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Greece and the IMF

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The ongoing crisis affecting Greece has reached a delicate point. Greece can obtain further funding from financial markets, but it finds that the interest rate it has to pay (6.5% for ten-year bonds) is unbearable. Germany seems to have taken the position that no support is needed (and none will be granted) as long as Greece can refinance itself on the market and that the country just has to accept the conditions that the market is offering. This stand-off has prompted a lot of speculation that Greece might turn to the IMF for support. The German government now seems favourably disposed to this approach.

Upon closer inspection, however, it appears that the IMF (alone) cannot provide a solution to the problem.

Greece's quota in the IMF amounts to about €900 million. Under ordinary circumstances, the IMF can lend a country six times its quota, but under exceptional circumstances it can be more. In the case of Hungary, for example, the amount was equivalent to 10 times its quota, and in the case of Iceland, the Fund was willing to lend 12 times the quota. However, the Icelandic programme came in the wake of a total collapse of the banking system and the country's economy. It is clear that an IMF package for Greece could not amount to much more than €10-12 billion.[1]

Moreover, the IMF programmes always foresee a disbursement in tranches, linked to economic criteria. The tranches are usually scheduled for payment at intervals of more than 6 months apart and the first tranche amounts to less than one-half of the total. This implies that the most that Greece could hope to immediately obtain in funds from the IMF would total about €3-5 million over the next few months. This sum is only a fraction of the approximately €20 billion the country has to refinance over this same period (and would be an even smaller fraction of the €50 billion that Greece has to refinance this year).

Moreover, the IMF often insists that countries in the region should top-up its own programme. This would be difficult in the case of Greece, however, whose largest neighbour is Turkey.

It is thus clear that an IMF programme can alleviate the liquidity needs of Greece only if eurozone countries contribute in a substantial way. This would be done either via bilateral loans or if other eurozone member countries 'lend' their quotas to Greece. Either way, the funding of the programme would effectively be European (or rather eurozone).

[1] In principle, there are no preset limits on the Flexible Credit Line (FCL). But it does not seem appropriate in the case of Greece since: "The FCL is for countries with very strong fundamentals, policies, and track records of policy implementation ……."

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Given that the IMF programme cannot in any way be more lenient than that of the European Union, it is difficult to see what Greece could gain from going to the IMF. The only gain would be debt servicing savings: the IMF charges at present only about 1.5% on its loans (which are short-term), a full 5 percentage points less than the 6.5% (for longer-term funds) that Greece has to pay on the market. On a full IMF programme of €10 billion, Greece could thus save half a billion a year, or less than 0.3% of GDP. It remains to be seen what terms will be set for the European contributions. Could euro area member countries agree on similar terms of bilateral loans? Even if they lend their IMF quotas to Greece, they are effectively providing a substantial interest rate subsidy to Greece.

Against this modest gain, one would have to answer a key question that is often overlooked: In what position would Greece be if it went to Washington now and then had to come back to its EU partners later in the year because the risk premium has not gone down and/or the fiscal adjustment had not worked as planned?

The key issue that will remain for the next few years, and not just for the immediate weeks to come, is whether Greece can demonstrate to financial markets that it is actually able (and willing) to service its huge foreign debt. No IMF or other rescue programme will work as long as doubts persist on this account. Substantial IMF or other official loans could actually lead to an increase in the risk premium because they would be senior to private sector claims, thus lowering the funds available for private sector creditors in the case of default.

To go to the IMF or not? In reality this quandary boils down to the following trade-off: The IMF has fewer political constraints in giving cheap money but it is unable to provide enough to make a lasting difference to Greece. However, if the country were to go to the IMF, it might serve to provide a convenient smoke screen with which to temporarily paper over the fundamental differences on how the euro area should be run.