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Economic Intelligence

Up-to-the-Minute Analysis from
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26 June 2015 Issue 08/2015

Two (Potentially Fatal) Achilles' Heels: Can a Mythical Greek Accord Be Made to Work?

After months of perilous brinkmanship and marathon meetings, culminating in virtually round-the-clock negotiations this week, an agreement between Greece and the institutions still remains elusive, and another drop-dead eurogroup meeting has been set for Saturday, 27 June. A European Council which considered a high-level report on "Completing the Economic and Monetary Union" risked instead presiding over a major setback to the EMU process itself.[1] Unsurprisingly, given the alternatives, the European Council decided that efforts toward an agreement should continue.

While this is the reasonable course of action, expectations must be tempered by the awareness that any Greek agreement that may be reached is vulnerable to two, potentially fatal, Achilles' heels. These pitfalls are distinct, and more critical, than the shortcomings of the draft accord itself (notably its emphasis on tax increases). They are intrinsic to the profile of the two sides at the table, and thus inherently difficult to overcome. On one side, there is a debtor who has a fundamentally different view of the requirements of the situation, well-removed from those of a traditional adjustment programme, with thus no ownership of any plan that mimics such a programme, as sought by the lenders. On the other side are the country's major creditors who, as such, have sizeable stakes in the game (both financial and political) and thus can hardly act as evenhanded brokers between Greece and the broader international community.

If you don't own it, you break it

The first Achilles' heel lies in the near-zero ownership of the proposed adjustment programme by the Greek government. Never (or almost never) has a government seeking a

[1] Jean-Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, *Completing the Economic and Monetary Union,* Brussels, June 2015. http://goo.gl/Y3WfAp

programme been so ideologically adverse to its underlying rationale. Relatedly, seldom has there been such a degree of mistrust on the part of the lenders.

Ownership is essential to programme execution, as evinced by the International Monetary Fund's multi-year experience.[2] This is also recognized at European Union level: a 2012 precursor to the latest Presidents' Report stressed that "national ownership is pivotal to implementation of structural reforms," and added that "a national debate on the priority measures and approval of reform agreements by national parliaments are essential to ensure national ownership."[3]

The circumstances in Greece are, however, inimical to genuine national ownership, and were so from the start. Suffice it to recall the IMF's definition of ownership to grasp its elusiveness in the case of Greece: "Ownership is a willing assumption of responsibility for an agreed programme of policies by officials in a borrowing country, who have the responsibility to formulate and carry out those policies, based on an understanding that the programme is achievable and is in the country's own interest."[4]

Key elements of this definition were destined to remain missing in Greece, given the government's economic manifesto and electoral commitments. Furthermore, its rejection of conventional technical negotiations *in situ*, where differences are traditionally ironed out, meant that the process of negotiation never approached the sort of dialogue capable of bringing the views of the parties closer together. The authorities' preference for high-level political exchanges, combined with the euro zone's intergovernmental approach to crisis management, served to further politicise the negotiations, and to bring them under the glare of the international media – a hostile setting for compromise. Indeed, as negotiations dragged on, they became increasingly acrimonious. Rather than a shared understanding, they generated growing mistrust.

It is precisely such mistrust that led to the unprecedentedly long list of required "prior actions" presented by the creditors on the eve of the European Council meeting.[5] The policy of "prior actions" was first introduced by the IMF in 1979 in cases where a given measure was seen as market-sensitive or politically delicate, but macro-economically critical to the programme's success. The typical action of this type consisted in an upfront devaluation, where this was seen as a *sine qua non* for the programme's workings. Over time, the range of prior actions was widened, with the aim of ensuring the execution of measures meeting with some official resistance. Nevertheless, their scope remained generally limited – until now, for Greece.

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[2] James M. Boughton, *Who's in Charge? Ownership and Conditionality in IMF-Supported Programs*, WP/03/191 (IMF: Washington DC, September 2003). http://goo.gl/gqCvjX

[3] Herman Van Rompuy, José Manuel Barroso, Jean-Claude Juncker, and Mario Draghi, *Towards a Genuine Economic and Monetary Union*, Brussels, 05 December 2012. http://goo.gl/M91gsC

[4] International Monetary Fund, *Strengthening Country Ownership of Fund-Supported Programs* (IMF: Washington DC, December 2001). http://goo.gl/Kn2coM

[5] Peter Spiegel, "Leaked: Creditors' bailout plan for Greece sent to eurogroup," *Financial Times*, 25 June 2015. http://goo.gl/qch1g4 and http://goo.gl/Wp6Y1m

Such an extensive approach to "prior actions," however, flies in the face of the lessons that the IMF itself has drawn from its experience with the practice. These are essentially three:[6]

1. "Prior actions, like any other conditionality, can be subject to superficial or temporary observance if domestic ownership/political commitment is weak."

2. "Prior actions imposed for 'symbolic' reasons, rather than in view of their criticality for the achievement of programme objectives, do not enhance programme effectiveness."

In addition, given the press of time, the Greek Parliament is being asked to approve the wealth of legislation involved in great haste. Apart from the practical and political realism of such an expectation, it also runs counter to a third lesson, as follows:

3. "Prior actions can also turn out to be counterproductive when they force the hasty adoption of a measure, through procedures that subsequently put its implementation at risk."[7]

All in all, then, there are compelling reasons to doubt the effective implementation of Greece's programme. Front-loading the programme with a raft of "prior actions" may temporarily ease the minds of creditors, but does nothing to increase ownership (likely the reverse). Nor does it materially change what is, in truth, a long-standing feature of Greece's political economy.[8]

Creditors cannot be your best friends

As is known, Greece has from the start insisted that a debt restructuring should be part of any agreement. In this, it has been supported by the IMF. In the words of its chief economist, Olivier Blanchard, a credible deal must include difficult measures from the Greeks but, also, "the European creditors would have to agree to significant additional financing, and to debt relief sufficient to maintain debt sustainability."[9]

Debt restructuring is of course far from unusual for countries embarking on an adjustment programme. Indeed, the delay in carrying out such a restructuring with Greece's private creditors constitutes the "original sin" underlying the current crisis. What is unusual – even unprecedented – is for a debtor to have to negotiate the details of an adjustment programme

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6 The quotations ares all from IMF Independent Evaluation Office, *Evaluation of Prolonged Use of IMF Resources*, (IMF: Washington DC, 2002). http://goo.gl/0a1ZAB

7 Ironically, this lesson was drawn from an attempt to expand the VAT base – a central plank of Greece's programme as well. Such a measure was foreseen as a prior action in a 1994 programme with the Philippines. Although formally passed, its implementation was long delayed by judicial challenges to its hasty adoption procedures. See IMF Independent Evaluation Office, *Ibid.*

8 In fairness to Syriza, lack of programme ownership is not limited to today's Greece. In 1985, for example, Greece was granted a EU Community Loan to deal with a balance of payments crisis; a study of that experience concluded that "within the government, the programme lacked the support of ministers; party cadres had also openly and repeatedly asked for a reversal of economic policy." See Eleni Panagiotarea, *Greece in the Euro: Economic Delinquency or System Failure?* ECPR Press, 2013.

9 Olivier Blanchard, "Greece: A Credible Deal Will Require Difficult Decisions by All Sides," *iMFdirect*, 14 June 2015. http://goo.gl/zRlQZU

directly with its main creditors. Having allowed private creditors to rush for the exits and unload onto the public purse in 2010-11, the bulk of Greece's debt is now held by the official sector with eurozone governments, the European Central Bank and the IMF together accounting for close to 80% of outstanding debt.

Participants in the Brussels Group thus hold appreciable stakes in the game, complicating mediation and compromise. Contrast this with the typical negotiating set-up in other countries with a large debt overhang. Their debt is typically owed to international private creditors (banks and bondholders); the latter are not party to the programme negotiations in any form. Such negotiations are left to the IMF who, when a debtor is seen to be acting in good faith, can even exercise leverage vis-à-vis private creditors via its "lending into arrears" policy (as indeed the IMF has intimated it might do in the case of Ukraine).[10]

In addition to such support from the IMF, many debtors have also enjoyed support from political mentors; typically, in the Latin American crises, from the United States. Thus, for example in the Uruguay restructuring of 2003, the country benefitted from strong U.S. backing – not only in bringing on board the rest of the G-7, but also more concretely via bridge loans and guarantees. Such "big brother" support placed debtor countries in an appreciably stronger negotiating position vis-à-vis their private creditors. Greece today enjoys no such advantage vis-à-vis its official creditors, who at the same time are also counterparts in the programme negotiations and holders of the purse strings.

Unsurprisingly, in this setting, Greece's debt overhang remained unaddressed throughout the negotiations, and a potentially helpful *quid pro quo* has been kept off the table.

Ne'er the twain shall meet?

The continued search for an agreement is of course opportune. At the same time, and quite apart from misgivings about its specific content, one cannot but caution about two major pitfalls set to mark any agreement. First, the striking lack of national ownership in Greece risks thwarting the programme's implementation at every step, undercutting its chances of success. And, second, the still unresolved debt issue will continue to be a millstone weighing heavily on the country's prospects. If the twain requirements of a strong reform commitment by the Greek authorities and of debt relief by its major creditors fail to ever join together, these pitfalls may prove to be as fatal for Greece, and its eurozone partners, as the Prince of Troy's arrow was for Achilles. Hopefully, it is never too late to focus more fully on these risks and address them accordingly.

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[10] The "lending into arrears" policy was established by the IMF in 1989, and consists of IMF lending to members after arrears to private creditors have emerged, but before agreements to restructure such debts have been reached. See IMF, *Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion* (IMF: Washington DC, July 2002). http://goo.gl/4V7uYF

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Published under the editorial responsibility of the Lisbon Council.
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