IMF Proposal on Greece Sets Up Battle With Germany

Updated May 17, 2016 1:18 p.m. ET

BERLIN—The International Monetary Fund is demanding that Europe free Greece from all payments on its bailout loans until 2040, in the opening bid of a struggle that pits IMF math against German muscle.

A new IMF proposal shared with Europe late last week goes far beyond what Greece’s eurozone creditors, led by Germany, have said they are willing to do to help the country regain its financial health. Germany is leading the pressure on the IMF to dilute its demands and rejoin the Greek bailout program as a lender.

The IMF wants eurozone countries to accept long delays in the repayment of Greece’s bailout loans, which would fall due in the period from 2040 to 2080 under the proposal, according to officials familiar with the talks.

The IMF is also pressing for Greece’s interest rate on its eurozone loans to be fixed for 30 to 40 years at its current average level of 1.5%, with all interest payments postponed until loans start falling due.

German leaders are confident that the IMF will soften its stand, people familiar with the negotiations say. The Washington-based fund is ultimately controlled by its majority shareholders, European Union governments and the U.S., who want a deal in the coming weeks that keeps the IMF on board and Greece afloat. But Berlin officials also know they will have to offer the IMF major concessions, engaging in a long-delayed debate about Greece’s debt burden that Germany previously claimed wasn’t needed.

A compromise between Germany and the IMF is needed by June, when Greece is in danger of running out of money to pay its bills, and definitely by July, when major debts fall due. If the IMF and Germany can’t bridge their differences, eurozone lenders might have to continue lending to Greece without IMF participation—despite German Chancellor Angela Merkel’s long-standing policy that the Greek bailout is credible only if the IMF is involved.

The IMF’s proposal on Greek debt—described by one European official as “hard-core, really”—would keep Greece’s annual debt-service needs below 15% of its gross domestic product, under the IMF’s forecast for Greece’s long-term economic trajectory. The numbers are the IMF’s main weapon in the negotiations, since even the IMF’s board can’t force through a loan program that IMF staff say doesn’t add up.

Many European policy makers believe the IMF’s projections are too pessimistic. Berlin officials say IMF staff have often been wrong in their Greek forecasts before, and are pressing the fund to be less bleak. IMF staff are under heavy pressure not to be an obstacle to a deal, people familiar with the talks say.

Eurozone bailout loans to Greece currently total just over €200 billion ($226 billion), with around a further €60 billion to come under the latest Greek bailout plan.

Many eurozone officials are open to demoting the IMF to a technical adviser in the Greek bailout, removing it from lending and reducing its influence. But Germany, the eurozone’s dominant economic power, insists that the IMF must say it is prepared to rejoin the program as a lender. Only then do officials in Berlin want to ask the German parliament, the Bundestag, to release further bailout funds for Athens.

The IMF stayed on the sidelines last summer when Europe agreed on a new bailout plan with Greece, citing concerns about the sustainability of Greece’s debt. Ms. Merkel promised the Bundestag that the IMF would join the program before Europe’s next disbursement of rescue funds.

The chancellor and many of her conservative lawmakers believe that, without the IMF, the eurozone wouldn’t be able to enforce rigorous fiscal and economic overhauls in Greece in return for loans. The European Commission,
which partners with the IMF in overseeing the bailout, is seen in Berlin as too soft on Greece. Finland and the Netherlands also want the IMF on board.

U.S. Treasury officials have said publicly Washington is pressing both the IMF and Germany to find a compromise on debt relief that allows for full IMF involvement in the bailout. The U.S., conscious of the EU’s multiple current challenges and political fragility, wants to avoid a repeat of 2015’s Greek crisis, when the country came close to bankruptcy and exit from the euro. Some U.S. officials fear a deal could fail because of inflexible positions on all sides.

German officials aren’t opposed in principle to delaying maturities and interest payments while lowering the latter. Greece previously received such concessions on its loans in late 2012. But German leaders fear that another round of loan restructuring could lead to a contentious debate and vote in the Bundestag, with the potential for a rebellion among conservative lawmakers and a boost to the rising right-wing populist party AfD.

Officials in Berlin thus want to make only limited adjustments to Greece’s loan terms now, and postpone the major changes, which would need a Bundestag vote, until 2018—after Germany’s national elections in 2017.

Germany’s aim in the talks is to arrive at a formula that assures the IMF that Greece’s debt will be tackled “if necessary,” based on Greece’s fiscal and economic situation in 2018, while letting Germany delay final decisions until then.

The IMF’s suggestion that Europe lock in low interest rates for Greece for decades to come is hard for the eurozone to digest. The bloc’s bailout vehicles, such as the European Stability Mechanism, would then need subsidies from national budgets to cover a part of their own funding costs. IMF staff “like solutions that imply budgetary transfers,” said a European official.

Given the difficult negotiations, many EU officials would prefer to lend Greece more money now, without the IMF, and carry on talking in the fall.

But a debt deal would become politically more difficult as Germany’s election year of 2017 approaches, some participants in the talks point out. Failure to bring the IMF back on board now could therefore mean the end of its role as a Greek lender and enforcer of economic overhauls. That would be a major embarrassment for Ms. Merkel.

Many European officials are hoping for a deal by the time eurozone finance ministers meet on May 24, allowing a disbursement soon afterward. But some negotiators believe more time may be needed.

The IMF is also at odds with eurozone authorities and Greece’s government over how to ensure Athens hits its budget targets. But Greece is expected to pass the bulk of the fiscal measures that creditors want from it by next week. The crucial fight is now among the creditors. “Greece is basically out of the picture,” says another European official. “This is a dialogue between the IMF and the countries that really want the IMF.”

Greece is entering the seventh year of its troubled bailout still struggling to begin a recovery. The country has largely closed the gaping budget deficit that triggered its debt crisis. But the IMF-European bailout—including austerity measures that in total have amounted to more than 30% of GDP so far—contributed to a 25% decline in the country’s economic output since before the debt crisis.

—Gabriele Steinhauser in Brussels and Ian Talley in Washington contributed to this article.

Write to Marcus Walker at marcus.walker@wsj.com