The IMF "Defense" of its Actions against the Greeks is an Unintended Confession

William K. Black

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The IMF, the heedless horseman of the *troika* that announced it would stop negotiating with the Greeks and go home, has attempted to justify its position through Olivier Blanchard, its "Economic Counsellor and Director of the Research Department." Blanchard entitled his defense "Greece: A Credible Deal Will Require Difficult Decisions By All Sides." That is a "serious person" title, but it is also economically illiterate – and no one knows that better than Blanchard. After all, it is the IMF's deeply neo-liberal economists whose research has confirmed that the IMF's austerity policies are self-destructive responses to the Great Recession and that fiscal stimulus programs are even more effective than economists had predicted.

That means that Blanchard and the IMF know that an economically-literate deal does not "require difficult decisions by all sides." It requires, instead, the *troika* to cease its destructive demands that Greece "bleed the patient" to "heal" it. The *troika's* austerity demands forced Greece into a Great Depression that is worse than the Great Depression of the 1930s in terms of sustained, obscene unemployment rates. And treating Greece in an economically rational manner would set a wonderful precedent that could be extended to Spain and Italy, which also have unemployment rates today that are near or even worse than they suffered in the Great Depression of the 1930s – seven years after the acute phase of the global financial crisis.

As we (UMKC economists and NEP bloggers) and Paul Krugman have explained repeatedly, the fiscal response to a Great Recession does not require "difficult decisions" and "sacrifices." It requires funding worthwhile projects that provide an enormous "win-win" for the nations suffering from the Great Recession – and it helps their neighbors' economies. Germany's economy would be much stronger today if it had not insisted on forcing Greece, Spain, and Italy into Great Depressions. Because of the inherently flawed structure of the euro, this requires the ECB to be used far more aggressively than was contemplated by its inept architects, but it can be done. It would be an awkward, inelegant, bastardized system, but the problem in getting it done isn't the economics, it's the toxic interconnection of politics, economic dogmas spread by the *troika* and the credulous media, and disdain of the EU core for the peoples of the EU periphery that pose the insuperable problems.

The EU nations need to be spending much more on infrastructure and employing the enormous number of citizens trapped in long-term unemployment by the *troika's* dogmas. Instead, of course, the *troika* is demanding more destructive austerity.

Instead of a "win-win" of increasing useful spending the *troika's* dogmas insist on a "lose-lose," as Blanchard unintentionally admits. "At the core of the negotiations is a simple question: How much of an adjustment has to be made by Greece, how much has to be made by its official creditors?" That is the wrong question, and when you ask the wrong questions you make it a near certainty that you will get the wrong answer. "Adjustment," in the case of Greece, is simply code for "austerity." (This is not to say that Greece has no public policies that should be changed. Wealthy Greeks, for example, have long engaged in massive tax evasion and the new government of Greece is the first to make a serious effort to prevent that crime.) Austerity, however, is not an "adjustment" or a "reform" – it makes things worse.

Read how economically insane the *troika's* "plan" for Greece was in Blanchard's own words.

> It also agreed to a number of reforms which should lead to higher growth. In consideration, and subject to Greek implementation of the program, European creditors were to provide the needed financing, and provide debt relief if debt exceeded 120 percent by the end of the decade.

Here, "reforms" is code for austerity. Recall that even the neo-liberal IMF economists admit that austerity slows recovery – leading to *lower* growth. The reality is that the *troika's* 2012 plan threw Greece into a Great Depression – as the IMF's own economists warned. The Greek economy was weak before the financial crisis became acute in 2008, was battered severely when the ECB dithered for years before ending the bond "vigilantes'" reign of terror, and was driven even deeper into Great Depression levels of unemployment by the *troika's* austerity *diktats* that formed the 2012 "deal." (The *troika* famously deposed the Prime Minister of Greece when he announced plans to allow the Greek people to vote on whether to accept the *troika's* austerity diktats.)

With that background in mind, we can see what the *troika* was demanding of the Greek people before the *troika* was willing to **consider** "provid[ing] debt relief" in *2020*. Blanchard misstates the terms of the *troika's* 2012 *diktats*. He purports that the 2012 "deal" requires the creditors to provide debt relief if the Greek debt ratio is 120% or more in 2020. The reality is explained by the *Financial Times*: "Debt relief was agreed as a possible way to reach the targets if Greece was able to run a primary budget surplus."

Greece's debt-to-GDP ratio is not anywhere near 120% -- and the debt ratio is increasing as the *troika's* austerity *diktats* further weaken the economy. The same article explains:

> In February, Brussels forecast Greek debt would fall from 176.2 per cent of GDP in 2014 to 170.2 per cent this year; the new forecasts predict it will rise to 180.2 per cent this year.

The Greek unemployment rate has been above 12% since 2010. The *troika's* plan is to continue, via its austerity demands, to keep the Greek economy in Great Depression levels of unemployment for an entire **decade** (2010-2020). At the end of that period of abuse through austerity – where Greece's debt would be increased by the *troika's* insistence on throwing the Greek economy into a Great Depression – everyone knew that Greece's public debt would exceed "120 percent" of GDP. Now, these debt-to-GDP ratios are nonsense for a nation with a sovereign currency, but they can be dangerous for a nation like Greece that has no sovereign currency and is part of a currency union but not a true political union. Blanchard was one of the early deficit hawks claiming that even modest debt-to-GDP ratios were unsustainable.

In any event, it is official *troika* dogma that these debt-to-GDP ratios are of paramount importance and that a ratio of 120% means that a country's growth rate will be crippled and it will be highly vulnerable to a financial crisis. The Maastricht Treaty calls for the ratio not to exceed 60 percent – so under EU dogmas the 120% target for Greece represents an unsustainable disaster. Greece, today, has a debt ratio roughly three times higher than the Maastricht maximum permissible ratio. The ECB, a member of the *troika*, published a research paper in 2009 that claimed that Greece needed to be running substantial budgetary *surpluses* then in order to be prepared to face huge expenditures that would be required to care for its elderly citizens by 2020 and beyond. (The study was not referring to the "primary surplus," which excludes interest payments on debt. That means that it was calling for far more draconian austerity.)

Particularly in 2012 when the *troika* imposed its *diktat* on Greece, the *troika* was in the grips of neoliberal nostrums about the alleged black magic of "high" debt-to-GDP ratios. *Bloomberg* summarized these claims in an article in 2013. This was the height of the poorly designed and executed studies that ignored whether the nation had a sovereign currency and claimed that there was a dangerous debt-ratio tipping point (90%) – beyond here thar' be dragons. Carmen Reinhart and Kenneth Rogoff blundered most spectacularly. Their 2009 book claimed "Across both advanced countries and emerging markets, high debt/GDP levels (90 percent and above) are associated with notably lower growth outcomes." BIS economists (the folks who did so much to blow up the global economy by designing Basel II to aid their banker patrons) got in on the competition and claimed in a 2011 article that the black magic kicked in at 85 percent.

It was the IMF, however, that won the competition in debt hysteria in a paper published by the IMF in 2010. The Bloomberg article continues:

> And two IMF economists, Manmohan Kumar and Jaejoon Woo, found "a significant negative effect on growth" above the 90 percent threshold. For every 10 percentage-point increase in an advanced country's overall debt-to-GDP ratio, growth fell by 0.15 percentage points per year, they said.

The study's abstract contains the key claim:

> The empirical results suggest an inverse relationship between initial debt and subsequent growth, controlling for other determinants of growth: on average, a 10 percentage point increase in the initial debt-to-GDP ratio is associated with a slowdown in annual real per capita GDP growth of around 0.2 percentage points per year, with the impact being somewhat smaller in advanced economies. There is some evidence of nonlinearity with higher levels of initial debt having a proportionately larger negative effect on subsequent growth.

Blanchard has headed the IMF's research group since 2008. If Blanchard believed his own economists, then he must have believed in 2012 at the time he was helping to inflict the *troika's* austerity *diktats* on the Greeks that there was no chance that Greece could meet the growth targets in the plan because its growth potential would have been crippled by its high and sharply rising debt ratio. And Blanchard would have to believe that at its current ratio (180%), Greece cannot escape the debt trap without a very large write down of the principal amount of its debt.

The *troika* knew that its 2012 plan was based on wildly optimistic assumptions that violated economic theory and experience. It knew that even under those assumptions Greece could not meet the 120% requirement. It knew that austerity would **increase** the debt ratio. It knew that the plan, if things went even modestly different than those wildly optimistic assumptions, would produce what it considered to be even more unsustainable debt levels. It knew that Greece would likely be caught in an inescapable debt trap absent substantial write-downs of the debt. An article by a neo-liberal Greek economist who supported the *troika* admitted these facts.

> A recent analysis conducted by the Troika (Greece: Preliminary Debt Sustainability Analysis, confidential report, 15 February 2012) suggested that Greece will need additional write-offs to lower its debts to 120% of GDP by 2020. In the Troika's baseline scenario based on current policy assumptions, Greece is expected to lower its debt to 129% of GDP by 2020, well above the 120% target. The Troika report suggested that a restructuring of the Greek debt held by the European Central Bank and the Eurozone central banks would reduce the country's debt-to-GDP ratio by 9 percentage points, thus facilitating the implementation of the 120% target. However, the sensitivity analysis shown in the report concluded that the Greek debt could reach 160% of GDP in 2020, if the recession turns out to be more severe than assumed in the basic scenario, and if structural reforms are not carried out at the proper speed. Moreover, the Troika contended that it is difficult to carry out the kind of adjustments which the Greek economy requires without an initial increase in the debt-to-GDP ratio. Reduced levels of this ratio are expected insofar as structural reforms and internal devaluation will start stimulating the domestic economy. Debt sustainability is strongly dependent on the assumptions of privatisations, growth and primary surpluses. The Troika warned that if the Greek primary surplus does not rise above 2.5% of GDP, from -1% in 2012, debt would be on an ever-increasing trajectory. If revenues from privatisations were 10 billion [euros] instead of 46 billion [euros] by 2020, the Greek debt would reach 148% of GDP. If the growth rate was permanently higher than 1%, debt would fall to 116% of GDP by 2020, but if it was permanently lower, debt would rise to 143%. Because the main financing source of Greece will be the European Financial Stabilization Fund (EFSF) and the ESM, a rise in the borrowing costs by 100 bps would lead the Greek debt to 135% of GDP in 2020.

To put that in plain English – the *troika's* 2012 plan was designed to leave Greece in disastrous economic shape if the *troika* believed its own dogmas and its own wildly optimistic projections.

It was only after forcing the Greek people into a pointless purgatory of a decade of disaster that the *troika* would **consider** providing "debt relief." The reality, in 2015 (and 2014 under the prior Greek government), is already far worse in terms of the Greek debt-to-GDP ratio that the *troika* used in its supposedly worst-case projections for how bad things could get by 2020.

Given German politics, and Germany's hegemony over the EU and the ECB, the German disdain for the Greek people, and German politics it was dubious that there would be any debt relief even after a decade of pointless human sacrifice by the Greeks. The probability that Germany would agree to allow adequate debt relief in 2020 to permit the Greeks to finally escape the creditor's debt trap was effectively zero.

Debt relief for Greece is unquestionably what is needed, as all serious financial analysts agree. Such debt relief is routine for corporate debtors – but when a public debtor seeks the same type of relief the character of the nation's leaders and peoples are endlessly abused. The *troika's* "bailout" went overwhelmingly to the creditors of Greek banks – not the Greek government of people. Those creditors are overwhelmingly EU banks. The *troika's* "Greek bailout" is fundamentally a bailout of EU banks.

It is nonsensical to force a nation into a decade of Great Depression-level unemployment – and then provide debt relief. Providing the debt relief now (which should have been provided five-to-seven years ago) is the policy that would minimize damage not just to the Greek people, but the peoples of the EU.

The IMF, via Blanchard, demands still greater austerity that the IMF knows will cause further harm to the Greek and EU economies and offers words, but no actions in return.

> On the other hand, the European creditors would have to agree to significant additional financing, and to debt relief sufficient to maintain debt sustainability. We believe that, under the existing proposal, debt relief can be achieved through a long rescheduling of debt payments at low interest rates.

According to *troika* and IMF dogmas about "debt sustainability," Greece is far past the point of "debt sustainability" – and inflicting further austerity on a nation that is already suffering a Great Depression will only make that worse. In order to achieve "debt sustainability" as the *troika* uses that term, the *troika* should be providing at least a 50% reduction in the Greek public debt. Note that the IMF, however, offers zero reduction in the principal amount of the Greek public debt. The only "debt relief" they offer to discuss is a "long rescheduling of debt payments at low interest rates." This, under their own dogmas, will lock Greece into a long-term debt trap that will materially lower Greece's growth rate for decades and leave it constantly vulnerable to recurrent financial crises. That is a recipe for disaster for Greece, Italy, and Spain (collectively, 100 million citizens) and for the EU. It is financial madness – and that ignores the political instability it will cause to force an EU member nation to twist slowly in the wind for 50 years.