While the Eurogroup has recently approved a new tranche, worth €2.8 billion, of the third, and last, aid package to Greece (which is worth a total of €86 billion), the tension between the International Monetary Fund (IMF) and European countries, most notably Germany, is still high. The IMF position is simple: it claims that it cannot participate in additional lending because Greek's fundamentals are weak and its debt unsustainable. In other words, according to the IMF, debt restructuring is a necessary condition for Greece to grow out of the crisis and pay back international creditors. The Eurogroup, which includes Greece's main official creditors, disagrees with the IMF and argues that not only a haircut on Greek debt has already taken place, but also that current interest payment obligations are very favourable, and amount to an annual expenditure of less than 4% of the country's GDP.

Ironically, the extreme uncertainty over the economic prospects of Greece is exacerbated by the very favourable conditions that international, and mostly official, creditors have granted the country.

In the meantime, Greece, and the Syriza government, continue on the narrow and difficult path of structural reforms. To win approval for the last instalment of the aid package, the government majority had to push forward, among others, reforms that improve competition in the energy market, and transfer public assets to a new privatization fund which, in turn, will sell them to private, and possibly foreign, investors. The latest signals coming from the Greek economy are finally positive. The economy could, possibly, start growing again already in 2016, and is expected to growth at 2.8% in 2017. Even though these numbers are stellar if compared to those of countries like Italy, they could be simply the natural byproduct of the extremely severe recession that hit Greece. Consequently, some more pessimistic economists believe the Greek economy is just bouncing back after having reached a very low bottom, and point to other figures that are not as encouraging, like the unemployment rate, close to 24%, public debt, which has reached 176% of GDP, and the fact that, despite all attempts to increase revenues, less than half of the country's employees pay any income tax.

Different views on debt sustainability

How can we rationalize the very different positions of the IMF and the Eurogroup? First, it is difficult to evaluate the financial sustainability of any country over a very long horizon, as this requires making several assumptions about future variables like economic growth, borrowing costs, inflation. In fact, the IMF itself has recently changed its position on Greece more than once over a very short time. For example, in June 2014, the IMF stated that the Greek public debt would have stayed stable. Only a year later, in July 2015, the IMF changed its mind and announced that it would not have participated in further programs unless international creditors would agree on a substantial restructuring, arguing that the latter was a necessary condition for Greece's debt to be sustainable.

Ironically, the extreme uncertainty over the economic prospects of Greece is exacerbated by the very favourable conditions that international, and mostly official, creditors have granted the country. Currently, Greece pays on its debt interest rates that are an order of magnitude lower than market rates, and lower than those currently paid by countries like Italy and Spain. In addition, the average maturity of Greece's public debt is very long compared to those of other developed countries, and European partners, once more because of the extremely favourable conditions that were part of the three different aid packages. As a result, the expenditure on interest payments, as correctly pointed out by the Eurogroup, will stay at low levels for a very long time, as shown in Figure 1.

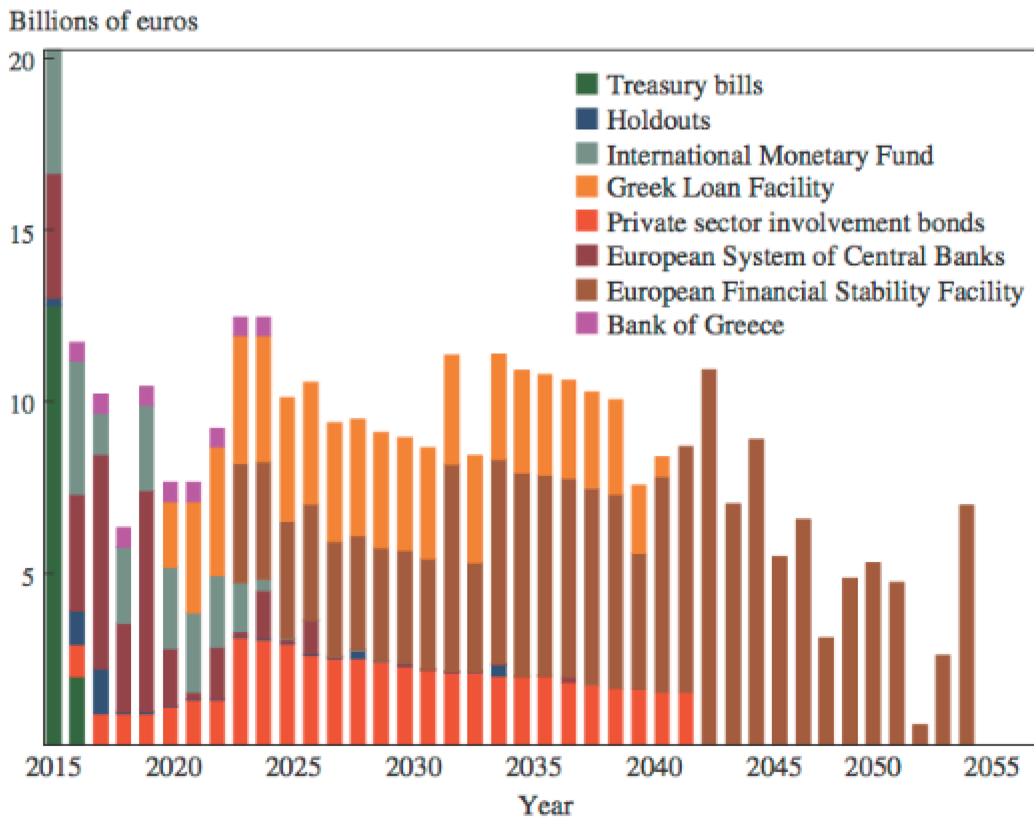

Figure 1: Greek debt repayment profile (face value) by creditors, 2015-54. Source: Schumacher and Weber di Mauro (2015).

However, these favorable conditions hold for existing loans, which originated from the rescue packages. But what is going to happen when, in the next few years, some of the loans will mature?—starting from those issued by the IMF and the European Central Bank (ECB), which will be maturing in the next few years (those issued, directly or indirectly, by the Eurogroup will instead not be expiring for quite a long time). It is plausible to assume that Greece will have to borrow new resources to pay back maturing loans. But at what conditions will the country be able to refinance these maturing loans?

The Eurogroup forecasts that Greece, after having successfully completed the agreed structural reforms, will be able to tap international credit markets at much more favourable conditions than those assumed by the

IMF.

The answers to these questions are at the origin of the disagreement between the IMF and the Eurogroup. The model used by the IMF assumes much higher interest rates, on the new loans, than the current ones, and less optimistic forecasts of the budget primary balances, which capture the capacity of a country to pay back the debt over time. The IMF's assumptions imply that, over the medium- to long-term, the gross financing needs of Greece will increase substantially and will take an extremely large, and unsustainable, fraction of its GDP. On the contrary, the Eurogroup makes very different assumptions, and forecasts that Greece, after having successfully completed the agreed structural reforms, will be able to tap international credit markets at much more favourable conditions than those assumed by the IMF.

A halfway solution?

It is hard to say who is right. But we can safely say that it is likely that Greece will need at least some time before being able to access international credit markets with reasonable costs and conditions. If this is the case, the Eurogroup, with the support of the IMF, should refinance maturing loans at conditions that are in between those very favourable from the aid packages and those, more penalizing, currently prevailing in the credit markets. However, any new loans should be conditional on the approval and implementation of additional reforms, in order to avoid that these additional resources are wasted in non-productive public spending. Instead, debt restructuring, either in the form of a haircut (i.e. a reduction of the face value of debt at maturity), or a lengthening of the maturity of repayment, would not be effective as it would affect liabilities that are already very far from today.

An Italian version of this article has appeared on Lavoce.info

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