010 Euro-Greek crisis. To infer that there were only bad choices in 2010 only underscores the failures of IMF surveillance on the Euro Area in the decade prior to. On that, Blanchard is silent. Such IMF failure to look ahead is again reflected in its role in this Euro-Greek deal.

Further, while Blanchard notes that Greek output declines were much larger than forecast, he ignores what that implies. To acknowledge now that some output decline was inevitable and had many roots does not address the fact that the IMF diagnosis, prescription, and prognosis for it in 2010 was utterly and predictably wrong.

Among the obvious problems with the IMF program in 2010 is that despite Greek price rises of 25% relative to those in Germany since Euro accession (measured by their relative GDP deflators) and much talk at the time of need for "internal devaluation", the program numbers anticipated bold export and real GDP growth from 2011 without any correction in that chronic disequilibrium in output prices.

This among many other errors, meant that the IMF both grossly understated the fiscal adjustment necessary and the associated multipliers, both of which led to great overstatement of Greece's debt-carrying capacity.

Sadly, these "technical" errors were no consequence of political interference, as the public record now shows, despite the interference on the related question of debt restructuring. At the time, the Europeans, and some dissenting IMF board members, were far closer than the IMF staff to the mark on these technical matters, despite the staff being called in by Merkel for its reputed technical prowess.

For Blanchard to pass over all this carries the implication that he and the IMF would apply the same policy prescriptions from 2010 regardless if output over 4 years would rise by 5 percent (as predicted) or fall by a quarter (as happened). Similar technical problems with IMF projections and prescriptions bedevil the new Euro-Greek deal.

Furthermore, given that the scale issue (the GDP outlook) was so badly misdiagnosed by the IMF, it is remarkable for Blanchard now to argue that output decline in part reflected that reforms were not implemented or not implemented on a sufficient *scale*.

He should acknowledge instead that far from "lagging", the actual contraction in real public expenditure between 2010 and 2015 *far* exceeds what was demanded under the original 2010 and 2012 programs. Thus, the Greek policy effort, not laggardly at all, has been Herculean.

And given the incoherence of the IMF GDP (and hence fiscal revenue) projections in the programs, it is astonishing that as many as 5 of the 12 program reviews were completed because doing so required the Greeks to chase after constantly receding finish-lines. It is a testament to resilience that their political system has held up at all, not only under the duress of meeting such draconian demands, but having to submit again and again to such such serially-incompetently determined demands.

So far, frustration only been reflected in the election of Syriza and in its breaches of Eurogroup etiquette. But after yesterday's Euro-Greek deal and the inevitable consequent political tumult in Greece, there is risk of considerably worse to come.

Then Blanchard claims that Syriza's election, which he treats as an exogenous event, forced reconsideration of the policies and financing of the program. However, the implication that "all was well until Syriza" is contradicted by the IMF's own numbers on the macro and debt sustainability in 2014. Growth picked up then not despite "austerity" but due to a pause in it—a fiscal *relaxation*—in 2014, and even so, debt was sustainable in the 2014 IMF DSA only under utterly implausible fiscal policy and long-run structural assumptions. Indeed, for Blanchard to describe the then prevailing IMF program primary surplus targets—rising to 4 1/2 percent of GDP by 2016—as "small, increasing over time" is unreconstructed double-speak.

Essentially, the IMF presumption, reiterated in his blog, that bad Greek politics in 2015 wrecked good economics rather than that bad economics to 2015 completely upended Greek politics in that year remains. It is the achilles heel of yesterday's Euro-Greek deal.

Finally, Blanchard suggests that the IMF should essentially wash its hands regarding the underlying choices ahead, seeing them as essentially political. He writes:

> "Fundamentally, the Euro area faces a political choice: lower reforms and fiscal targets for Greece means a higher cost for the creditor countries. The role of the Fund in this context is not to recommend a particular decision, but to indicate the tradeoff between less fiscal adjustment and fewer structural reforms on the one hand, and the need for more financing and debt relief on the other."

It sounds so reasoned and neutral. But there is no acknowledgement here that exactly the same paragraph could have been written to defend what the IMF did on the Euro since 1999, including in 2010, implying that the IMF then and now is unconcerned that the actual "political" choices that were made produced chaotic intra-Euro financial flows in the decade to 2008, consequent Euro convulsions from 2010 on, and a great depression in Greece.

It is sadly telling about the IMF itself—and for prospects for the latest Euro-Greek deal—that its pre-eminent Chief Economist, leading technical experts in an institution originally founded to prevent a recurrence of the Great Depression, sees it as having no substantive role when "political choices" have consequences of those orders of magnitude. There is not the slightest hint of a presumption that the IMF should speak "truth to power" here.

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IMF and Euro-Greece now

So what do these four key gaps in Blanchard's defense of the IMF—failure of surveillance in the long antecedents to Euro crisis; gross technical misdiagnosis and forecasting errors in 2010 and 2012; interpreting the problem now as bad politics upending good economics, rather than vice-versa; and the absence of any presumption that the IMF should speak truth to power—say about prospects for and the role of the IMF in the Euro-Greek deal now?

On the first, failure to look ahead, the problem of ownership—its total absence in the wake of the humiliation of Greece and the specification of most reforms as "prior actions" to start negotiations, let alone to make the first disbursement—should tell the IMF that this program has no chance of success. But instead, the Managing Director says the IMF stands ready to move this important effort forward.

This IMF failure to look ahead has a further key dimension of immediate relevance to the Euro-Greek deal. The substantive reason why the option of "temporary Euro exit" was even floated in recent days is that there is no sovereign insolvency mechanism inside the Euro. And any ad hoc initiative to that end to Greece's benefit could not readily be ring-fenced from other potential beneficiaries, including Ireland and Italy. A temporary euro exit, however nonsensical on other grounds, had the merit of accommodating debt write-offs and ring-fencing the initiative—by making it prohibitively costly for others who might be interested. What IMF surveillance—despite commentary on every other conceivable Euro issue—has missed, is need to design an effective Euro sovereign insolvency mechanism.

This oversight will bedevil IMF engagement in this Euro-Greek program now. Blanchard has said in his blog that more than maturity extensions will be needed given developments even since the DSA issued just days ago. But the Euro-Greek deal expressly rules out nominal haircuts and leaves the broader issue of debt relief both contingent and uncertain. The lack of a Euro sovereign insolvency mechanism could, on these grounds, not only prevent even the minimal debt write offs the IMF now (post Blanchard blog) regards as necessary to secure sustainability, but if so, it could thereby prevent the IMF from supporting the program financially or force it, as in 2010, to find another way around its rules.

On the second issue, technical misdiagnosis, all the elements are in place for yet another recurrence of this. The IMF still projects Greece to grow in the face of a fiscal withdrawal to 2018 of 3 percentage points of GDP, despite the evidence that fiscal relaxation was key to the 2014 turnaround. With the political turmoil to follow in the wake of yesterday's deal and the possibility that the fiscal targets could yet be tightened once again so as to reduce financing needs, prospects for an early blossoming of "confidence" to offset this fiscal drag is remote. This Euro-Greek program is as technically incoherent as its two predecessors.

On the third issue—misinterpretation of *the* problem as exogenous bad politics upending good economics rather than the other way around—the new program badly compounds the error. Tsipras, for all his evident tactical and strategic shortcomings, has proven himself able to rally and move his countryfolk in a way that no-one else there can, even able to carry many of them with him in his U-turn after Oxi. No "government of National Unity"—which would inevitably include those interests most responsible for Greece's prior political and economic failures—or technical government can hope to match his political pull as was prior to his weekend humiliation. In short, the creditors have a deal on paper, and in giving him barely anything on debt relief, may have destroyed the only politician who had the remotest political chance of delivering anything remotely close to it. If so, they, along with the IMF, will say that proves they were right all along on the issue of "trust".

And on the last issue—speaking compliance to power—both Blanchard's blog and the Managing Director's welcome of the deal continues long-established precedent. In respect of "political choices", the IMF cannot be relied upon to warn of, let alone ward off, the greatest dangers in Europe.

Perhaps, in light of all this, it is less puzzling why Greece is so averse to continued engagement of the IMF in the program. The role it has played in calling for debt relief has been late, compromised, and inadequate. And with these ongoing four key shortfalls in its work, from the Greek perspective perhaps, at best, the IMF simply adds clutter to an already way over-cluttered creditor side of the table.

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Some have noted that this image might become iconic of the Euro-Greek deal, with uncomfortable echoes of this image which has became iconic of the Asian crisis. If so, that might prove prescient as the event captured in the latter initiated a program which was so badly mis-designed that it had to be completely reset within months as Indonesia spiraled out of control under the auspices of its initial IMF program.

Similarly, though its European masters will not countenance the idea, with the latest Euro-Greek deal so ill-starred, perhaps it would be better for the Greeks and for the IMF itself were the Fund just to stay completely out of it.

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