IMF go home

By Daniel Gros
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The curtains are up on another act of the Greek debt drama. Eurozone finance ministers and the International Monetary Fund have agreed with Greece to begin, per the IMF's demands, providing some debt relief to the country, and to release €10.3 billion ($11.6 billion) in bailout funds. Greece, for its part, has agreed to another round of austerity and structural reform.

Until recently, the IMF insisted that it would participate in the next Greek rescue program only if it deemed Greek debt to be sustainable. Based on the IMF's most recent debt sustainability analysis, that is not the case. Germany, however, insisted that the IMF remain on board – and, with the latest deal, it seems to have prevailed, in exchange for agreeing to debt relief that it opposed.

The victory may well not have been worth the sacrifice. In fact, it would have been better to let the IMF pull out, for two reasons. First, the IMF's assessments of debt sustainability in Greece are undermined by a deep conflict of interest. Second, and more important, IMF credits are too expensive.

In a normal bailout procedure, the IMF acts as an impartial judge of the troubled country's debt sustainability; then, if it so chooses, it can step in as the lender of last resort. This is what happened in 2010, when the private sector wanted to flee from Greece and a systemic crisis loomed.

But today Greece has only a few private-sector obligations. Eurozone governments are the ones offering large amounts of funding. For its part, the IMF has a large volume of credits outstanding.

Of course, if Greece's creditors accept a haircut, the IMF's credits would become more secure – hence the conflict of interest. Indeed, the IMF's debt sustainability analysis can hardly be considered neutral, and would surely be rejected by private-sector actors. A neutral judge – not one of the creditors – usually sets the terms in insolvency proceedings.

This is not to say that the IMF's conclusion is necessarily wrong. In fact, one could debate the question of Greece's debt sustainability endlessly. Some might suspect that Greece's debt is sustainable, since the Greek government has to pay less in interest than Portugal or Italy, both of which have much lower debt levels.

The IMF, however, argues that, despite these low interest payments, the refinancing needs of Greece will surpass 15% of GDP (an arbitrary threshold, to be sure) at some point – perhaps as soon as 15 years. What the IMF fails to highlight is that, if that happens, it will be primarily because of the IMF itself – or, more precisely, the high cost of its loans.

The IMF is charging a much higher interest rate (up to 3.9%) than the Europeans (slightly above 1%, on average), largely because it has surcharges of up to 300 basis points on its own funding costs, compared to less than 50 basis points for the European lenders. Moreover, IMF loans are to be repaid in just 5-7 years, on average, compared to up to 50 years for the European funding.

The IMF assumes that its loans will be substituted by private-sector loans at even higher interest rates (over 6%). This would cause Greece's debt to snowball, given that its GDP growth is highly unlikely to achieve such a rate in the foreseeable future.

The good news is that there is a simple way to avoid this outcome: replace the IMF's expensive short-term funding with cheap long-term European loans. With that switch, Greek

Refunding the Fund

Eurozone countries' repayments to the IMF (millions of euros)

	2010-2015	2016-2020	2010-2020
Greece	3,602	1,384	4,986
Ireland	2,012	249	2,261
Portugal	2,811	2,608	5,419
Total	8,425	4,241	12,666

Note: Data provided by the author.

debt may well become sustainable, even by IMF standards.

Of course, this would require more funding from the European Stability Mechanism, the eurozone's rescue fund. But the ESM would face lower risks, because the IMF has "super-senior status," meaning that its loans are supposed to be repaid first, anyway. (It should be noted that the most senior creditor usually charges the lowest, not the highest, interest rate, as the IMF does.)

The savings for Greece would be huge. Given that the average surcharge on the IMF's Greek loans is about 250 basis points, and the IMF has more than €14 billion in outstanding credits, the IMF is extracting huge profits from Greece – more than €800 million annually since 2013, nearly the equivalent of the Fund's yearly operating costs. The IMF is a valuable global institution, but it should not be financed mainly by Greek taxpayers (and pre-financed by eurozone taxpayers).

By sending the IMF packing today, Greece might save several billion euros over the next decade, with a commensurate reduction in risk for European creditors. Add to that the IMF's inability to provide impartial analysis of Greece's debt sustainability, and it is hard to see how anyone can argue that the Fund can make a contribution to the Greek negotiations today.

There is a broader point as well. Greece is not the only country suffering from the high cost of IMF loans. The outstanding IMF loans held by Ireland and Portugal, which amount to another €23 billion, should also be re-financed. If IMF loans are replaced with ESM financing, eurozone taxpayers will save hundreds of millions of euros per year.

The IMF's participation in the rescue programs for Greece, Ireland, and Portugal has already cost taxpayers in those countries nearly €9 billion in excess charges. While that mistake cannot be reversed, it can be rectified. If it is handled quickly enough, some €4 billion could still be saved.

A few years ago, European bodies may not have had the expertise to manage adjustment programs without the IMF's guidance. That is no longer true. There is no good reason to keep the IMF around today – and there are billions of good reasons to send it home.

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