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Independent Evaluation Office
of the International Monetary Fund

EVALUATION REPORT

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Background Work

The following Background Papers are available on the IEO website at www.ieo-imf.org.

BP/16-02/01. The IMF and the Crises in Greece, Ireland, and Portugal: An Evaluation by the Independent Evaluation Office—Summary of Views of the Advisory Group
BP/16-02/02. The IMF Executive Board and the Euro Area Crisis—Accountability, Legitimacy, and Governance
BP/16-02/03. IMF Surveillance of the Euro Area: From Conception Through Crisis
BP/16-02/04. The IMF's Role in Ireland
BP/16-02/05. The Portuguese Crisis and the IMF
BP/16-02/06. The IMF's Role in the Euro Area Crisis: What Are the Lessons from the IMF's Participation in the Troika?
BP/16-02/07. The IMF and the Euro Area Crisis: The Fiscal Dimension
BP/16-02/08. Living with Rules: The IMF's Exceptional Access Framework and the 2010 Stand-By Arrangement with Greece
BP/16-02/09. IMF Engagement with the Euro Area versus Other Currency Unions
BP/16-02/10. The IMF's Role in the Euro Area Crisis: Financial Sector Aspects

The following conventions are used in this publication:

- An en dash (–) between years or months (for example, 2015–16 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2015/16) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY 2016).
- Billion means a thousand million; "trillion" means a thousand billion.
- "Basis points" refers to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

As used in this publication, the terms "country" and "economy" do not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

Some of the documents cited and referenced in this report were not available to the public at the time of publication of this report. Under the current policy on public access to the IMF's archives, some of these documents will become available 3 or 5 years after their issuance. They may be referenced as EBS/YY/NN and SM/YY/NN, where EBS and SM indicate the series and YY indicates the year of issue. Certain other types of documents may become available 20 years after their issuance. For further information, see www.imf.org/external/np/arc/eng/archive.htm.

Foreword

This report examines the effectiveness of the IMF's engagement in Greece, Ireland, and Portugal in 2010–14 in order to draw lessons and to enhance transparency. The crises in these countries, coming so soon after the global financial and economic crisis, and occurring in a common currency area comprising highly integrated economies, posed extraordinary challenges to European and world policymakers. The IMF was called upon to provide financing and technical expertise in the management of these crises. The IMF's role has been a subject of extensive commentary and scrutiny by experts around the world.

The IEO report approaches the topic by asking whether the IMF's crisis management was appropriate, given the exceptional circumstances; whether it compromised its best economic judgment because of the way it engaged the euro area; and what it could have done differently to achieve better outcomes. The evaluation concludes that the Executive Board generally played a limited role in its supervisory function, and that the IMF's overall performance in surveillance and crisis lending was uneven. The IMF's handling of the euro area crisis raised issues of accountability and transparency, which helped create the perception that the IMF treated Europe differently.

Based on the lessons drawn from this experience, the report makes five recommendations for the IMF, in order to improve its governance and operational effectiveness. All of these recommendations received full or qualified support from the Executive Board when it met to discuss the report in July 2016. In supporting these recommendations, the Board reaffirmed the role of independent evaluation as key to good governance and as a means of enhancing the IMF's external credibility.

I am encouraged by the willingness of the Managing Director and the Executive Board to learn from the past, in order to improve the IMF's technical capacity and decision-making process. It is hoped that this report, along with systematic efforts to address the issues identified therein, will contribute to strengthening the IMF's central role in the international monetary system.

Moises J. Schwartz
Director
Independent Evaluation Office

The IMF and the Crises in Greece, Ireland, and Portugal

This report was prepared by an IEO team led by Shinji Takagi. The team included Donal Donovan, George Kopits, Ling Hui Tan, Nicolas Véron, Sanjay Dhar, Silvia Sgherri, Miguel de Las Casas, and Carlos de Resende. Martin Eichenbaum, Russell Kincaid, Felipe Larraín, Francesco Luna, Yung Chul Park, Theodore Pelagidis, Sergio Rebelo, Susan Schadler, and Charles Wyplosz contributed substantive inputs, while Roxana Pedraglio, Franz Loyola, Chris Monasterski, Tam Nguyen, and Joshua Wojnilower provided capable research assistance. The team gratefully acknowledges Annette Canizares, Arun Bhatnagar, and Amy Gamulo for providing administrative assistance and Rachel Weaving, Roxana Pedraglio, and Esha Ray for editorial and production management assistance.

The evaluation benefited from comments from an Advisory Group comprising Hamad Al Sayari, Jorge Braga de Macedo, Michel Camdessus, Malcolm Knight, Rachel Lomax, Ngozi Okonjo-Iweala, Jean Pisani-Ferry, Guillermo Ortiz, Yaga Venugopal Reddy, and Edwin Truman, who met on April 7, 2016 to discuss a preliminary version of this report. A summary of the discussion is being issued as a background paper to this evaluation (see Boorman, 2016). In addition, Jacques de Larosière, Clemens Fuest, and Hiroshi Watanabe reviewed the draft report to provide comments. Although this final report has benefited from the comments provided by these individuals, the IEO alone is responsible for the views and assessments stated therein. The report was approved by Moises Schwartz.

Abbreviations

CEMAC	Central African Economic and Monetary Community
CFA	Coopération Financière en Afrique Centrale (CEMAC) or Communauté Financière Africaine (WAEMU)
EC	European Commission
ECA	European Court of Auditors
ECB	European Central Bank
ECCU	Eastern Caribbean Currency Union
ECOFIN	Economic and Financial Affairs Council (EU)
EDIS	European Deposit Insurance Scheme
EDP	Excessive Deficit Procedure (EU)
EFF	Extended Fund Facility (IMF)
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilization Mechanism
ELA	Emergency Liquidity Assistance (ECB)
EMU	Economic and Monetary Union (EU)
EPE	ex post evaluation (IMF)
ESM	European Stability Mechanism
EU	European Union
FAD	Fiscal Affairs Department (IMF)
FSAP	Financial Sector Assessment Program (IMF)
G7	Group of Seven (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States)
G20	Group of Twenty (G7 plus Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, and the European Union)
GDP	gross domestic product
IEO	Independent Evaluation Office (IMF)
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee (IMF)
LTRO	Long-Term Refinancing Operations (ECB)
MCM	Monetary and Capital Markets Department (IMF)
OMT	Outright Monetary Transactions (ECB)
PSI	private sector involvement
RFA	regional financing arrangement
SBA	Stand-By Arrangement (IMF)
SDR	special drawing right (IMF)
SGP	Stability and Growth Pact (EU)
SMP	Securities Markets Program (ECB)
SRM	Single Resolution Mechanism (EU)
SSM	Single Supervisory Mechanism (EU)

TA	technical assistance
TARGET	Trans-European Automated Real-Time Gross Settlement Express Transfer System (ECB)
TOR	terms of reference
TSR	Triennial Surveillance Review (IMF)
VAT	value-added tax
WAEMU	West African Economic and Monetary Union

Executive Summary

A series of crises hit several euro area countries from 2010 to 2013. The crises, coming so soon after the global financial and economic crisis of 2007–08, and occurring in a common currency area comprising advanced and highly integrated economies, posed extraordinary challenges to European and world policymakers. This evaluation assesses the IMF's engagement with the euro area during these crises in order to draw lessons and to enhance transparency. In particular, of the five financing arrangements the IMF concluded with four euro area members, this evaluation covers the 2010 Stand-By Arrangement with Greece, the 2010 Extended Arrangement with Ireland, and the 2011 Extended Arrangement with Portugal.

Key Findings and Lessons

Surveillance

The IMF's pre-crisis surveillance mostly identified the right issues but did not foresee the magnitude of the risks that would later become paramount. The IMF's surveillance of the euro area financial regulatory architecture was generally of high quality, but staff, along with most other experts, missed the buildup of banking system risks in some countries. In general, the IMF shared the widely-held "Europe is different" mindset that encouraged the view that large imbalances in national current accounts were little cause for concern and that sudden stops could not happen within the euro area. Following the onset of the crisis, however, IMF surveillance successfully identified many unaddressed vulnerabilities, pushed for aggressive bank stress testing and recapitalization, and called for the formation of a banking union.

Decision making

In May 2010, the IMF Executive Board approved a decision to provide exceptional access financing to Greece without seeking preemptive debt restructuring, even though its sovereign debt was not deemed sustainable with a high probability. The risk of contagion was an important consideration in coming to this decision. The IMF's policy on exceptional access to Fund resources, which mandates early Board involvement, was followed only in a perfunctory manner. The 2002 framework for exceptional access was modified to allow exceptional access financing to go forward, but the modification process departed from the IMF's usual deliberative process whereby decisions of such import receive careful review. Early and active Board involvement might or might not have led to a different decision, but it would have enhanced the legitimacy of any decision.

Working with European partners

The IMF, having considered the possibility of lending to a euro area member as unlikely, had never articulated how best it could design a program with a euro area country, including conditionality on policies under the control of regional institutions. In the circumstances of these programs, where there was more than one conditional lender, the troika arrangement (in which the Fund worked with the European Commission and the European Central Bank) proved to be an efficient mechanism in most instances for conducting program discussions with national authorities, but the IMF lost its characteristic agility as a crisis manager. And because the European Commission negotiated on behalf of the Eurogroup, the troika arrangement potentially subjected IMF staff's technical judgments to political pressure from an early stage.

Program design and implementation

The IMF-supported programs in Greece and Portugal incorporated overly optimistic growth projections. More realistic projections would have made clear the likely impact of fiscal consolidation on growth and debt dynamics, and allowed the authorities to prepare

accordingly or persuaded European partners to consider additional—and more concessional—financing while preserving the IMF's credibility as an independent, technocratic institution. Lessons from past crises were not always applied, for example when the IMF underestimated the likely negative response of private creditors to a high-risk program. The IMF's performance was uneven although there were instances where IMF staff shone technically and many officials have expressed a positive assessment of the Fund's overall contribution.

Accountability and transparency

The IMF's handling of the euro area crisis raised issues of accountability and transparency, which helped create the perception that the IMF treated Europe differently. Conducting this evaluation proved challenging. Some documents on sensitive issues were prepared outside the regular, established channels; the IEO faced a lack of clarity in its terms of reference on what it could or could not evaluate; and there was no clear protocol on the modality of interactions between the IEO and IMF staff.[1] The IMF did not complete internal reviews involving euro area programs on time, as mandated, which led to missed opportunities to draw timely lessons.

[1] The IEO is currently working with staff to develop a clear protocol for future evaluations.

Recommendations

Recommendation 1: The Executive Board and management should develop procedures to minimize the room for political intervention in the IMF's technical analysis.

Recommendation 2: The Executive Board and management should strengthen the existing processes to ensure that agreed policies are followed and that they are not changed without careful deliberation.

Recommendation 3: The IMF should clarify how guidelines on program design apply to currency union members.

Recommendation 4: The IMF should establish a policy on cooperation with regional financing arrangements.

Recommendation 5: The Executive Board and management should reaffirm their commitment to accountability and transparency and the role of independent evaluation in fostering good governance.

CHAPTER

1 Introduction

1. This evaluation by the Independent Evaluation Office (IEO) assesses the IMF's engagement with the euro area, focusing on its surveillance and crisis management in Greece, Ireland, and Portugal. In April 2010, Greece became the first euro area country to request financial support from the IMF. The IMF joined the European Commission (EC) and the European Central Bank (ECB)—thus constituting what informally came to be known as the troika—in providing emergency financing, with the Fund's contribution taking the form of a three-year Stand-By Arrangement (SBA) approved in May; this was replaced two years later by a four-year arrangement under the Extended Fund Facility (EFF) (Table 1).[2] By the middle of 2013, the IMF, as part of the troika, had programs in three more euro area countries—Ireland (three-year Extended Arrangement approved in December 2010), Portugal (three-year Extended Arrangement approved in May 2011), and Cyprus (three-year Extended Arrangement approved in May 2013). In addition, the IMF provided technical assistance to Spain in support of European financial assistance for the recapitalization of Spanish financial institutions. The IMF was also active in providing policy advice to European institutions and governments throughout much of the crisis period.

2. Three aspects set the IMF's assistance in the euro area apart from other IMF crisis management programs. First, the euro area programs were the first instances of direct IMF involvement in adjustment programs for advanced, financially developed, and financially open countries within a currency union, and were the first instances since the mid-1970s of IMF financial assistance to countries that used a reserve currency. Second, they involved intense collaboration with regional partners who also were providing conditional financial assistance, and the modality of collaboration evolved in real time. Third, the amounts committed by the IMF to Greece, Ireland, and Portugal (though not Cyprus) were exceptionally large.[3] They entailed exceptional access to Fund resources, meaning that the amount of financing exceeded the normal limits of 200 percent of quota for any 12-month period or 600 percent cumulatively over the life of the program. In all three countries, access exceeded 2,000 percent of quota.[4] For the financial years 2011–14, these countries accounted for nearly 80 percent of the total lending provided by the IMF.

3. In conducting this evaluation, the IEO was guided by its terms of reference to focus on drawing lessons for the IMF's future operational work. The evaluation also aims to enhance transparency by assessing the processes by which important decisions were made within the IMF. It is not the purpose of the evaluation to judge the merits of the decisions themselves or to enhance academic understanding of the euro area crisis for its own sake. The exclusive concern of the evaluation is with the decisions of the IMF itself, not those of other official parties involved. Even so, it must be acknowledged that disentangling the decisions of the IMF from those of its partners is often difficult.

[2] Stand-By Arrangements are designed to help countries address short-term balance of payments problems, while the Extended Fund Facility helps countries address medium and longer-term balance of payments problems reflecting extensive distortions that require fundamental economic reforms. See www.imf.org/external/np/exr/facts/eff.htm.

[3] The largest nonprecautionary IMF arrangement remains the 2002 SBA for Brazil (SDR 27.4 billion, including SDR 7.6 billion from the Supplemental Reserve Facility) while the largest in relation to quota was previously the 1997 SBA for Korea (1,938 percent).

[4] Even so, the IMF financing amounted to at most half of that provided by euro area governments and institutions.

Table 1. IMF-Supported Programs in the Euro Area, 2010–13

Country	Greece		Ireland	Portugal	Cyprus
Arrangement	SBA, 3-year	EFF, 4-year	EFF, 3-year	EFF, 3-year	EFF, 3-year
Date of approval	May 9, 2010	March 15, 2012	December 16, 2010	May 20, 2011	May 15, 2013
Approved amount in SDRs	SDR 26.4 billion	SDR 23.785 billion	SDR 19.466 billion	SDR 23.742 billion	SDR 891 million
As percent of quota	3,212	2,158.8	2,321.8	2,305.7	563
As percent of GDP	13.56	14.64	13.62	14.87	5.70
Amount drawn (Percent of total in parentheses)	SDR 17.54 billion (66.4)	SDR 10.22 billion (43.0)	SDR 19.466 billion (100.0)	SDR 22.942 billion (96.6)	SDR 792 million (88.9)
Date of last completed review	December 5, 2011	May 30, 2014	December 13, 2013	April 17, 2014	January 27, 2016
Date of expiration or cancellation	March 14, 2012 (canceled)	January 15, 2016 (canceled)	December 15, 2013	June 30, 2014	March 7, 2016 (canceled)
Memorandum					
Amount in euros (Percent of total financing)	€30 billion (27.3)	€28 billion (16.2)	€22.5 billion (26.5)	€26 billion (33.3)	€1 billion (10)
Amount from European partners	€80 billion	€144.7 billion	€45 billion[1]	€52 billion	€9 billion

Source: IMF, Strategy, Policy, and Review Department, Fund Arrangements since 1952, updated May 2, 2016.
[1] In addition, the Irish authorities contributed €17.5 billion from the country's own cash reserves and other liquid assets.

4. The euro area crisis has received extensive discussion and commentary by numerous experts and official bodies, including the IMF. The unusually large literature includes comprehensive analyses of the origins of the crisis and European decision making, as well as accounts of negotiations underlying important decisions (e.g., Walker and others, 2010a, 2010b; Forelle and others, 2010; Forelle and Walker, 2011; Walker and Forelle, 2011; Bastasin, 2012; Irwin, 2013; Spiegel, 2014; and Blustein, 2015). Books, articles in professional journals, working papers from academic institutions and think tanks, and chapters in edited volumes are too numerous to count (e.g., Pisani-Ferry, 2011; Mody and Sandri, 2012; Donovan and Murphy, 2013; Pisani-Ferry, Sapir, and Wolff, 2013; Palaiologos, 2014; Pelagidis and Mitsopoulos, 2014; Baldwin and Giavazzi, 2015). In addition, a number of official reports or evaluations have been issued in recent years by the Irish authorities and Parliament, the European Parliament, the European Court of Auditors, and the IMF itself (Box 1). While this evaluation has benefited from these and other studies, it makes no attempt to discuss at length what is elucidated elsewhere.

5. The IMF's handling of the euro area crisis has been controversial. The literature cited above is generally critical of the way the IMF handled the crisis, especially in Greece. In July 2015, Olivier Blanchard, then Economic Counsellor of the Fund, rebutted some of the criticisms as they pertained to Greece (Blanchard, 2015). He summarized them in three broad strands: first, the Greek programs "only served to raise debt and demanded excessive fiscal adjustment;" second, the financing was "used to repay foreign banks;" and third, "growth-killing structural reforms, together with fiscal austerity, have led to an economic depression."[5] These criticisms specifically targeted the IMF's handling of Greece because that country experienced a much deeper contraction of output than did any other euro area country (more than 25 percent from its peak in 2007 to 2013). In Ireland and Portugal, the adverse economic and social consequences of austerity figured prominently in criticisms

[5] Blanchard then added a fourth, nontechnical, criticism: "creditors have learned nothing and keep repeating the same mistakes." At the risk of oversimplification, Blanchard's rebuttal of the three technical criticisms can be summarized as follows: (i) large fiscal adjustment was inevitable, given the lack of market access and a limit to the amount of official financing; (ii) the bailout benefited not only foreign banks but also domestic depositors and households; and (iii) most structural reforms were not implemented and "fiscal consolidation explains only a fraction of the output decline."

Box 1. Ex Post Evaluations of the IMF's Euro Area Crisis Programs

In instances of exceptional access to IMF resources, IMF policy is for the staff to complete an ex post evaluation (EPE) within one year of the end of the arrangement and preferably prior to discussions on a new arrangement (IMF, 2010a). The aim of an EPE is to determine whether justifications presented at the outset of a program were consistent with IMF policies and to review performance under the program by providing a critical and frank consideration of two key questions: (i) were the macroeconomic strategy, program design, and financing appropriate to address the challenges faced by the member in line with IMF policy, including the exceptional access policy; and (ii) did outcomes under the program meet the program objectives?

The EPE for Greece's 2010 Stand-By Arrangement (SBA) (IMF, 2013c) concluded that the IMF-supported program succeeded in achieving strong fiscal consolidation, putting the pension system on a viable footing, allowing the country to remain in the euro area, and containing the effect of any spillover on the global economy. But it also observed that the SBA failed to restore market confidence, achieve debt sustainability, restore competitiveness, or carry out structural reforms; that it overestimated the country's ownership and implementation capacity; that the recession was much deeper than expected, and marked by exceptionally high unemployment; and that the burden of adjustment was not sufficiently spread across different strata of society. The EPE report, labeled strictly confidential, was sent to the IMF Executive Board on May 21, 2013 (14 months after the Greek SBA program was canceled) and was released to the public two weeks later after the Board discussion. The reaction from European partners to the report was negative (see, for example, Spiegel and Hope, 2013).

The EPE for Ireland's 2010 Extended Arrangement (IMF, 2015a) concluded that the IMF-supported program successfully stabilized the country's banking sector and met almost all program targets, allowing Ireland to regain market access by the program's end. By design, however, unsecured senior creditors of failed banks were not bailed in and arrears and personal insolvency issues were not addressed early; fiscal and banking sector vulnerabilities remained. The adverse growth impact of the deterioration of government, corporate, and banking balance sheets, combined with a large household debt burden, was underestimated, leading to weaker-than-expected domestic demand, with high unemployment, amid a challenging external environment.

As of May 2016, the EPE for Portugal's 2011 Extended Arrangement was still under preparation, nearly two years after the expiration of the program.

of the IMF-supported programs though not with the same intensity.[6]

6. These criticisms are part of a larger criticism of the IMF's governance and its role in the international monetary system. Critics claim that the IMF was "forced by political pressures . . . to participate in programs" (El-Erian, 2015); that it "acquiesced" though knowing that "a program of harsh fiscal austerity, with no devaluation and no restructuring," would not work (Palaiologos, 2015); and that it has become "a tool of the Eurozone policy-making elite" (Warner, 2011). Taylor (2015) considers that the Fund, as "junior partner," "never had control" of the programs. Thus the IMF treated the euro area "not as a patient to be cured," and failed to "impose conditionality on the broken central institutions" (Sterne, 2014; see also Wroughton and others, 2015). Critics further argue that these failings resulted from "European domination" of the decision-making process within the IMF (Seitz and Jost, 2012), which led to a more favorable treatment of Europe (Donnan, 2015; Lee, 2015) and called into question the IMF's credibility as an independent, technocratic institution (Ito, 2015; El-Erian 2015). Evans-Pritchard (2015) characterized the IMF's unwillingness to "confront" euro area creditors as "a public policy scandal of the first order." These criticisms constitute part of the background against which this evaluation assesses the role of the IMF in the euro area crisis.

7. The scope of the evaluation should be clearly understood from the outset. It does not cover the second Greek program (the EFF-supported program approved in March 2012) or the EFF-supported

[6]Many of these criticisms were raised as part of a larger debate on austerity in the euro area (e.g., Lachman, 2011; Summers, 2012; Wolf, 2013) and, reflecting the strong ownership of these programs by the national authorities, were targeted more at the governments (or the policy itself) than at the IMF (e.g., Wise, 2013, 2014).

program in Cyprus, both of which were ongoing when the evaluation was launched in early 2015. The IEO faced a lack of clarity in its terms of reference (TOR) regarding what it could or could not evaluate. When the evaluation was about to be launched, several Executive Directors and other senior IMF officials expressed the view that, since the ongoing Extended Arrangement in Greece was a continuation of the 2010 SBA, it was not possible to separate the two and that any attempt to evaluate the IMF's engagement in Greece, including the canceled SBA-supported program, would be a breach of the TOR.[7] In the event, the IEO followed the majority interpretation of its TOR by including in this evaluation only the three programs that had expired or had been canceled before 2015,[8] but given the lack of consensus, the IEO operated with uncertainty with respect to the extent of cooperation it could expect from the rest of the institution. Although Greece's Extended Arrangement was canceled in January 2016, and Cyprus' in March 2016, covering them in this evaluation would have significantly delayed the completion of this report.

8. Three overarching questions guide this evaluation. First, was the IMF's crisis management appropriate, given the exceptional circumstances? Second, did the IMF compromise its best economic judgment because of the way it engaged the euro area? Third, what could the IMF have done differently to achieve better outcomes? The evaluation attempts to answer these questions as it assesses the IMF's key decisions, performance, and decision-making processes within the three areas of IMF competence: surveillance, crisis lending, and technical assistance. In making these assessments, the evaluation occasionally goes beyond the three crisis countries to discuss issues that pertain to the euro area as a whole (as in the case of surveillance) or another euro area member, when they help shed additional light on the IMF's surveillance and crisis management roles in these countries.

9. To gather evidence, the evaluation team interviewed a number of decision makers and reviewed a large volume of IMF documents. The interviewees included the current and previous Managing Directors of the IMF; other former members of IMF management; former and current members of the IMF Executive Board and senior staff; former and current officials of member country governments and central banks, especially in France, Germany, Greece, Ireland, Italy, Portugal, and Spain; and current and former officials of European institutions, especially the European Commission and the European Central Bank. In addition, the team met with market participants, civil society representatives, and academic and other private sector experts to seek their views. At the final stage of the evaluation, an advance draft of this report was shared with a select group of international experts, which included two past Managing Directors of the IMF, in order to take account of their views in finalizing the report.

10. The IEO did not have full access to confidential IMF documents in a timely manner. IMF staff cooperated in providing a large volume of internal documents to the IEO, but it was learned that many documents were prepared outside the regular, established channels (and sometimes retained in personal files); written documentation on some sensitive matters, even with the help of generous staff resources, could not be located. Some sensitive documents were provided to the IEO following the Managing Director's intervention at the IEO's request, and after a draft of this report had been circulated to staff for comments.[9] Even so, the IEO is not in a position to state that it saw all relevant documents. As a result, the IEO in some instances has not been able to determine who made certain decisions or what information was available, nor has it been able to assess the relative roles of management and staff.

11. In presenting the evidence and forming assessments, the IEO invited a group of experts, consisting of leading scholars and former IMF senior staff who had not been directly involved in decision making during the euro area crisis, to prepare background papers on different aspects of the IMF's engagement with the euro area. The authors of these papers had considerable latitude in approaching their topics and exercising their own professional judgement. All the background papers form part of the evaluation, and this report draws on their analyses and assessments as inputs even though it may not fully share all the specific judgments stated therein.[10]

[7]The relevant passage states: "In conducting its work, the IEO should avoid interfering with operational activities, including current programs."

[8]The Executive Board had offered a different interpretation of the word "interfering" in the IEO terms of reference in 2002 when it strongly supported the IEO's evaluation of an SBA for Brazil, which was ongoing at the time.

[9]Staff documents on informal Board meetings were provided to the IEO after the Evaluation Committee of the Executive Board clarified the terms under which the IEO could access such documents in April 2016.

[10]In addition, to enhance the evaluation with external perspectives, the IEO asked distinguished scholars to provide inputs from their regional perspectives.

12. The rest of the report is organized as follows. Chapter 2 describes the evolution of the euro area crisis as background for the remainder of the report (a knowledgeable reader may consider skipping this section). Chapter 3 assesses two critical decisions made by the IMF at the outset of its involvement. Chapter 4 evaluates the IMF's performance in surveillance, crisis lending, and technical assistance. Chapter 5 discusses governance-related issues, such as the IMF's role in the troika and how the IMF Executive Board performed its oversight responsibilities. Chapter 6 summarizes the key findings and lessons from the evaluation and proposes recommendations to improve the effectiveness of the IMF's operational work. Appendix 1 presents an IMF-centric timeline of important events during the euro area crisis.

CHAPTER 2

Background: The Evolution of the Euro Area Crisis

13. The third and final stage of European Economic and Monetary Union (EMU) began on January 1, 1999 when a common currency, the euro, was adopted by 11 member states of the European Union (EU).[11] On January 1, 2001, Greece joined the euro area as its twelfth member. The EMU architecture, as specified by the Maastricht Treaty of 1992, included (i) an independent central bank, the European Central Bank (ECB), focused on price stability and (ii) a set of rules (fiscal deficit and public debt ceilings of 3 percent and 60 percent of GDP, respectively) designed to promote fiscal discipline in individual member states. The Stability and Growth Pact (SGP), adopted in 1997, introduced a "corrective arm" that specified the procedure to be followed by a country violating these limits (known as the Excessive Deficit Procedure, EDP) and a "preventive arm" requiring countries to maintain fiscal positions close to balance or in surplus over the medium term.[12] Banking supervision and deposit insurance remained national competencies.

14. Among its many consequences, the introduction of the euro caused sovereign bond yields to converge at a lower level, as country and exchange rate risks were perceived to have been virtually eliminated.[13] The convergence sharply lowered borrowing costs for countries in the European periphery and encouraged increases in borrowing from the euro area core. For the periphery countries, the result was generally to raise consumption and investment (especially in real estate) and economic growth. From 1999 to 2008, Ireland grew by more than 5 percent per year and Greece by 3.5 percent, compared with the euro area average of 2.1 percent (Figure 1). Portugal's average growth rate, at 1.6 percent, was less than the area average because for various reasons the country could not sustain the rapid growth experienced in 1999 and 2000. The counterpart of external borrowing was a widening of current account deficits. Greece's current account balance widened from 5.1 percent of GDP in 1999 to nearly 15 percent of GDP in 2008 (Figure 2). Portugal's current account deficit averaged nearly 10 percent of GDP in the first decade of the euro, remaining high even when growth stalled. Ireland was a special case, because only in 2007 did that country begin to run a sizable deficit, which reached 5.7 percent of GDP in 2008.

15. Academic experts have increasingly come to believe that the euro area crisis was precipitated by "sudden stops," whereby cross-border capital flows came to a halt in an environment of diminished risk appetite caused by the global financial crisis (Merler and Pisani-Ferry, 2012; see Baldwin and Giavazzi, 2015 and Baldwin and others, 2015 for a summary view of the literature). Weak public finances were clearly central to the crisis in Greece (Table 2), but according to the sudden-stop narrative "the key was foreign borrowing" (Baldwin and Giavazzi, 2015).[14] Even so, because the crisis countries were members of a currency union the crisis did not evolve as a conventional balance-of-payments or currency crisis. The Eurosystem (consisting of the ECB and national central banks) provided liquidity to crisis countries (and their banks) through facilities such as Long-Term Refinancing Operations (LTRO) and Emergency Liquidity Assistance (ELA), as

[11]The original members were Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain.

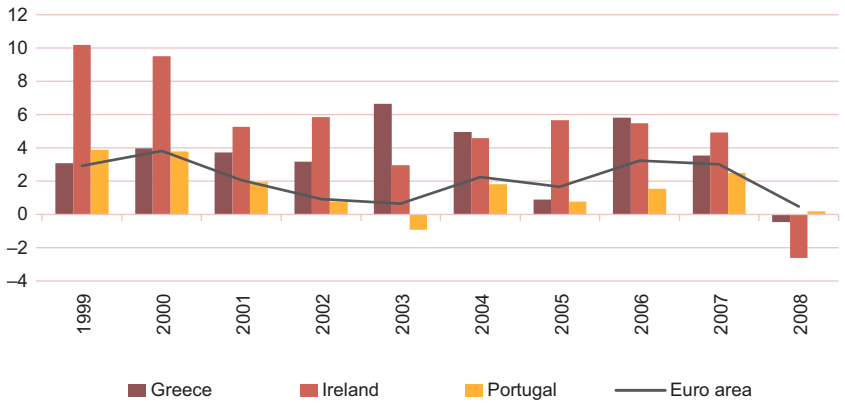
[12]The SGP framework was amended in 2005 to give more emphasis to cyclically adjusted deficits. This followed the Council's decision in November 2003 to suspend the EDP for France and Germany (Buti and Carnot, 2012).

[13]Three reasons have been offered to explain the convergence of bond yields. First, financial markets treated all sovereign debt as risk-free, encouraged in this belief by regulatory and collateral rules (Buti and Carnot, 2012). Second, despite the no-bailout clause, the markets expected "some sort of rescue for individual sovereigns in trouble" (Obstfeld, 2013). Third, euro participation was considered to be permanent. This perception changed in 2010–12 with the possibility of "Grexit"—Greece's exit from the euro—which introduced "redenomination risk."

[14]Regardless of the state of public finances, no country that had a current account surplus experienced a crisis. See Gros (2015).

Figure 1. Real GDP Growth, 1999–2008

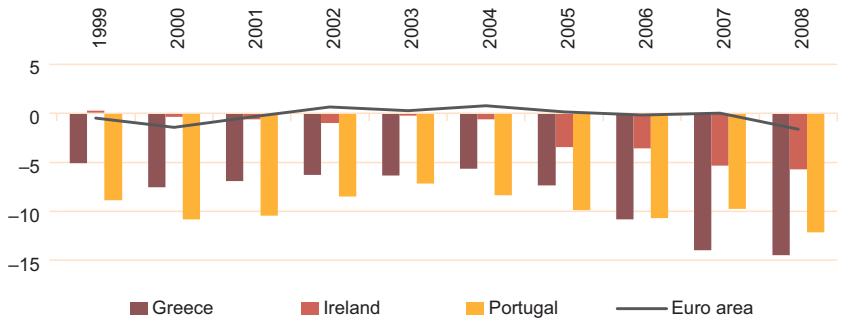
(In percent per year)



Source: IMF, *World Economic Outlook* database, October 2015.

Figure 2. External Current Account Balances, 1999–2008

(In percent of GDP)



Source: IMF, *World Economic Outlook* database, October 2015.

Table 2. Fiscal Developments, 2001–09

(In percent of actual or potential GDP)

	2001–05[1]	2006	2007	2008	2009
Greece					
Headline fiscal balance	–5.4	–6.1	–6.7	–9.9	–15.3
Structural fiscal balance[2]	–5.4	–8.4	–10.5	–13.9	–18.6
Gross government debt	98.1	102.9	102.8	108.8	126.2
Ireland					
Headline fiscal balance	0.8	2.8	0.23	–7.0	–13.8
Structural fiscal balance[2]	–2.3	–5.6	–9.9	–13.1	–11.0
Gross government debt	26.1	23.6	23.9	42.4	61.8
Portugal					
Headline fiscal balance	–5.0	–1.99	–3.0	–3.8	–9.8
Structural fiscal balance[2]	–5.8	–1.9	–3.8	–5.2	–8.6
Gross government debt	60.8	61.6	68.4	71.7	83.6

Source: IMF, *World Economic Outlook* database, October 2015.
[1] Averages for 2001–05; end-2005 for gross debt.
[2] IMF staff estimates.

well as through the area-wide settlement system known as TARGET2.[15]

16. The literature has highlighted two underlying causes of the crisis (Pisani-Ferry, 2011; Buti and Carnot, 2012). Some authors view the crisis as resulting from policy failures in individual countries, such as lack of fiscal discipline, failure to carry out structural reforms, and external borrowing that was not productively invested. Others see it as rooted in a flaw in the euro architecture—for example, monetary union unaccompanied by banking, fiscal, or political union—or a flaw in the operation of the union—for example, reluctance of member countries to transfer more powers to the union. Baldwin and Giavazzi (2015), summarizing what they call the consensus view, argue that the fallout from the sudden stop was amplified by the absence of a national central bank to provide a sovereign lender-of-last-resort support in its own currency; by the predominance of bank financing; by the vicious feedback between banks and sovereigns; and by the rigidity of labor and product markets in crisis countries.

17. A first sign of crisis within the euro area appeared in Ireland, when Bear Sterns was rescued by public funds in March 2008, thereby signaling to the market that governments would provide financial support to banks in difficulty (Mody and Sandri, 2012).[16] This is when sovereign spreads in Europe started to diverge noticeably. Following the collapse of Lehman Brothers in September 2008, pressure on the sovereign debt of periphery countries intensified. The size of Ireland's underlying banking and budgetary problems started to become more apparent after the property bubble burst and a deep recession began. From early 2009, IMF staff informally inquired about the Irish authorities' possible interest in a precautionary financial arrangement from the IMF.[17] It was against this background that in late October 2009 the newly elected Greek government of George Papandreou announced that the Greek deficit for the year was likely to be 12.8 percent of GDP rather than the 3.6 percent previously estimated (the actual figure would rise to 15.6 percent).[18]

18. Market reaction was subdued at first, and it was only from December 2009 that Greece's sovereign spreads saw a sustained rise as rating agencies successively downgraded Greek debt;[19] sovereign spreads for Ireland and Portugal rose in tandem, albeit much more slowly (Figure 3). The rise in sovereign spreads was gradual in the early months of 2010, while reacting to the actions or statements of European officials. Though Europe was facing an unexpected situation, a crisis management mechanism was deliberately absent in the euro area, in part to lessen moral hazard. Article 123 of the Treaty on the Functioning of the European Union (as last revised in 2007) prohibited the monetary financing of budgetary deficits, while Article 125 prohibited the EU or any member state from assuming the commitments of another state. This was interpreted by much of the official sector as a prohibition against an intergovernmental bailout.

19. The IMF was in close contact with Greek and other European authorities from the beginning, but it remained on the sidelines as initial options were debated. At the outset, there was resistance in Europe to having an IMF-supported program for Greece, as has been widely documented (Bastasin, 2012). The IMF at this stage provided technical assistance to Greece on tax administration and public financial management through the Fiscal Affairs Department (FAD), and financial sector advice to the Greek central bank through the Monetary and Capital Markets Department (MCM). Gradually, though, an alternative view began to prevail within Europe: that it would be desirable to draw on the IMF's program expertise and crisis management experience (Pisani-Ferry and Sapir, 2010).

20. On March 25, 2010, euro area leaders announced their readiness to contribute to coordinated bilateral loans as part of a package involving substantial IMF financing.[20] On April 11, the euro area member states issued a statement specifying the modality of support to Greece, namely bilateral loans centrally pooled by the EC with non-concessional interest rates as

[15]As a result, the size of official financing to these countries was mainly determined by budgetary, not balance of payments, financing needs (Pisani-Ferry, Sapir, and Wolff, 2013).

[16]Some even trace the start of the euro area crisis to the end of July 2007, when the German authorities bailed out IKB, a specialist lender based in Dusseldorf. This served as a signal that failing banks in the euro area would be rescued. "Germany Rescues Subprime Lender," *Financial Times*, August 2, 2007.

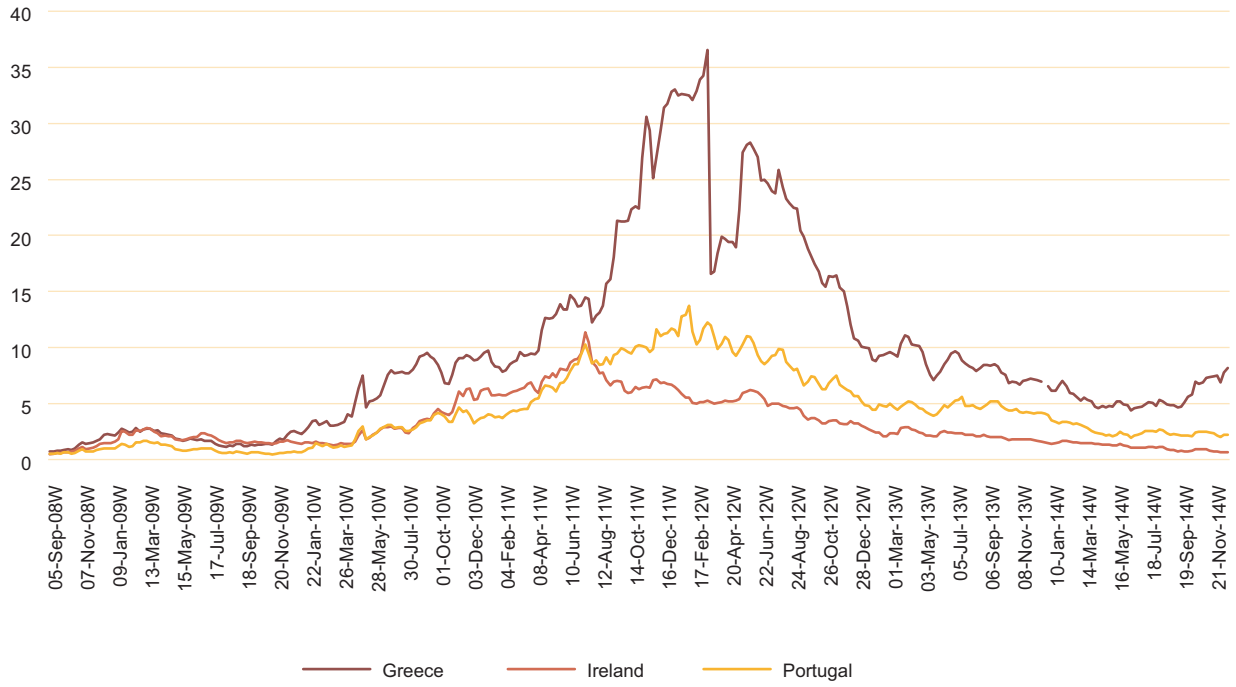
[17]The authorities were not receptive. Informal discussions on a program with Ireland started only in late September 2010.

[18]In 2010, the IMF found Greece in breach of members' reporting obligations under Article VIII, Section 5, of the Articles of Agreement (IMF, 2010e).

[19]Greece's rating was eventually downgraded to speculative-grade status in late April 2010. The ECB relaxed its collateral rules in several steps to keep Greek government debt eligible for refinancing operations.

[20]Statement by the Heads of State or Government of the Euro Area, March 25, 2010.

Figure 3. Ten-Year Government Bond Yields in Euro Area Crisis Countries, September 2008–December 2014
(In percentage points above comparable German bond yields)



Source: Haver Analytics.

"incentives for Greece to return to market financing."[21] The statement also noted that the EC, in liaison with the ECB and the IMF, would begin to prepare a joint program with the Greek authorities, starting on April 12. The same day, the IMF Managing Director expressed the IMF's readiness to "join the effort, including through a multi-year Stand-By Arrangement, to the extent needed and requested by the Greek authorities" (IMF, 2010b).

21. Greece formally requested EU-IMF financial assistance on April 23, 2010. On May 2, an IMF staff mission, in consultation with representatives from the EC and the ECB, reached agreement with the Greek authorities to support their adjustment program with a three-year SBA and with conditional financing of €80 billion, to be provided in the form of bilateral loans from 15 euro area partners (IMF, 2010c). The SBA for Greece, approved by the Executive Board on May 9, included financing in the amount of SDR 26.4 billion (approximately €30 billion). Market anxiety may have eased somewhat as European policymakers announced on May 10 the first of a series of measures to build firewalls against the impact of a future crisis on the euro area (Box 2).

22. Banking sector fragility played a greater role in the unfolding of crises in Ireland and Portugal than it did in Greece, as Irish and Portuguese banks heavily dependent on external financing came to rely increasingly on funding from the Eurosystem. With their spreads over German debt rising to above 6 percent, Ireland and Portugal turned to the IMF for financial support. In December 2010 and May 2011, respectively, they received assistance under the EFF in the amounts of SDR 19.466 billion (€22.5 billion) and SDR 23.742 billion (€26 billion). These financing packages were combined with additional financing of €45 billion (for Ireland) and €52 billion (for Portugal) from the European Financial Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM), both of which were created subsequent to the Greek package to provide emergency financing to a country in financial difficulty.

[21] Statement on the Support by Euro Area Member States, Brussels, April 11, 2010.

Box 2. Building Euro Area Firewalls

European Financial Stability Facility (EFSF): a temporary €440 billion crisis response and assistance mechanism (to be phased out after three years) that was created by euro area member states on the basis of an Economic and Financial Affairs Council (ECOFIN) decision on May 9, 2010. The facility was established as a public limited liability company in Luxembourg on June 7, 2010. Its notional size was increased to €780 billion in June 2011, in order to increase the effective size to €440 billion while maintaining a triple A rating.

European Financial Stabilization Mechanism (EFSM): also created by the ECOFIN decision of May 9, 2010, this was a €60 billion European Union (EU) instrument whose creation derived from Article 122 of the Treaty on the Functioning of the European Union (regarding financial assistance to a member state that is in "difficulties or seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control"). The EFSM was modeled after the existing EU balance of payments assistance instrument.

Securities Markets Program (SMP): a Eurosystem program to purchase primarily sovereign bonds issued by euro area member governments in the secondary market. The program was announced by the Governing Council of the European Central Bank (ECB) on May 10, 2010, and was superseded by Outright Monetary Transactions (see below) in 2012.

European Stability Mechanism (ESM): a permanent €500 billion mechanism to supersede the EFSF and the EFSM. The ESM was created by an intergovernmental treaty that was signed on February 2, 2012 and entered into force on October 8, 2012. Set up as an international organization, its financing is provided to member countries in financial difficulty and is subject to strict policy conditionality. A euro area member requesting financial assistance from the ESM is expected to address, "whenever possible," a similar request to the IMF.

Banking union: an agreement was reached at the euro area summit of June 28–29, 2012 to initiate a process of centralizing at the euro level most of the banking regulatory authorities exercised at the national level. In its final form, banking union will consist of three pillars: a Single Supervisory Mechanism (SSM) that establishes the European Central Bank (ECB) as the central supervisor of euro area banks; a Single Resolution Mechanism (SRM) that establishes a new framework for bank crisis management and resolution, with a new agency, the Single Resolution Board; and a European Deposit Insurance Scheme (EDIS). The SSM has been in force since November 2014 and the SRM since January 2016. The EDIS is yet to be finalized.

Outright Monetary Transactions (OMT): an ECB program announced on August 2, 2012 by the ECB Governing Council to purchase a potentially unlimited amount of sovereign bonds issued by euro area member governments, superseding the SMP. The creation of OMT followed the announcement, at the end of July 2012, by the ECB President that the ECB would do "whatever it takes" to save the euro—an announcement that had an immediate calming effect on the markets. OMT would take place in the context of a request by a euro area member for financial assistance from the ESM (or EFSF). OMT have not been activated for any country.

23. The crisis in Ireland occurred after years of robust growth, which had masked the vulnerabilities of the country's financial sector and the fragility of its public finances dependent on property-related revenues.[22] In the wake of the global financial crisis, Irish banks faced severe liquidity pressures that prompted the Irish authorities to introduce a blanket state guarantee covering nearly all of their liabilities. From 2009 to 2010, the banks' insolvency began to emerge more clearly, while the collapse of the property sector and a severe recession turned the country's small fiscal surplus into a very large deficit. The ongoing Greek crisis and the announcement that the Irish banks would need yet more capital injections, among other things, led to major pressures on Irish bond spreads. With wholesale funding in decline, Irish banks turned to the ECB for liquidity support. These were the circumstances under which the Irish authorities, in November 2010, turned to their European partners and the IMF for emergency financial assistance.

24. The case of Portugal differed from those of Greece and Ireland. Even though Portugal's boom period had ended in 2000, the fiscal balance remained in deficit, and the private sector continued to borrow

[22]From the mid-1990s, Ireland had been among the fastest growing advanced countries. The country saw an unprecedented boom in living standards and attained full employment, while its budget position remained generally in surplus with a low debt-to-GDP ratio of about 25 percent. These "Celtic Tiger" years ended abruptly with the global financial crisis.

extensively from abroad, pushing the country's net international investment position to about –115 percent of GDP by the time the crisis broke. Financial markets' apparent indifference to Portugal's growing indebtedness changed,[23] when public finances deteriorated sharply in the aftermath of the global financial crisis.[24] In May 2010, when the SBA-supported program for Greece was approved, sovereign spreads of Portuguese versus German bonds stood at more than 200 basis points. In early 2011, Portugal's sovereign debt was approaching, if not exceeding, 100 percent of GDP.[25] As one credit rating agency after another downgraded Portugal's sovereign debt, the country faced an acute retrenchment of net capital flows, with a sovereign spread over German bonds of nearly 700 basis points. On April 8, 2011, the Portuguese authorities requested emergency financing from European partners and the IMF.

25. In July 2011, the IMF had a change in Managing Director when Christine Lagarde was selected to replace Dominique Strauss-Kahn, who had resigned in May. When the new Managing Director arrived at the IMF, Greece was negotiating with its private creditors for possible debt relief. In late July, euro area authorities agreed in principle to a debt reduction of 21 percent in net present value (as well as to lengthen the maturities of official loans to Greece and to lower lending rates),[26] but a sharp deterioration in Greece's economic situation made any debt relief envisaged under the agreement insufficient for restoring debt sustainability.

26. The next round of Greek debt relief negotiations began with full IMF participation, and led to a substantial reduction in the face value of Greek debt held by private (but not official) creditors. In March and April 2012, Greece exchanged bonds worth €199.2 billion in face value for a set of four instruments to achieve a net relief of about €100 billion in present value terms—equivalent to more than 50 percent of 2012 GDP under reasonable assumptions. In December 2012, Greece implemented a debt buyback that resulted in further relief equivalent to 6–11 percent of GDP, depending on the discount rate assumed (Zettelmeyer and others, 2013; see also Xafa, 2014).

27. From the summer of 2011, the crisis spread to Italy and Spain, the countries that experienced the largest capital outflows. When a Group of Twenty (G20) summit convened in Cannes on November 3–4, 2011, Italy seemed about to be cut off from market financing. European partners failed to persuade Italy to seek IMF assistance but welcomed the "measures presented by Italy in the Euro Summit [on October 26]" and its decision to "invite the IMF to carry out a public verification of its policy implementation on a quarterly basis."[27] Likewise, Spain accepted IMF assistance in a non-lending role in July 2012, when the Fund agreed to provide technical assistance in the context of European support (up to €100 billion) for the Spanish authorities' efforts to recapitalize the financial sector.[28] The IMF conducted quarterly monitoring missions to Spain from October 2012 onwards and prepared quarterly "progress" reports. In the event, decisive action, coupled with aggressive bond purchases by the ECB, allowed Italy to contain the crisis without the IMF's formal involvement in what was contemplated as "enhanced surveillance" (Box 3).[29] Likewise, Spain stabilized its situation through a combination of decisive action and European financial assistance.

28. The three IMF-supported programs evaluated were completed or canceled by the middle of 2014 (Table 1). Ireland completed the EFF-supported program on schedule in December 2013, regained market access, and saw its growth recover and unemployment fall sharply, with a declining debt-to-GDP ratio. Most of the amounts that Ireland owed to the IMF were repaid early. Portugal, after allowing its EFF-supported program to elapse in June 2014 without completing

[23]The sovereign spread of Portuguese 10-year bonds over German counterparts averaged about 20 basis points between 2000 and 2007. See Eichenbaum, Rebelo, and de Resende (2016).

[24]Not only did the government ease fiscal policy, but it also reclassified some state-owned enterprises and public-private partnerships as part of the general government in keeping with an agreement reached with the European authorities. These liabilities, amounting to about 10 percent of GDP in 2011, required additional financing by the government.

[25]According to the data available at the time, Portugal's government debt was 90.6 percent of GDP in April 2011. The revised data show that the actual amount was 111 percent of GDP. See Eichenbaum, Rebelo, and de Resende (2016).

[26]Statement by the Heads of State or Government of the Euro Area and EU Institutions, Council of the European Union, Brussels, July 21, 2011.

[27]Communiqué, G20 Leaders' Summit, Cannes, November 3–4, 2011.

[28]"Spain—Terms of Reference for Fund Staff Monitoring in the Context of European Financial Assistance for Bank Recapitalization," July 20, 2012.

[29]The IMF's public statements, except in one instance, did not use the term "enhanced surveillance," which is a procedure developed in 1985 whereby the IMF provides monitoring of a quantified economic program "generally formulated with the assistance of the staff" (IMF, 1993). Enhanced surveillance is a service provided at the request of a member under Article V, Section 2*(b)* of the IMF Articles of Agreement (IMF, 1994b).

Box 3. Proposed "Enhanced Surveillance" for Italy

Italy's economic situation became precarious in the summer of 2011 against the background of heightened political uncertainty and the evolving euro area crisis. In August, European central bankers highlighted the need for fiscal consolidation measures, for which the Italian government secured parliamentary approval in September. By mid-October, however, public outcry over some elements of the austerity package was becoming louder while European partners were calling the package "too little, too late" (Marshall, 2012). It was under these circumstances that, on the sidelines of a G20 meeting in Cannes in early November, European and non-European leaders urged Prime Minister Berlusconi to consider accepting an IMF-supported program of macroeconomic adjustment.

The IMF's "enhanced surveillance" role for Italy was a counterproposal from the Italian authorities, who were convinced that, given the size of the Italian economy, any official financing would be insufficient and might well be counterproductive. The idea was for the IMF to monitor Italy's implementation of detailed policy measures to be agreed with the European partners. On November 4, the IMF Managing Director noted that the IMF was to "come independently as third parties based on our expertise of such situations to verify" if Italy was "doing what it said it would do."

In the event, the IMF did not find a formal role to play in Italy. Negotiations with the Italian authorities over how the monitoring was to be conducted continued for some time. On February 23, 2012, an IMF spokesman stated that "this enhanced monitoring of the Italian economy is very much at the government's own initiative, and really it's up to the government to decide on the timing of that." Decisive action taken by the new government (which took office on November 16, 2011), coupled with aggressive bond purchases by the ECB, caused the spreads of Italian bonds to decline sharply. The Italian authorities no longer needed the credibility of the IMF as an independent assessor to restore market confidence.

Sources: Marshall (2012); Irwin (2013); and IEO interviews.

the final review, also regained market access, though its growth has not yet picked up and unemployment and the debt-to-GDP ratio remain high. In Greece, the SBA-supported program, after an impressive start, went off track following the third review amid mounting uncertainties about the future of the country in the euro area. The program was canceled in March 2012 to be succeeded by a new one. Compared to the initial program projection for 2012, Greek GDP was lower by more than 15 percent, and unemployment stood at over 25 percent. The country's debt-to-GDP ratio continued to rise despite the sovereign debt restructuring of 2012.

CHAPTER

3 Two Key IMF Decisions

29. In May 2010, the IMF Executive Board approved a decision to provide exceptional access financing to Greece without seeking a restructuring of Greece's sovereign debt, in circumstances where the debt could not be "deemed sustainable with a high probability." Thus, the Board was required to change one of the criteria under the IMF's policy governing exceptional access, by introducing what became known as the systemic exemption clause (see below). This decision had implications beyond Greece, as the systemic exemption clause was invoked again in the cases of exceptional access support for Ireland and Portugal. This section assesses separately the decision to provide exceptional access financing to Greece and the decision to amend the exceptional access framework.

A. How Did the IMF Come to Provide Financial Support to Greece?

30. Perhaps no other IMF decision connected with the euro area crisis has received more criticism than that of providing exceptional access financing to Greece when its sovereign debt was not deemed sustainable with a high probability. The decision not to seek preemptive debt restructuring left debt sustainability concerns unaddressed. It also magnified the required fiscal adjustment, and thereby, at least in part, contributed to a large contraction of output and a subsequent loss of public support for the program. Moreover, by allowing private creditors to cut their exposures, the decision reduced the amount of sovereign debt eligible for the haircuts that eventually took place in the spring of 2012. The IMF's internal ex post evaluation of the Greek SBA observed that "not tackling the public debt problem decisively at the outset . . . created uncertainty about the euro area's capacity to resolve the crisis and likely aggravated the contraction in output. An upfront debt restructuring would have been better for Greece although this was not acceptable to the euro partners" (IMF, 2013c).

31. A proper assessment of the IMF Executive Board's approval of the decision to lend to Greece in May 2010 requires an understanding of the following facts. First, the European Commission, the European Central Bank, and some euro area governments were firmly opposed to restructuring Greece's sovereign debt for economic, technical, legal, or political reasons, and the Greek authorities accepted this position as a condition for receiving European assistance. Second, the IMF was kept on the sidelines in late 2009 and early 2010 when approaches to dealing with the developing crisis in Greece were being debated in Europe. By the time the IMF was invited to provide its expertise and financing in late March 2010, the option of debt restructuring at the program's outset was off the table. As a former senior IMF staff member interviewed by the IEO put it, "the train had already left the station." Third, with the fallout from the Lehman collapse of September 2008 still fresh in policymakers' memories, there were concerns that such a credit event could spread to other members of the euro area, and more widely to a fragile global economy struggling to recover from the global financial and economic crisis. The decision not to seek debt restructuring at the outset was the preferred choice of a majority (by voting power) of the IMF membership.

32. While general skepticism prevailed among IMF staff, key senior IMF officials were divided on the issue. Interviews with the senior staff involved suggest that the views were almost evenly split. One group took the position that, with strong action, Greece would be able to manage the crisis successfully without debt restructuring. Another group believed that the Greek debt was not sustainable with a high probability, and that debt restructuring would be feasible and any contagion manageable if the restructuring were appropriately executed. A third group agreed that the debt was not sustainable with a high probability but felt that debt restructuring at that juncture would be either infeasible, given the time constraints,[30] or too risky to attempt, given the lack of European firewalls.

[30] A large Greek debt service payment was coming due later in May 2010.

The Managing Director's decision was to go along with the decision already reached by European policymakers, and to take a chance on the possibility, however uncertain, of restoring Greece to financial and macroeconomic stability through official financing, fiscal adjustment, and structural reforms—and thereby to avoid any direct fallout from a preemptive debt restructuring.

33. What could the IMF have done differently to avoid the situation it faced in April 2010 wherein it was seen accepting a decision already reached in Europe, and to escape from the subsequent criticism that it had yielded to European interests? Irrespective of the merit of the final decision, to preserve independence in decision making—and to prevent the appearance of treating Europe differently—would have required the Fund to conduct a comprehensive analysis of the issues at hand and to follow an established, transparent procedure. For example, the IMF's decision making could have been strengthened by taking one or both of the following steps during the early months of 2010: (i) a formal, open, and early discussion of all options available to the IMF; and (ii) a more rigorous attempt to quantify likely contagion outcomes under different options.

34. First, even though the possibility of engaging with a euro area country in a program relationship became real in early 2009 (when IMF staff raised the issue informally with the Irish authorities), *no Executive Board meeting ever took place to discuss, let alone articulate, how the IMF could engage with a euro area country in a program relationship.* (The first informal Board meeting during the euro area crisis was held on March 26, 2010, but only to discuss developments in Greece.) IMF management had earlier established small, ad hoc staff task forces to explore various contingencies, but the work of these groups was so secret that few within the institution knew of their existence, let alone the content of their deliberations. The IEO has seen some, but not all, of the written reports prepared by these groups.

35. More open and earlier discussion by a wider group within the IMF, including the Board, could have crystallized the options available to the IMF, allowed the Fund to communicate its official position to European partners before it was formally invited to participate, and likely diminished any perception that the IMF yielded to European interests behind closed doors (De Las Casas, 2016). The Fund could have considered a number of options other than exceptional access financing without debt restructuring, including but not limited to: (i) regular access financing without debt restructuring, but possibly with a standstill agreement (in the manner of the Vienna Initiative),[31] or with greater European financial assistance in the absence of such an agreement; (ii) regular or exceptional access financing with debt restructuring; and (iii) technical assistance to the euro area in designing an adjustment program without IMF financing. Internal documents suggest that IMF staff did consider options, but given incomplete documentation, the IEO cannot say whether the IMF's contingency planning involved a discussion of all available options, along with the pros and cons of various modalities of engagement, including options (i) and (iii) stated above. Certainly, there was no open discussion, including with the Board, of these and other options.

36. Second, a more rigorous attempt to quantify likely contagion outcomes under different scenarios might have allowed a more objective comparison of options and helped to coalesce management, staff, and the Board sooner into a unified position, but there was not an extensive discussion of quantitative analyses of contagion. A review of documents provided to the IEO indicates that early analysis by the staff (i) identified channels for contagion (albeit with limited analysis of which were the most important); and (ii) assessed so-called conditional distress probabilities—that is, measurements derived from market prices of how default in one country might change the probability of default in other countries. However, the IEO has not seen any rigorous analysis of the spillovers to other countries of *not* restructuring Greece's sovereign debt, that is to say, how a decision not to restructure the Greek debt might affect the behavior of investors holding the sovereign debt of Greece and other euro area countries.

37. From its experience in earlier crises, the Fund had already learned that in the face of debt sustainability concerns, private investors may rush to exit in order to lessen their exposure to default risk. Filling the resulting gap with more preferred-creditor debt might only increase the size of haircuts needed for sovereign debt held by the private sector. While some within the staff, keenly aware of such a possibility, argued for the need to deal decisively with the debt at the outset, including through private sector involvement, their position did not prevail in the end. Critically, there was no rigorous attempt to articulate a convincing path to restoring debt sustainability in Greece, other than a program of official financing, fiscal adjustment, and structural reforms.

38. Just as the Greek SBA was about to be approved, an academic debate on the need for restructuring Greek sovereign debt emerged openly (see, for example, Calomiris, 2010, published in March). On May 7, 2010, two days before the Board approved the program, prominent

[31]The Vienna Initiative, officially launched in January 2009, was designed, inter alia, to prevent massive capital withdrawals from emerging Europe by securing commitments from international banks to maintain their exposure.

legal experts issued a paper explaining how Greece's sovereign debt could be restructured in "five to six months" if done efficiently. The authors (Gulati and Buchheit, 2010), recognizing that debt restructuring would not relieve Greece of the need for significant fiscal adjustment or official financing, correctly argued that it would change how some of the funds were spent (i.e., "backstopping the domestic banking system as opposed to paying off maturing debt in full"). In July 2010, Janssen (2010) was among the experts who noticed that the SBA had merely "exchanged debt ownership to save European banks and creditors," with no impact on Greece's debt sustainability.[32] The IMF's initial strategy thus likely failed to convince the markets that there would be no debt restructuring down the road, as predicted by some in the staff in their internal deliberations.

39. The IMF's eagerness to participate, perhaps with exceptional access financing, may have worked against fully exploiting these opportunities.[33] This is not to suggest that the outcome necessarily would have been different if management and staff had taken these steps.[34] A number of experts consulted for this evaluation expressed a range of views to the IEO. On one end of the spectrum is a view that, although there was no easy, obvious solution, "on balance," the decision not to restructure Greece's sovereign debt at the outset was appropriate; and that the Fund did the right thing in providing exceptional access financing. On the other end is a view that the decision to provide exceptional access financing without addressing debt sustainability concerns was inappropriate; and that if the European opposition could not be overcome, the IMF should not have provided Greece with financing, especially exceptional access financing. The diversity of views in part reflects the different expectations people hold of the role political judgments should play within the IMF—whether a program-related decision should pay respect to the preferences of its major shareholders or the IMF should remain a technocratic institution managed strictly on the basis of established rules. Regardless, by not following an open, transparent process, the Fund created the perception that a decision made in Europe had been imposed on it.

[32]Janssen (2010) correctly predicted that "three years from now, Greece will be facing an even higher debt burden" and that "jobs and economic growth will have been sacrificed."

[33]The news of having been invited by the euro area to participate in a financing package for Greece was received with much excitement by many at the IMF, according to IEO interviews

[34]In Ireland, IMF staff pushed for bailing in senior unsecured creditors of Irish banks as part of the 2010 EFF-supported program but did not receive the support of global policymakers. The Fund nonetheless provided exceptional access financing to Ireland. See Chapter 4, Section B.

B. How Did the IMF Come to Modify the Exceptional Access Framework?

40. Another controversial IMF decision with far-reaching consequences was taken in May 2010, to modify the framework for providing exceptional access to Fund resources. This framework had a procedural and a substantive component.[35] The procedural component included: a process for early and regular consultations with the Board on progress towards reaching agreement on a program; the presumption that staff reports would be published; an assessment of the risks to the IMF; and an ex post evaluation within one year after the completion of arrangements (Box 1). The substantive component consisted of four criteria that a member had to meet to obtain exceptional access. In May 2010, the Executive Board, in approving the SBA-supported program for Greece, simultaneously approved the introduction of an exemption from the second of these criteria if a crisis presented a significant risk of adverse systemic spillover effects (Box 4).[36]

41. Amending the second criterion to allow the "systemic exemption" was dictated by two considerations. First, it was a compromise to get all the key senior IMF staff members involved to back the Greek program before it was submitted to the Board for approval. While those who believed that Greece's sovereign debt was sustainable did not think the criteria needed to be amended, those who thought otherwise wanted to signal their concerns about debt sustainability while preserving their professional reputation against pressure to agree to support an exceptional access program that did not meet one of the criteria. Second, the IMF's Legal Counsel observed that making a special exception for Greece would violate the principle of uniformity of treatment;[37] thus any revision must apply to all similar situations in the future.

[35]The design of the framework drew on the Prague Framework for Private Sector Involvement (PSI), which was endorsed by the International Monetary and Financial Committee (IMFC) at the Annual Meetings in Prague in 2000. The 2000 IMFC communiqué read in part: "In yet other cases, the early restoration of full market access on terms consistent with medium-term external sustainability may be judged to be unrealistic, and a broader spectrum of actions by private creditors, including comprehensive debt restructuring, may be warranted to provide for an adequately financed program and a viable medium-term payments profile. This includes the possibility that, in certain extreme cases, a temporary payments suspension or standstill may be unavoidable."

[36]This decision was purely an internal IMF matter and was not taken at the behest of euro area partners.

[37]As Schadler (2016) notes, when the exceptional access framework was developed, the Executive Board considered adding a special provision relating to contagion or systemic effects. It was determined then that such a provision "could create a bias toward higher access for larger members, which could not be reconciled with the principle of uniformity of treatment" (IMF, 2003b; see also De Las Casas, 2016).

Box 4. Exceptional Access Criteria

1. The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account resulting in a need for Fund financing that cannot be met within the normal limits.

2. A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. *However, in instances where there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over this period, exceptional access would be justified if there is a high risk of international systemic spillovers.*[1]

3. The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.

4. The policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.

Source: IMF (2010d).

[1] The italicized passage was added by the same Board decision that approved the SBA for Greece on May 9, 2010.

42. The way in which the second criterion was modified lacked transparency (De Las Casas, 2016). The proposal to change the exceptional access framework was embedded in the staff report for the Greek SBA request, and Executive Directors received no advance notice that such a change was forthcoming.[38] While several Board members had noticed the two sentences tucked into the text on Greece's overall adherence to the exceptional access criteria, few recognized the implications of the language until one of them raised the issue during the meeting. Otherwise, the decision would have been approved without the Board's full knowledge. The intent of the exceptional access criteria, as originally designed, was to make the IMF less "vulnerable to pressure to provide exceptional access when prospects for success are quite poor and debt burden of the sovereign is likely to be unsustainable" by limiting the "degree of discretion and flexibility" in the existing framework (IMF, 2002a). The decision of the IMF to participate in an exceptional access arrangement in an environment where debt was not sustainable with a high probability undermined the very purpose for which the exceptional access framework had been designed.

43. In January 2016, the Executive Board modified the IMF's exceptional access framework again by removing the systemic exemption clause. In the staff report proposing the Board decision, IMF staff gave four reasons. "First, to the extent that a member faces significant debt vulnerabilities despite its planned adjustment efforts, the use of the systemic exemption to delay remedial measures risks impairing the member's prospects for success and undermining safeguards for the Fund's resources. Second, from the perspective of creditors, the replacement of maturing private sector claims with official claims, in particular Fund credit, will effectively result in the subordination of remaining private sector claims in the event of a restructuring. Third, the systemic exemption aggravates moral hazard in the international financial system and may exacerbate market uncertainty in periods of sovereign stress. Finally, it is far from clear that invoking the systemic exemption to defer necessary measures on debt can be relied upon to limit contagion, since the source of the problem—namely, market concerns about underlying debt vulnerabilities—is left unaddressed" (IMF, 2016). The revised framework nonetheless leaves room for the IMF to provide exceptional access financing in cases where debt is not deemed to be sustainable with a high probability.[39]

[38] The initial note that was circulated to the Board on April 15, 2010 included a preliminary assessment that the four criteria were met. No written evidence has been presented to the IEO to show that staff ever informed the Board differently before issuing the staff report requesting the SBA.

[39] The revised second criterion reads in part as follows: "Where the member's debt is considered sustainable but not with a high probability, exceptional access would be justified if financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt sustainability and sufficiently enhances the safeguards for Fund resources. For purposes of this criterion, financing provided from sources other than the Fund may include, inter alia, financing obtained through any intended debt restructuring. This criterion applies only to public (domestic and external) debt. However, the analysis of such public debt sustainability will incorporate any relevant contingent liabilities, including those potentially arising from private external indebtedness" (Decision No. 15931 (16/4), adopted January 20, 2016).

CHAPTER

4 IMF Performance

A. How Effective Was IMF Surveillance?

44. At the launch of the euro, the IMF adopted a double-track approach to its surveillance of euro area countries (Executive Board Decision No. 11846 (98/125), December 9, 1998). The IMF conducted Article IV consultations, usually annually, with individual member countries that also belonged to the euro area. It also held twice-yearly staff discussions with the EU institutions responsible for common policies in the euro area; according to the Board decision, these discussions were to be "considered an integral part of the Article IV process for each member." How to integrate these two strands of surveillance activity has since posed a challenge to the IMF.[40]

Did the IMF warn about vulnerabilities in crisis countries?

45. The Fund's country- or national-level surveillance for the most part identified the right issues but did not foresee the magnitude of the risks that would become paramount in the crisis to follow. In all crisis countries, IMF surveillance consistently stressed the need for fiscal discipline and structural reforms. In Greece, the staff in 2005 pushed for deep reforms to tax administration and expenditure management, as recommended by an earlier FAD technical assistance mission (Kopits, 2016). In Greece and Portugal, the need for structural reforms, especially in the labor and product markets, was noted virtually every year. In Ireland, the staff saw signs of overheating including in the form of house price inflation, warned the authorities of the potential consequences of inaction, and called for determined fiscal tightening; the staff also warned that over-reliance on wholesale borrowing made the banking system vulnerable to a change in market sentiment. However, the IMF underestimated the buildup of banking system vulnerabilities, most notably in Ireland (Donovan, 2016).

46. A number of factors undermined the quality and effectiveness of surveillance. First, the analysis often lacked sufficient depth, rigor, or specificity. In the area of structural reform, advice often amounted to an exhortation to do good (e.g., "staff urged the authorities to make the labor market more flexible") without quantifying the impact of specific measures.[41] In Ireland, the staff did not pay sufficient attention to the composition of government revenue and therefore overestimated the structural fiscal surplus; nor did it pay systematic attention to developments in the critical commercial property sector that would be the major cause of the subsequent collapse of the banking system (Donovan, 2016). In Portugal, IMF surveillance after 2005 considered a lack of international competitiveness as the primary cause of the large current account deficit, while failing to (i) critically examine sectoral unit labor costs and the components of the trade balance (unit labor costs in the tradable sector did not rise substantially); (ii) acknowledge that the exports/GDP ratio did not fall significantly; and (iii) recognize sufficiently the role of private sector behavior as the main driver of the fall in savings. Also, the IMF did not include the liabilities of state-owned enterprises and public-private partnerships in its calculations of Portugal's public debt. As a result, Portugal's financing needs were underestimated when the country approached the IMF for emergency financial assistance in 2011 (Eichenbaum, Rebelo, and de Resende, 2016).

[40] This issue was first addressed in a report by Watson (2008) that was prepared for the 2008 Triennial Surveillance Review (TSR). Pisani-Ferry, Sapir, and Wolff (2011), as part of the 2011 TSR, found that the analysis in national Article IV consultations had rarely taken account of spillovers across countries.

[41] In this connection, the ECB (2015) recommended that the IMF "provide stronger and more clearly formulated policy recommendations on structural reforms, including their estimated impact."

47. Second, the IMF staff was often quick to praise national authorities for reforms without assessing the actual implementation or impact of the reforms. Reforms announced or implemented were generally cast in a positive light, albeit with a caveat that more were needed. In Greece, for example, the 2007 Article IV consultation discussed in favorable terms the reforms in tax administration and expenditure control that were part of the National Reform Program (2005–08), as well as the passage in November 2007 of the Law on Tax Evasion. In reality, very little substantive reform was being implemented; instead, during 2004–09, the Greek government was legislating numerous structural impediments in the product market (Katsoulakos, Genakos, and Houpis, 2015; Mitsopoulos and Pelagidis, 2011; Pelagidis and Mitsopoulos, 2014). In part, the lack of a more rigorous appraisal of structural issues reflected the predominantly macroeconomic focus of IMF surveillance. Even so, this shortcoming in pre-crisis surveillance proved costly: after beginning its program relationship with Greece in May 2010, the IMF took several months to realize that the country's administrative capacity remained weak and that vested interests' opposition to reforms was almost insurmountable.

48. Third, IMF surveillance did not sufficiently highlight the adverse consequences of not promptly addressing identified fiscal or structural issues in countries that belonged to a monetary union—where, for example, debt could not be monetized or inflated away. As noted by Pisani-Ferry, Sapir, and Wolff (2011), "a country with a high debt to GDP ratio and low competitiveness" could increase "the real burden of debt." Surveillance in a common currency area should have focused more on the need to absorb asymmetric shocks with sufficient fiscal space and wage flexibility. Arguably, the Fund should have sounded a louder warning about the pro-cyclically expansionary fiscal stance that the crisis countries adopted, irrespective of their compliance with the Stability and Growth Pact or correction under the Excessive Deficit Procedure (Kopits, 2016).

49. Greece's problems with data reporting did not initially receive the attention they deserved from the IMF. In 2004, Greece revealed that it had grossly misreported national and public sector accounts going as far back as 1997. In 2009, as noted above, new misreporting related to the public sector accounts emerged. IMF senior staff and management downplayed the repeated warnings by mission teams of the dismal condition of Greece's public sector accounts, according to staff interviews (Kopits, 2016). As a result, IMF staff "took a generally approving stance with only occasional expressions of mild concern" (IEO, 2016). The IMF took no formal action with respect to the 2004 misreporting, perhaps considering that the issue would be competently dealt with by Eurostat, the EU's statistical office. In 2010, related to the newer misreporting, the IMF found Greece in breach of obligations under Article VIII of the Articles of Agreement (IMF, 2010e).

Did the IMF warn about euro area vulnerabilities?

50. Before the launch of the euro in January 1999, the IMF's public statements tended to emphasize the advantages of the common currency more than the concerns about it that were being expressed in the broader literature. Individual staff members did express such concerns. Interviews with former and current senior staff members suggest that, after a heated internal debate, the view supportive of what was perceived to be Europe's political project ultimately prevailed in guiding the Fund's public position. Thus, while other observers saw potential vulnerabilities arising from the operation (if not the design) of the Stability and Growth Pact or from the inadequacy of the framework to resolve systemic problems, the IMF *World Economic Outlook* stated in 1997 that "the emerging policy framework appears to strike a good balance between rules and the necessary scope" for judgment in the monetary and fiscal areas (IMF, 1997).

51. The Fund's euro area surveillance, perhaps justifiably, focused on the larger European economies. Apparently seeing little risk that a smaller country in the periphery could become a source of vulnerability to the rest of the monetary union, euro area surveillance did not analyze sufficiently how policies pursued in one country might affect other members of the monetary union. Staff resources were shifted away from countries that would later face crises. Missions to these countries also were less likely to involve participation from the functional departments (Fiscal Affairs Department and Monetary and Capital Markets Department) where fiscal or financial expertise resided (Dhar and Takagi, 2016). While not a central failure of the Fund's euro area surveillance, inadequate attention to vulnerabilities in periphery countries may have diminished any scope for exercising peer pressure on those countries.

52. The IMF was more insightful in the area of financial supervision and resolution. In the early years of the common currency, IMF multilateral surveillance covered the systemic risks and vulnerabilities associated with the financial stability architecture, expressing

concern about the adequacy of a nationally oriented framework for handling euro-wide problems, especially as regional financial integration and consolidation progressed (Schinasi, 2012; Véron, 2016). Several European officials who were interviewed for this evaluation praised this aspect of the IMF's pre-crisis euro area surveillance, although it had limited impact.

53. The IMF, like most other observers, missed the buildup of risks in the euro area's banking system overall, though not in all countries. In fact, the IMF remained upbeat about the soundness of the European banking system and the quality of banking supervision in euro area countries until after the start of the global financial crisis in mid-2007. This lapse was largely due to the IMF's readiness to take the reassurances of national and euro area authorities at face value (Véron, 2016). *The quality of euro area financial sector surveillance improved after the Lehman failure of September 2008.* The IMF was successful in identifying European banks' unaddressed vulnerabilities and pushed for aggressive bank stress-testing and recapitalization. In 2009, the Fund was also among the first to acknowledge the role of the bank–sovereign vicious circle. As early as 2007, it had begun articulating a vision of what is now called banking union, which played a role in the euro area decision of mid–2012, an important turning point in the evolution of the crisis (Véron, 2016).

Did the IMF recognize the possibility of a sudden stop?

54. One analytical oversight stands out in the IMF's pre-crisis surveillance at both the national and the euro area level. It is the failure to identify the nature of current account imbalances and therefore to recognize the possibility of a sudden stop within the monetary union. The IMF staff, along with other economists, tended to see the divergence in current account balances as part of a natural process of convergence, and not to fully appreciate the fact that the widening imbalances coincided with the acceleration in gross debt flows and "risk on" conditions in global financial markets (Lane, 2012). To be sure, the staff raised concerns over intra-area imbalances but, with notable exceptions,[42] its approach was almost exclusively in terms of growth and inflation differentials; it did not sufficiently focus on capital surges that financed excess demand, or on vulnerabilities related to sudden reversals of intra-area flows. Instead, when current account issues were discussed, the focus was typically on the area-wide current account, which remained in approximate balance.

55. In national-level surveillance, the staff typically approached divergent current account balances from the perspectives of trade and competitiveness. The financing aspect—that is to say, the idea that the current account deficit was a counterpart of the large inflows of portfolio capital and wholesale bank funding—was downplayed. Part of the reason is that the possibility of a balance of payments crisis in a monetary union was thought to be all but nonexistent—a view widely shared in the policy and academic communities (Pisani-Ferry, Sapir, and Wolff, 2011). While the staff from time to time expressed its concern about the risks associated with portfolio and wholesale banking inflows (including the consequence of a change in investor sentiment), its overall message was positive—with the 2007 Article IV consultation with Greece, for example, noting that in view of "Greece's EMU membership, the availability of external financing [was] not a concern" (IMF, 2008). As a result, the staff understood the adjustment mechanism, not in terms of a sudden stop followed by a balance of payments or banking crisis, but as an example of the price-specie-flow-like mechanism first analyzed by Meade (1953) in the context of a European monetary union. The 2001 Article IV consultation with Portugal (which was concluded in March 2002), for example, characterized the likely adjustment as a gradual process: "inadequate adjustment of the large imbalances could precipitate an extended period of slow growth" as it would require a fall in domestic demand (IMF, 2002c).[43]

56. The Fund's failure to foresee a sudden stop reflected two analytical weaknesses: (i) failure to recognize the link between the default risks of sovereigns and banks and the possibility that the financial system could become segmented along national lines; and (ii) failure to grasp fully the functioning of the single currency through the TARGET (or TARGET2)

[42]For example, an IMF economist, in a co-authored paper, examined the heterogeneity of external positions across the euro area and how individual countries could be affected differently by global current account developments (Lane and Milesi-Ferretti, 2007).

[43]The European Commission's understanding of the adjustment mechanism in the monetary union was also of the price-specie-flow type. EC (2006) argued that the real exchange rate or "competitiveness" was the principal channel of aligning member countries' cyclical positions following a country-specific shock. (That is, resource costs in a booming economy rise such that activity slows until cyclical conditions move back in line with the euro area average.) The EC's analysis then documented how the "competitiveness channel" operated in the euro area and called for reforms to promote more rapid and symmetrical price and wage adjustments in order to improve the mechanism.

settlement system. In 1998, the staff had observed that if various country-specific risks caused the financial system to become segmented, "residents of an EMU member could find themselves unable to borrow, on suitable terms, as much as is appropriate and necessary to avoid measures destructive of national or international prosperity" (IMF, 1998).[44] With respect to the TARGET system, Garber (1998, 1999), noting the role played by national central banks with their own balance sheets, had argued that speculative one-way capital flows could occur in the euro area if the ECB's willingness to provide unlimited credit was challenged. Somehow, these insights were lost in the euphoria of the pre-crisis period.

Why was IMF surveillance in the euro area ineffective?

57. This evaluation corroborates the conclusions of an external study that was prepared for the IMF's 2011 Triennial Surveillance Review (TSR): that the Fund fell "victim to a 'Europe is different' mindset," and that "eagerness to play a role in the complex European policy process reduced the IMF's effectiveness to be an independent and critical observer" (Pisani-Ferry, Sapir, and Wolff, 2011; Box 5). The authors of this study further noted that European policymakers considered IMF surveillance "to be of little help," and that its tone was "too close to the official line of the Commission and the ECB." Similar views were expressed to the IEO by senior European officials interviewed for this evaluation. Since 2011, the IMF has taken a number of measures to strengthen its surveillance of the euro area,[45] the outcome of which was recently assessed by a task force of the European Central Bank (ECB, 2015; Box 5). The present evaluation does not address how these recent initiatives may have improved the quality and effectiveness of IMF surveillance in the euro area.

58. To be sure, much of the 2000s was marked by complacency not just within the IMF but also in the broader policymaking community, against the backdrop of the "Great Moderation." Failure to identify the buildup of vulnerabilities and to anticipate crises was not unique to the IMF or to the euro area. An earlier IEO evaluation (IEO, 2011), for example, documented how IMF surveillance had failed to pay sufficient attention to the risks of contagion or spillovers from a crisis in advanced economies from 2004 to 2007. Compounding such complacency was the view held by some IMF staff members that euro area authorities were "in the front line" (Donovan, 2016) for addressing most, if not all, of the issues they saw. A major downsizing of the IMF staff that took place during 2008–09 reflected this culture of complacency among the IMF's membership, though the downsizing cannot be a reason for the failure of IMF surveillance before the global financial crisis.[46]

B. How Well Did the IMF Design Its Programs?

59. The three crisis countries faced similar constraints: (i) being members of a monetary union, currency depreciation was not an option for them; (ii) a political decision had ruled out preemptive sovereign debt restructuring, a bail-in of private creditors, and a standstill agreement; and (iii) the amount of official financing was limited. Under these circumstances, the IMF-supported programs involved an unusually strong, front-loaded fiscal adjustment. The fiscal adjustment required of these countries was among the largest in recent history: the adjustment in the programmed primary balance amounted to 5.5 percentage points of GDP for Greece (or 7.0 percentage points if cyclically adjusted), 8.2 (7.6) percentage points for Ireland, and 4.8 (4.2) percentage points for Portugal over the program years. The average annual programmed fiscal adjustment of 3.5 percentage points of GDP in the euro area programs (almost 4.5 percentage points in Greece) was larger than the 1.6 percentage points of GDP required in large Latin American programs in the 1980s and 1990s (Larraín, 2016).[47]

[44] Nonetheless the staff considered such an event extremely unlikely: "Balance of payments surpluses or deficits could . . . arise in individual members of the monetary union in the event that the union-wide financial system became segmented. For a union like EMU, of course, this would be extremely unlikely" (IMF, 1998).

[45] Likewise, measures were taken within the euro area to strengthen surveillance through agreements on the so-called Six-Pack, Two-Pack, and fiscal compact, which included a macroeconomic imbalances procedure. It is beyond the scope of this evaluation to assess the impact of these measures.

[46] The staff downsizing led to some countries being placed on a 24-month consultation cycle and others being subject to "simplified procedures" involving shorter visits and fewer topics covered in less depth.

[47] Econometric analysis suggests that the size of the initial fiscal disequilibria more than accounts for the difference (Larraín, 2016). The author, in coming to this result, included all five euro area programs. An implication of his finding is that the size of official financing in the euro area was larger relative to the size of the initial fiscal disequilibria than in the Latin American cases.

Box 5. Highlights from Evaluations of IMF Surveillance of the Euro Area by European Experts, 2011 and 2015

External Study for the 2011 Triennial Surveillance Review (Pisani-Ferry, Sapir, and Wolff, 2011)

While the IMF made strong and relevant policy recommendations, it did not sufficiently integrate national and euro area-wide analyses and often did not identify spillovers between euro area countries.

The IMF fell victim to a "Europe is different" mindset, with the result that it did not address economic divergence across countries, including large national current account imbalances.

Eagerness to play a role in the complex European process reduced the IMF's effectiveness as an independent and critical observer.

The IMF did not fundamentally criticize the weaknesses of the governance of the euro area, including the design of the SGP and lack of fiscal integration, though it did identify those of the EU financial supervision and resolution framework.

The IMF improved its surveillance of the euro area considerably, following the start of the financial crisis in 2008, in terms of policy proposals and in warning about banking sector problems.

ECB International Relations Committee Task Force Report (ECB, 2015)

The IMF has significantly improved its surveillance of the euro area, with more consistent and focused messages, better accounting of linkages and spillovers, better integration of bilateral and euro area-wide surveillance, better assessment of risk, and expanded coverage of financial stability issues.

Scope remains for further strengthening the analysis of interconnections, risks, financial stability issues, and external stability, through strengthened analysis of spillovers from shocks and policies, being more specific in proposals and further linking the financial and external analysis, and deeper analysis of rebalancing within the euro area and greater use of gross balance sheet analysis.

Should the IMF have pushed harder for bailing in private creditors?

60. IMF management and staff, having decided not to push for debt restructuring for Greece, did not make a case for it when the program's likelihood of success increasingly came into doubt, starting from the fall of 2010.[48] The initial strategy for Greece was highly risky, as the staff report for the 2010 SBA request clearly acknowledged: "there are . . . substantial risks to the program . . . the margin to respond to negative shocks is limited" (IMF, 2010d). This was a razor-edge program whose viability depended on a number of optimistic assumptions coming true. Some within the IMF who opposed preemptive debt restructuring believed that the debt needed to be restructured when conditions permitted. This idea—known internally as the Blanchard Plan after then-Economic Counsellor, Olivier Blanchard—was not made operational until late 2011, even though initial steps were taken toward building European firewalls in May 2010.

61. The IMF was slow to press the case for debt restructuring for at least three reasons. First, the IMF did not forcefully place the issue on the table for discussion when it was invited by the European partners to join the financing package for Greece. The Fund's internal differences of view meant that, unless there was compelling new information or a fundamental change in the European position, it had no reason to change its initial stance. Second, during the early months of the program, Greece delivered on the agreed fiscal consolidation and structural reform, and the strategy seemed to be working as envisaged, bolstering the position of those who argued against debt restructuring. Third, the IMF remained divided on the merits and risks associated with debt restructuring. While the majority of IMF staff increasingly came to support debt restructuring, some key senior officials continued to take the position that the sovereign debt was sustainable. In September 2010, FAD published a paper arguing that, for "today's

[48]Leading European economists, writing in February 2011, concluded that Greece had become "insolvent" and that "further lending without a significant enough debt reduction [was] not a viable strategy." Their estimates also indicated that "the spillover effect from a sustainability-restoring haircut on sovereign debt" on the rest of Europe would be manageable (Darvas and others, 2011).

advanced economies," including "peripheral" euro area countries, "default would not be in the interest of the citizens" (Cottarelli and others, 2010). During the same month, IMF staff members joined the Greek authorities to defuse investors' fears by holding road shows in London, Paris, and Frankfurt, stressing the viability of the IMF-supported program (Hope and Oakley, 2010; IEO interviews). As a former senior staff member explained to the IEO, the staff had invested so much in selling the program to the European public as workable that it could not quickly change its tune, even though an agreement reached at a Franco-German summit in late October 2010 was widely interpreted by market participants as an official signal that sovereign debt restructuring would be acceptable in the euro area.[49]

62. In Ireland, in contrast, IMF staff pushed for a bail-in of senior unsecured creditors of Irish banks as part of the Extended Arrangement. The issue of whether these creditors should be bailed in or bailed out was first raised between the Irish authorities and the IMF during the fall of 2010. With support from the IMF team, the authorities came to the firm view that a write-down of debt held by senior unsecured bondholders of at least some Irish banks should form part of the program and that, at a minimum, a write-down of the debt owed by banks in resolution should occur (Chopra, 2015; Donovan, 2016; Véron, 2016). The European members of the troika, however, feared that imposing losses on senior unsecured bonds held by private creditors in a volatile, uncertain environment would adversely affect euro area banks and their access to funding markets. The issue was brought to the attention of the Group of Seven (G7) finance ministers, who supported the European position. In late November 2010, the authorities were informed by the IMF team that bailing in of senior bondholders was no longer an option (Donovan, 2016).

Were IMF-supported programs sufficiently flexible?

63. Perhaps the most conspicuous weakness of the IMF-supported programs in the euro area was their lack of sufficient flexibility. As the IEO's earlier evaluations of the IMF's capital account crisis programs in Argentina, Brazil, Indonesia, and Korea (IEO, 2003, 2004) noted, program outcomes often turn out to be different from expected in a crisis situation, and the appearance of persevering with a failing program can damage market confidence. The evaluations highlighted the need to have a contingency strategy from the outset, including criteria to determine whether the initial strategy was working and whether a change in approach was needed. Flexibility was a feature of post-global crisis programs *outside* the euro area, as documented by Takagi and others (2014). In the case of the euro area crisis, however, a senior staff member explained to the IEO that it was extremely difficult to change the programs' fundamental parameters as this would have required a protracted negotiation not only with national authorities (as would be the case in any program situation) but also with the European partners.

64. As a result, an increasingly unworkable strategy was maintained for too long. In Portugal as well as in Greece, when GDP contracted more than anticipated the nominal deficit ceiling was routinely tightened in order to achieve the original targets (which were set in relation to GDP in the EU programs) and maintain the official financing envelope (Kopits, 2016).[50] In Greece, the fourth IMF program review (July 2011) made highly optimistic assumptions about the revenues to come from privatization (the estimate was raised from €12.5 billion to €50 billion over the period 2010–15) as deflation and a deeper-than-expected contraction of output caused the underlying debt dynamics to start overshooting program projections by a large margin (Wyplosz and Sgherri, 2016; Pisani-Ferry, Sapir, and Wolff, 2013). The optimism about privatization revenues signaled a virtual admission that the program was underfinanced (IMF, 2013c). The original growth projections were marked down substantially only in the fifth review, in December 2011—more than 18 months into the arrangement—once a deal over private sector involvement had been reached and more favorable official financing terms had been agreed with the European partners (Wyplosz and Sgherri, 2016).

Were program assumptions and forecasts realistic?

65. Optimism has been a well-known feature of most IMF-supported programs (IEO, 2014a), sometimes prompted by the need to achieve internal consistency.

[49]On October 18, 2010, the French and German leaders agreed in Deauville, France that any future rescue of a euro area country would require a bail-in of private creditors if the debt was judged to be unsustainable. Though it was stated that this policy would take effect from 2013, the agreement created immediate reactions from policymakers and market participants (Forelle and others, 2010). See also Chaffin and Spiegel (2010).

[50]This tightening was tantamount to disallowing the operation of automatic stabilizers, thus aggravating the pro-cyclicality of the fiscal policy, which exacerbated the contraction. In contrast, the program for Ireland built in flexibility at the outset, allowing fiscal stabilizers to operate.

In Greece and Portugal, though not in Ireland, growth scenarios proved to be overly sanguine. In Greece and to a lesser extent in Portugal, the programs also proved overoptimistic about the national authorities' ability to implement a large number of politically difficult reforms. In contrast, it appears that many of the post-Lehman crisis programs *outside* the euro area were designed with more realistic assumptions (Takagi and others, 2014).

66. Much has been said about the fiscal multiplier (0.5) used by the staff, which turned out to be too small in Greece and Portugal.[51] Staff explained that the 0.5 multiplier was the average value that had been assumed for advanced economies in the past. But this assumption was inappropriate for the euro area programs, given the countries' inability to ease monetary policy let alone devalue the currency. The academic literature at the time indicated that the multiplier would be larger the more binding the zero lower bound on monetary policy and the larger the recession. For Portugal, Eichenbaum, Rebelo, and de Resende (2016) show that had the value of 0.8 been used instead of 0.5,[52] roughly 40 percent of the forecast error for the time-path of GDP from 2001 to 2014 would have been eliminated, and that a multiplier of 1.1 would have entirely eliminated the cumulative forecast error. For Greece, the confidence effect of the political crisis would probably have rendered almost any multiplier too small ex post. Yet, Gros and Alcidi (2010) argued in April 2010 that in Greece, given its limited openness and low savings rate, the multiplier might be as high as 2.5 and that GDP would fall by 15 percent. In the October 2012 issue of the *World Economic Outlook*, IMF staff concluded that "actual fiscal multipliers were larger than forecasters assumed" (IMF, 2012a).

67. Likewise, the assessment of public debt sustainability for Greece was based on a highly optimistic set of assumptions and a narrow definition of sustainability around a central scenario.[53] Staff did not assess the risks associated with the underlying projections (for example, for GDP growth and privatization receipts) or carry out country-tailored sensitivity analysis. This decision reflected both a strong optimistic bias and an unwillingness to consider substantially less favorable scenarios, which would have rendered Greece's debt sustainability more questionable. Interestingly, in the case of Greece, IMF staff had conducted a more in-depth public sector balance sheet assessment as part of the 2009 Article IV consultation, shortly before the onset of the crisis. Objective quantification of the intertemporal balance sheet had revealed a highly negative net worth for the public sector—that is, a severe case of sovereign insolvency (Traa, 2009).

68. In August 2011, the Executive Board reviewed the IMF's framework for fiscal policy and public debt sustainability analysis in market-access countries and identified several areas for improvement, including "the realism of baseline assumptions, the level of public debt as one of the triggers for further in-depth study, the analysis of fiscal risks, vulnerabilities associated with the debt profile, and the coverage of fiscal balance and public debt" (IMF, 2011c). The framework was reformed in 2013 to provide deeper analysis and more in-depth reporting on debt sustainability assessment, based on triggers of debt burden indicators and access to Fund resources (IMF, 2013d).

What was the experience with structural conditionality?

69. Along with fiscal consolidation, the IMF programs called for structural reforms to promote fiscal sustainability and internal devaluation. The IMF's approach to structural conditionality differed from that of the EU: while structural conditionality was extensive and intrusive in the EU programs, it was for the most part focused on macro-critical issues in the IMF programs.[54] Yet national authorities who were interviewed for this evaluation perceived the IMF and EU programs as single programs.[55] The multiplicity of measures, at times without adequate prioritization, imposed a considerable implementation burden on national authorities (Kopits, 2016; Eichenbaum, Rebelo, and de Resende, 2016). A lesson that the IMF had learned from the Asian crisis—that imposing a long list of structural conditions without prioritization would be

[51]Given the openness of the Irish economy, the multiplier estimate used in designing the Irish program (about 0.5) was broadly appropriate.

[52]Evidently, IMF staff had revised the multiplier upward to 0.8 by October 2012 (Eichenbaum, Rebelo, and de Resende, 2016).

[53]The IMF's standard template for debt sustainability analysis consists of debt-to-GDP projections under a few standard scenarios. Given the nature of the exercise, moreover, there is no objective threshold to determine sustainability. For these and other issues, see Schadler (2016).

[54]Based on the number of pages in the initial program documents as a rough proxy for the extensiveness of coverage, structural conditionality in the EU-supported programs was about 1,800 pages for Greece, 1,000 pages for Portugal, and 900 pages for Ireland (Sapir, Wolff, de Sousa, and Terzi, 2014; Park, 2016).

[55]The general public may have had similar perceptions, bolstered by the fact that both the IMF letter of intent and the EC memorandum of understanding were attached to the published IMF staff reports.

counterproductive—was not applied to the joint EU-IMF program (Park, 2016).

70. While the IMF-supported program focused heavily on structural fiscal reforms in Greece, the number of related structural conditions nonetheless increased as the program progressed.[56] The IMF staff initially overestimated the administrative capacity of the Greek government and underestimated the opposition that structural reforms would face from vested interests. It was in response to the apparent lack of administrative capacity and political will that structural measures proliferated at each successive review. For example, by the fifth review, one of the prior actions for fiscal structural reform had nine components. As it turned out, Greece made little progress with politically difficult measures, including competitiveness-related measures such as privatization, downsizing of the public sector, and labor market reforms (IMF, 2013c; Wyplosz and Sgherri, 2016). In terms of priority, those interviewed in Greece for this evaluation stated to the IEO that too much focus initially had been placed on labor market reforms at the expense of product market reforms, thereby making it difficult for internal devaluation to work.

71. Structural conditionality fared somewhat better in Portugal and much better in Ireland. In Portugal, most of the structural measures related to labor market reforms and public expenditure management. Several measures related to the financial sector were poorly implemented because of conflicting objectives and inadequate financing (Eichenbaum, Rebelo, and de Resende, 2016),[57] but overall the structural measures were largely completed as envisaged, though in some cases with delays. In Ireland, where labor and product markets were judged to be sufficiently flexible to begin with, structural conditionality was appropriately lighter,[58] and the few conditions were met in a timely fashion.

72. Although the structural conditions in the IMF-supported programs for Greece and Portugal focused mostly on macro-critical areas, they were more numerous than those in other IMF-supported programs in recent years. If we use the average number of structural measures (including prior actions and benchmarks) as a crude measure of intensity, the number was 22.5 per year for Greece and 20 per year for Portugal, compared to 5.2 per year in IMF-supported programs approved in 2008 and 8.5 per year for those approved in 2010 (Takagi and others, 2014).[59] While the Fund's approach to structural conditionality in these programs may thus appear inconsistent with the streamlining initiative that the Fund had had in place since the early 2000s (IEO, 2007b),[60] it should be acknowledged that, in the absence of currency depreciation as a policy instrument, structural reforms were virtually the only means to promote competitiveness. In this respect, the approach resembled that in the 2008 SBA-supported program for Latvia, where currency devaluation was ruled out and the number of structural measures averaged 16.7 per year. In the event, as the staff has concluded recently (IMF, 2015c), the strategy of internal devaluation did not work as quickly or effectively as envisaged, especially against an external environment of low inflation and slow growth.[61]

What was the experience with fiscal devaluation in Portugal?

73. The structural conditionality in the EFF-supported program for Portugal initially included a "fiscal devaluation" that would mimic a currency devaluation through fiscal measures.[62] Even though staff early on in the program shelved the idea, in September 2012, the

[56]Competitiveness-related reforms flowed from the EC's agenda. The SBA request contained only one structural benchmark related to competitiveness: the preparation of a privatization plan. The Fund's second program review set a structural benchmark on reforming the collective bargaining system, while the third review set a benchmark on repealing laws on closed professions. The fourth and fifth reviews specified a number of competitiveness-related prior actions (IMF, 2013c).

[57]For example, the objective of cleaning up banks' balance sheets conflicted with that of shoring up their capital. Given the inadequate financing, both of these objectives could not be achieved simultaneously. As a result, bad loans were evergreened to avoid recognizing them as delinquent.

[58]The initial IMF-supported program included no prior action or benchmark unrelated to fiscal and financial sector reforms.

[59]The latter numbers include structural performance criteria for programs approved during 2008. Structural performance criteria were abolished by an Executive Board decision in March 2009.

[60]In 1997, before the streamlining initiative, the number of structural measures included in IMF-supported programs was 15.3 per year (Takagi and others, 2014).

[61]The staff drew two main conclusions from the recent experience with crisis programs, including those outside the euro area: (i) for countries in currency unions, achieving internal devaluation "is very demanding, requiring ambitious macroeconomic adjustment and structural reforms sustained over a period that can well exceed the standard 3–4 year period of Fund-supported programs"; and (ii) "the growth payoffs from structural reforms in the short term were likely modest, and less than programs may have envisaged, suggesting a need for program design to be prudent about expectations in this regard" (IMF, 2015c, pp. 5, 42).

[62]This idea, adopted in Italy in 1992 in the form of devaluation with a wage freeze, was first proposed by Blanchard (2007) as a way to raise competitiveness in Portugal.

Portuguese authorities announced for the 2013 budget a cut in the share of social security payroll taxes paid by firms from 23.75 percent to 18 percent and an increase in the share paid by workers from 11 percent to 18 percent.[63] This scheme differed from the one envisaged in the initial program, which called for a revenue-neutral increase in the value-added tax (VAT) and a reduction in the payroll taxes paid by employers. The authorities' idea was partly motivated by the need to offset the budgetary cost of a Constitutional Court decision to annul a proposed expenditure-saving measure; they expected the increase in employees' contributions to reduce the government's own gross wage bill (Kopits, 2016).

74. Within days of the announcement, large-scale protests against the proposal led the government to abandon the idea. While fiscal devaluation was an attractive idea in principle for a country that could not devalue its currency, there were issues with technical and political feasibility. First, with respect to the initial proposal, the VAT rate for most consumer goods was already high, at 21 percent, so that a sizable increase in the VAT rate might not have raised revenue—because of non-compliance and Laffer-curve type considerations (Eichenbaum, Rebelo, and de Resende, 2016; Blanchard, 2007). Second, with respect to the government's proposal, shifting the tax burden from employers to employees was not politically acceptable; even employers opposed the measure because of its adverse consequences for labor relations. Third, internal simulations by EC staff indicated that neither proposal would appreciably affect Portugal's competitiveness (Kopits, 2016; IMF, 2011b). IMF staff has appropriately drawn a set of lessons from this experience (Jaeger and Martins, 2015).[64]

Did the IMF promote national ownership of programs?

75. The IMF's experience in promoting the national ownership of programs differed from country to country. Ownership may be defined as "a willing assumption of responsibility for an agreed program of policies" by responsible officials in a borrowing country (IMF, 2001). It has long been a dictum in the IMF that ownership is a prerequisite for the success of a program. In Greece, to a greater or lesser degree, successive governments blamed the outside world for the hardships imposed under the adjustment program. The Greek authorities' lack of ownership throughout the program was a serious handicap for successful implementation (Kopits, 2016).

76. In Ireland, unlike in Greece, a high degree of ownership characterized the program from the outset. The government had already announced many key elements of the fiscal and financial sector plans before the negotiations began (Kopits, 2016; Véron, 2016). In the area of fiscal policy the government, as part of the National Recovery Plan issued in early November 2010, had made a firm public commitment to achieve the budget deficit target of 3 percent of GDP by 2014 (the program set this target for 2015). In the run-up to the general election in early 2011, the main opposition parties announced their commitment to the deficit reduction trajectory. Against this background of strong national ownership, the IMF team was able to add significant value to the design and implementation of the adjustment program.

77. Portugal also demonstrated strong ownership. When there was a change in government soon after the program was negotiated, the succeeding coalition government fully honored the Extended Arrangement with the IMF. The resulting implicit consensus among political partners lasted until the fall of 2012, when the government made the failed attempt to shift part of the payroll tax from employers to employees. Whatever the reason, from around this time, opposition parties withdrew support for the program and pledged to reverse some of the fiscal measures if elected (Kopits, 2016; Véron, 2016; Eichenbaum, Rebelo, and de Resende, 2016).

78. Differences in national ownership may to some extent reflect differences in the approach to public communications, although the IMF or any other external party cannot by itself be expected to forge a national consensus on the adoption and implementation of agreed policies. In Ireland it was decided early on, with the authorities' support, that the IMF team would engage in extensive outreach activities vis-à-vis the media and other stakeholders, including the opposition parties, trade unions, and nongovernmental organizations. Joint press conferences with the EC and the ECB were held at the end of the negotiations and the first five review missions. Following a decision by the EC not to continue with this joint format, a conference call

[63] A standard result in public finance is that, in a world of flexible prices and wages, this type of fiscal devaluation would have no impact on labor market outcomes. To have an impact, nominal wages would have to be initially too high and rigid downward. See Eichenbaum, Rebelo, and de Resende (2016).

[64] Jaeger and Martins (2015, p. 20) drew four lessons from this experience: (i) trade-off between the size of required fiscal measures (to offset cuts in employers' contributions) and political acceptance; (ii) incompatibility of restricting the cuts to the tradable sector with EU competition rules; (iii) price rigidity in the nontradable sector limiting effectiveness; and (iv) perception of unfairness by trade unions and employers.

was held with the media at the end of each mission. The IMF mission chief also conducted a teleconference from headquarters with the Irish media when staff reports were published. In Portugal, contacts between the authorities and the public were less frequent than in Ireland but intensified at a later phase in the program, as a new IMF mission chief met with various media representatives after almost every visit (Kopits, 2016).

79. In Greece, the effectiveness of IMF public communications diminished over time. The Fund's early plans to engage with the Greece public were frustrated in early 2011, when the European and Greek authorities made a decision to terminate joint press conferences. Even though the IMF continued to engage with the Greek and international press on Greece, what it could do from Washington was limited in terms of reaching the Greek public. Given Greece's political climate, coupled with the generally hostile local media, the blame cannot be placed primarily on the IMF for its inability to help promote national ownership through public communications. Even so, the lack of communication was part of a general culture of opacity that prevailed within the IMF concerning the Greek program (Kopits, 2016).

Were IMF-supported programs successful?

80. Some officials in Europe stated to the IEO that, in their view, the troika-supported programs, including in Greece, were a success because they averted a breakdown of the euro area and a widely-feared exit of Greece from the single currency. Consistent with these views, the European Court of Auditors—commenting on the EU's post-2008 financial assistance programs, including those for Ireland and Portugal but notably not for Greece—stated that the programs succeeded in their purpose "to help countries repay or finance their maturing debt and deficit." The auditors further noted that the programs "addressed the need to safeguard the stability of the euro area or the EU as a whole" (ECA, 2015a).

81. Assessing the success or failure of an IMF-supported program is made difficult by the lack of clarity as to the extent to which the IMF should consider regional stability, in addition to the interest of the individual borrower, in a lending arrangement. Moreover, the outcome of any program is subject not only to the design of the program but also to a number of other factors beyond the IMF's control, including the ownership and capacity of national authorities who are largely responsible for implementing the program. In what follows, we simply make an assessment of the program outcomes on two levels: first, whether the programs met their targets; and second, whether they met their stated objectives. In one form or another, the stated objectives of all three programs amounted to restoring, achieving, or securing (i) market access; (ii) debt sustainability; (iii) financial stability; and (iv) economic growth (or competitiveness in the case of the SBA for Greece).

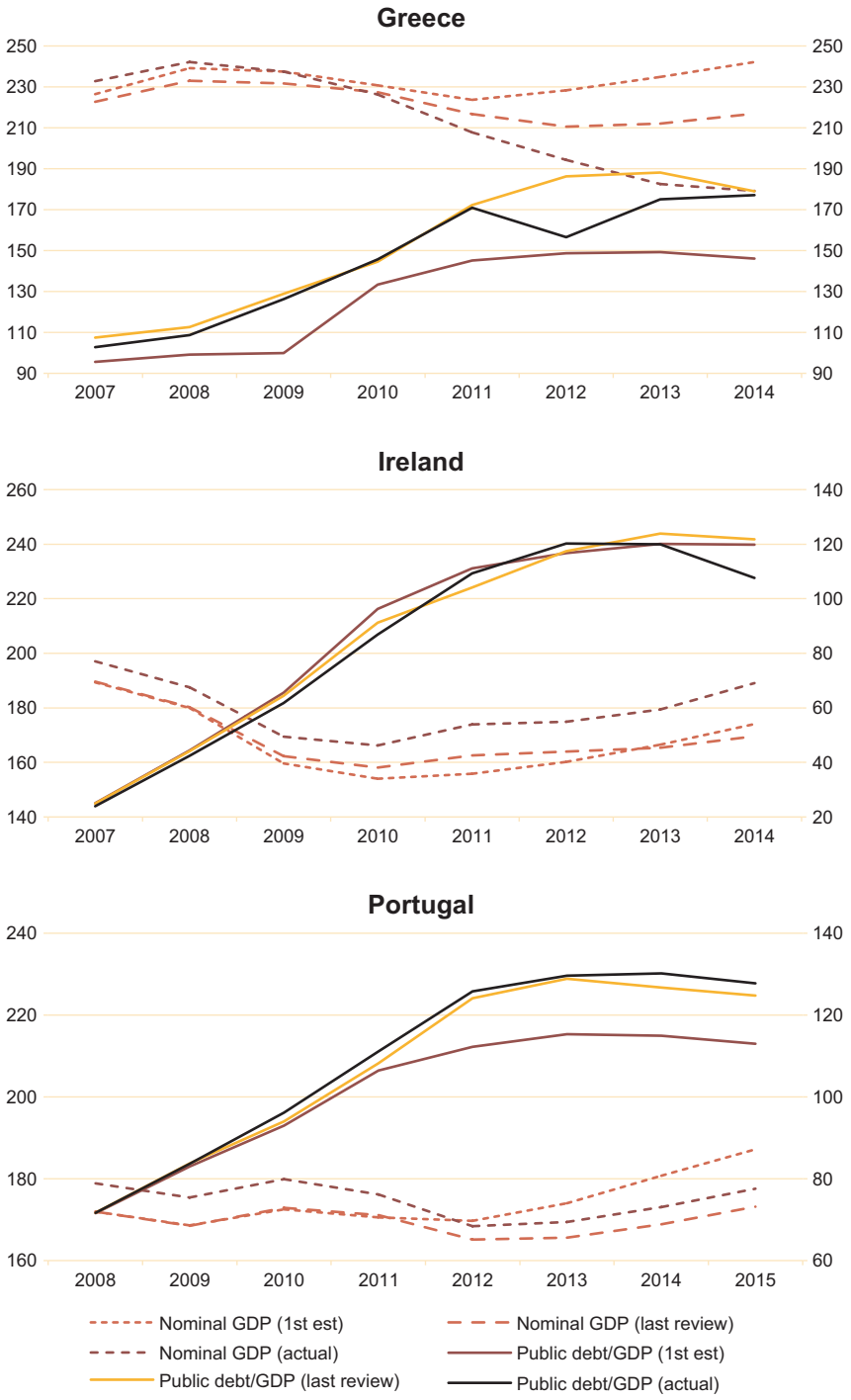
82. On the first count—whether programmed targets were met—the programs achieved considerable success in Ireland and, to a lesser extent, in Portugal. In Ireland, nearly all fiscal and structural targets were met in a timely manner, except for a delay in tackling the problem of mortgage arrears and the associated reform of the personal insolvency regime. In Portugal, too, most targets and benchmarks were met, though with delays in a number of areas; at the end of the program, IMF staff assessed that the outcomes of labor and product market reforms (numbering 10 areas in which measures were adopted) were mixed. From the IMF's perspective, Portugal missed only one conditionality measure, related to fiscal devaluation.

83. The same assessment cannot be made of the program outcome for Greece. Performance under the SBA was initially strong but began to suffer in late 2010; the program went off track in 2011 amid an emerging political crisis. While the authorities achieved substantial fiscal adjustment (a cumulative improvement of 8.25 percentage points of GDP from 2009 to 2011), it still fell short of the ambitious target. Implementation was hampered by strong domestic opposition, weak administrative capacity, and the social and political instability that the severe contraction of output created. The last program review observed that only 6 out of 15 "macro-structural reforms" were "completed" (IMF, 2011d, Table 5), while noting a disconnect between legislation and implementation. Greece adopted very few measures, with limited effectiveness, for enhancing revenue administration.

84. On the second count—whether stated objectives of the programs were met—Ireland was an unqualified success and Portugal a qualified one. In Ireland, growth had begun to recover by 2013, unemployment had fallen steadily, and incipient threats to financial stability from the banking sector were removed. Yields on Irish bonds fell sharply and Ireland was able to regain market access. Output recovered more than anticipated, and the debt-to-GDP ratio has been on a declining path (Figure 4). Most of the amounts owed to the IMF were repaid early. In 2013, Portugal too regained market access (albeit on less favorable terms than Ireland), but growth has not yet picked up despite productivity-enhancing structural reforms, and concerns about debt sustainability persist. Because a number of vulnerabilities were not decisively addressed,

Figure 4. GDPs and Debt-to-GDP Ratios in Euro Area Program Countries: Forecasts Versus Actuals

(Nominal GDP in billions of euros—right scale)
(In percent of GDP—left scale)



Note: The first estimates come from the respective SBA or EFF request documents; the last refer to the 5th review in December 2011 for Greece, the 12th review in December 2013 for Ireland, and the 11th review in April 2014 for Portugal. The data on actual outcomes are from the *World Economic Outlook* database, October 2015.

Sources: IMF staff projections in respective SBA or EFF request and last review documents; and IMF, *World Economic Outlook* database, October 2015.

Portugal's banking sector remained fragile when the program was allowed to elapse in June 2014 (and the bankruptcy of a major financial group followed the end of the program). A more aggressive clean-up of the financial sector, however, would have required larger program resources (Eichenbaum, Rebelo, and de Resende, 2016).

85. The SBA-supported program ultimately failed to restore Greece to financial and macroeconomic stability. In 2013, real GDP was only 77 percent of the 2009 level, and the rate of unemployment rose from 9.6 percent to 27.5 percent over the same period. The initial goal of placing the debt-to-GDP ratio on a declining trend from 2014 was not achieved. Investor confidence was shattered and deposit withdrawals accelerated amid a political and social crisis from 2011.

86. It is difficult to determine conclusively the extent to which the IMF is responsible for the outcome of any of these programs. Initially, markets reacted favorably to the *announcement* of a program for Greece, with spreads on sovereign debt experiencing a decline of nearly 100 basis points between March and May 2010. However, sovereign spreads hardly moved (and even rose slightly) when agreements on programs were concluded for Ireland and Portugal. The spreads then began to rise over the coming months. For example, the yields on Portugal's ten-year bonds increased from 10.9 percent in June 2011 to a peak of 13.9 percent in January 2012. It was only in early 2012 for Ireland, in late 2012 for Portugal, and in early 2013 for Greece that the spreads began to show substantial and steady declines (see Figure 3).

87. In this context, some have noted the important contribution that decisions by European authorities made to restoring stability. In particular, the summer of 2012 saw the European authorities take a number of decisions, including the proposal for banking union (in June); the ECB president's pledge to do "whatever it takes" to save the euro (in July); and the announcement by the ECB of Outright Monetary Transactions (in August). Several of the experts who were consulted for this evaluation considered these actions, and not the IMF-supported programs per se, as constituting an important turning point in the evolution of the euro area crisis. If so, the characterization by the IMF staff of Greece's SBA as "a holding operation" (IMF, 2013c) could also apply to all the IMF-supported programs covered by this evaluation: they allowed the European authorities time to come to agreement on institutional reforms needed to make the euro area more resilient to crisis.

C. Was IMF Technical Assistance Effective?

88. Those interviewed for this evaluation saw the technical assistance (TA) that the IMF provided in the context of the euro area crisis as of high quality, even though, for reasons beyond IMF staff's control, it did not achieve the intended purposes in all cases. IMF TA was provided to all three crisis countries in support of program objectives and to Spain in support of European assistance for banking sector restructuring. The amount of technical assistance given to Greece and Portugal was comparable to that provided to post-socialist transition economies in the 1990s (Kopits, 2016). Ireland received very little TA, though it benefited from a significant amount of technical work (not classified as TA) by the Monetary and Capital Markets Department on banking sector-related issues.

Was IMF TA effective in Greece?

89. IMF TA for Greece predated the approval of the SBA in May 2010. During the early months of 2010, multiple IMF teams were in Athens to provide technical assistance to improve expenditure control and to help design a mechanism by which banks would issue bonds guaranteed by the government and thus eligible as ECB collateral, and use them for access to Eurosystem liquidity.

90. The TA provided to Greece in the course of the program faced several challenges. The delivery was complicated by the need to coordinate with the EU Task Force for Greece, which relied on outside consultants from major EU member countries.[65] It was handicapped by lack of sufficient prioritization, ad hoc decision making, and moving targets under multiple initiatives, as well as by Greece's severely limited absorptive capacity. IMF TA was criticized by the European partners for focusing too much on organizational and managerial issues, rather than on providing hands-on training, though IMF staff stated to the IEO that, given the country's lack of managerial capacity, the focus was appropriate. In Ireland and Portugal, the IMF was the sole provider of TA on fiscal issues, with limited inputs from EU institutions. TA was much more successful in Ireland and Portugal (Kopits, 2016).

[65]The Task Force for Greece was set up by the European Commission in the summer of 2011 to coordinate and monitor TA efforts in Greece, in support of the EC's adjustment programs. In 2015, the European Court of Auditors audited the delivery of TA by the task force, with little reference to the IMF (see ECA, 2015b).

Box 6. IMF Technical Assistance for Spain

In June 2012, Spain requested financial assistance from the euro area to support its restructuring and recapitalization of the financial sector. While the Spanish authorities did not see a formal role for the IMF, other European authorities felt that the IMF could play a useful role not least in terms of providing expertise. It was thus agreed in July that the IMF would participate in the form of technical assistance under Article V, Section 2(b) of the IMF Articles of Agreement. The terms of reference, agreed with the Spanish Ministry of Economy and Competitiveness, the Bank of Spain, and the European Commission, stated that the "purpose of Fund staff monitoring" was to provide "independent advice;" IMF staff was "not party to the Memorandum of Understanding" and was not "responsible for the conditionality or implementation thereof."

The IMF staff's monitoring covered all issues that fell under its mandate and expertise, and its quarterly report included the IMF's assessment of the macroeconomic situation. The IMF contributed substantive inputs into the design of the program, maintained a financial sector expert in Spain, and participated in discussions with the Spanish, EC, and ECB officials during quarterly missions. The IMF, however, did not participate in macroeconomic discussions with the Spanish authorities (this was part of the European macroeconomic surveillance process); staff prepared a general macroeconomic assessment of Spain in the context of monitoring the financial sector as a whole. IMF missions visited Madrid five times between October 2012 and December 2013, with the last quarterly report prepared and circulated to the Executive Board for information in February 2014.

The FSAP team did not remain engaged with Spain—which some Spanish officials regretted. Part of the reason is that the TA operation was taken over by the IMF's European Department, because the work included not only the monitoring of financial sector restructuring but also a macroeconomic assessment. Most of the officials interviewed in Europe for this evaluation indicated to the IEO that the IMF's macroeconomic analysis added little value and, by increasing the size of IMF teams, became somewhat burdensome to the government.

Sources: Véron (2016); IEO interviews.

Was IMF TA to Spain effective?

91. The way the IMF engaged in Spain—providing inputs to the designing and monitoring of a program of policy measures linked to European support—differed from the usual manner in which the Fund provides technical assistance to a country. Providing TA was conceived as a way to involve the IMF without a financing arrangement (Box 6). The IMF's participation in July 2012 came at a favorable moment, as the Fund had just completed a financial system stability assessment for Spain under the Financial Sector Assessment Program (FSAP). The Fund's in-depth and up-to-date knowledge of the Spanish financial sector, coupled with its extensive cross-country experience in financial sector restructuring, placed it in a strong position vis-à-vis its European partners. The quality of technical inputs the IMF team provided in the context of European financial assistance for bank recapitalization (in terms of both designing the strategy and monitoring the program) was widely praised by the Spanish and other European authorities interviewed by the IEO (Véron, 2016).

92. The IEO has considered whether the IMF had any less influence in the case of Spain, where it had no financing role, than in the other crisis cases. IEO interviews yielded the following observations. First, the IMF's influence with its European partners in the case of Spain came from its intimate knowledge of the Spanish financial sector, acquired from its just-completed FSAP mission. The IMF's influence diminished as European institutions gained experience. Second, the IMF's independence was a source of credibility and traction with the Spanish authorities. Several former and current Spanish officials noted that, because the IMF did not have a financial stake, its advice carried greater credibility than that of its European partners. The Fund often though not always sided with the Spanish authorities when disagreement surfaced. Third, some European officials stated to the IEO that, while they had valued the expertise and experience that the IMF brought to the table, they had not been constrained by the IMF; if they wished, they could decline the IMF's advice. While the Spanish experience may not be replicable in all aspects, it nonetheless suggests that such an arrangement may be a useful way to engage with a crisis country when it does not require IMF financial support.

CHAPTER

5 IMF Governance

A. How Did the IMF Work with European Partners?

93. The term troika in the context of the euro area crisis appears to have been used in two alternative ways. First, in a strictly operational sense, the troika refers to an ad hoc coordinating device by which the IMF and the EC, in liaison with the ECB, economized on the process of negotiating with the authorities of crisis countries. Without such a device, the authorities would have had to negotiate with two or three different teams, increasing the costs of reaching agreement. Second, the term troika is sometimes taken to refer to a policy framework within which the IMF was expected to accept constraints imposed by the EMU membership. This distinction is important. The IMF could have been the sole lender to a euro area country, working within the legal, political, and other institutional constraints imposed by the country's EMU membership. In this scenario, the IMF would have faced the same policy constraints due to EMU membership as it did in joint lending operations, though it might have enjoyed greater leverage.

How did the troika work?

94. There were several aspects to the way the IMF operated within the troika arrangement (Kincaid, 2016). First, the IMF does not allow the use of Fund resources to be directly subjected to the rules and decisions of other organizations. Thus, the IMF cannot disburse funds conditional on the judgment of another organization that the borrower has met its conditions—a situation known as cross-conditionality. Even so, judgements reached by other lenders could affect the IMF's lending decision by virtue of what is known as the financing assurance policy, that is, the requirement that the program be fully financed. Thus, even if the IMF assesses that its own conditions have been met, it may not disburse if the IMF-supported program is not fully financed because the country has failed to meet conditions imposed by other lenders.

95. Second, there was no clear demarcation of responsibilities between the IMF and its European partners, and their areas of competence overlapped considerably (in contrast, in the case of IMF-World Bank collaboration, the IMF focuses on macroeconomic or macro-critical issues while leaving most structural and development-related issues to the World Bank).[66] The overlap not only made coordination more complicated but also led to a duplication of staff assignments and an increase in the size of troika teams. Troika teams to Greece reportedly could total 30-40 persons.

96. Third, the IMF and its troika partners did not fully unify their analytical frameworks or approaches to structural conditionality. For example, fiscal performance criteria in IMF programs were based on cash nominal amounts for the primary deficit in Greece and Ireland and the cash nominal overall deficit in Portugal. The EC fiscal targets, in line with the Stability and Growth Pact and the Excessive Deficit Procedure, pertained to the overall general government deficit relative to GDP, using a form of accrual accounting. As noted in the IMF's ex post evaluation of Ireland's Extended Arrangement, "a unified approach would have helped communicate the program objectives more effectively and avoid possible uncertainties and mixed signals" (IMF, 2015a).[67] In addition, structural conditionality was extensive and intrusive in EU programs, whereas it was focused on macro-critical issues in IMF programs, as noted earlier.

97. Fourth, collaboration required sharing confidential internal documents, including preliminary draft policy notes. The IEO was not shown any written documents to indicate that IMF management or the Board

[66]The IMF-World Bank Concordat includes agreed procedures for addressing policy differences between the two institutions, which could involve their respective Executive Boards.

[67]The European Court of Auditors observed that the EC's accrual-based targets had been "unreliable" as they could not be monitored in real time (ECA, 2015a).

formally authorized confidential information sharing or defined confidentiality rules among the troika partners. Interviews with those involved suggest that practices appear to have varied considerably, from mission chief to mission chief, or from program to program.

98. Fifth, decision making at the IMF proceeded at a different level and pace from the process in the euro area. The IMF's ex post evaluation of Greece's SBA noted that decision making by the European authorities was more fragmented, spanning multiple institutions and varying levels; the Greek authorities felt that this exacerbated uncertainties and reduced the chance for early agreements (IMF, 2013c).[68] In contrast, IMF mission chiefs had more delegated authority. As noted earlier, negotiations with the European partners to alter program assumptions or parameters, not to mention the negotiations to restructure sovereign debt, took a long time to complete, causing the IMF to lose its characteristic nimbleness and agility as a crisis manager.

99. Sixth, the troika was not the only vehicle that IMF staff used to interact with the authorities in Europe. There were multiple contacts between the IMF staff and senior officials of major euro area countries. While it is appropriate that IMF staff should consult with a wide range of stakeholders to seek their views, European members of the troika who were interviewed for this evaluation did not consider these contacts outside the troika arrangement favorably, seeing room for misunderstanding.

100. Finally, an unusual feature of the troika arrangement was that the IMF partnered with European policy institutions at the staff level, potentially subjecting the IMF staff's technical judgments to political pressure from an early stage. The European Commission, in the area of emergency crisis lending, acted as the agent of the Eurogroup, which in turn represented member states and decided whether to provide assistance.[69] The intergovernmental nature of the euro area lending operations—given the EC's consensus decision making—meant that negotiating positions had to be pre-agreed with individual creditor countries in order to ensure full European support (Pisani-Ferry, Sapir, and Wolff, 2013). IEO interviews and some internal documents suggest that political feasibility in creditor countries was an important consideration for EC staff and that IMF staff occasionally felt pressured to accept a less-than-ideal outcome. Because all members of the troika needed to agree on a unified position before jointly approaching the borrowing country for a program negotiation or review, this setup potentially exposed IMF staff to political decisions at an earlier stage than would normally be the case (see "Was the IMF a junior partner?" below).

101. From the point of view of the borrowing country, however, the troika arrangement may have been an efficient mechanism. Despite the potential governance and operational issues noted above, the arrangement allowed programs to be negotiated quickly and program reviews to be completed expeditiously in most cases. National authorities who were interviewed for this evaluation were generally satisfied with how the process worked. In addition, EC and ECB officials stated to the IEO that their working relationships with IMF staff were by and large effective and professional, although the modalities and practices of engagement evolved as they gained experience. The European Court of Auditors generally gave high marks to the operation of the troika ("the variety of expertise and experience among the three institutions' staff made it possible to produce more thorough assessments") and to the role of the IMF in particular ("working with the IMF helped the Commission in learning how to manage the programmes") (ECA, 2015a). European and national officials interviewed by the IEO generally considered the IMF's value-added and contribution to the troika process to be positive. A senior IMF official explained to the IEO that the arrangement had worked well as long as there were no major differences of view among the partners, a condition that may not have existed at all times.

102. There appears to be no formal procedure or guidance for staff on engaging on programs in the euro area. The IEO has not been given any documentation to show that IMF management consulted with the Board on the modalities for engagement with the euro area even after a considerable passage of time. At the Board discussion of the IMF's 2011 Conditionality Review in September 2012, a number of Executive Directors requested an in-depth review of the troika, whereas those representing euro area countries expressed the view that troika cooperation "proved quite successful" and was "very effective" and "well-functioning" (IMF, 2012b). The summing up of this 2012 meeting noted: "many Directors encouraged staff to draw preliminary lessons from these [euro area] cases in a timely manner, including on coordination with Troika partners and the modalities of designing programs and conditionality" (IMF, 2012c). The Board has not yet clarified its position on the modalities for engaging with the euro area, though at least three Board papers prepared by staff have addressed the need to establish guidelines

[68]ECA (2015a, p. 27) provides a diagrammatic presentation of the decision-making process in the euro area. See also Pisani-Ferry, Sapir, and Wolff (2013) for a discussion of the relative roles of various institutions, including the IMF, in the troika process.

[69]This differs from the EC's customary role as an independent principal protecting the EU interest (Pisani-Ferry, Sapir, and Wolff, 2013).

for engaging with regional financing arrangements (IMF, 2011a, 2013a, 2015c).

Was the IMF a junior partner?

103. Critics have frequently characterized the role of the IMF in the troika as that of a junior partner. In terms of financing, the IMF clearly was a junior partner, providing at most one-third of the program financing for Greece, Ireland, and Portugal. In terms of policy inputs, however, the distinction between the two meanings of the word troika becomes critical. The IEO, based on all available evidence, concludes that the IMF was not a junior partner in the troika if the troika is defined as a device for inter-agency coordination. The IMF was not a senior partner, either—which contrasted with the IMF's customary sole or lead role in its lending to emerging markets and developing countries. It is the consensus view of all interviewed for this evaluation that each member of the troika had a veto power. Thus, the troika arrangement was effectively viewed as consisting of coequal partners. The IMF's veto power stemmed from recognition of its considerable expertise and crisis management experience, and its credibility with key euro area members and their parliaments whose consent was required in the context of EFSF/ESM lending decisions. Those interviewed for this evaluation did not share the view that the IMF's relatively small financial contributions muted its voice in policy debates or its impact (Kincaid, 2016).

104. If the troika is defined more broadly as a policy framework in which the IMF was expected to operate, the question "was the IMF a junior partner?" is really that of whether the IMF too readily deferred to decisions that were made within the euro area. At the technical level, there is no evidence to suggest that the IMF staff too easily accepted the institutional constraints of EMU membership. A number of complaints the IEO has heard from European members of the troika—that IMF teams seemed not to understand or appreciate such constraints on policy options (e.g., EU regulations on state aid or competition in banking sector restructuring)—give support to the view that the staff often held its ground.

105. Serious conflicts arose at a higher, political, level but there was no agreed mechanism to address them. For example, in Ireland, the IMF staff's judgment was that senior unsecured creditors of Irish banks should be bailed in, but this position was overruled by the European partners, who were concerned about the spillover to the euro area's integrated banking market. In this case, as well as the case of preemptive debt restructuring in Greece, the ultimate decisions had the support of the IMF's largest advanced economy shareholders. The larger question therefore is about the role of political constraints in the IMF's decision-making process. In these cases, the IMF consulted with the United States and the other G7 countries. While consulting with major shareholders has been a standard practice in the IMF during times of crisis, it is legitimate to ask whether the Board—i.e., all shareholders—should have been consulted (see below).

106. These and other conflicts arose in part because the IMF's objectives were not fully aligned with those of the euro area. The overriding concern of the European authorities was to preserve stability, and especially to preserve the single currency project. In contrast, the IMF's responsibility was also to the individual countries requesting financial assistance. The IMF's Articles of Agreement stipulate that the use of its general resources is meant to "assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement" (Article V, Section 3*(a)*). In most cases, conflicts do not arise because policies aimed to help solve a member's balance of payments problem contribute to maintaining or restoring systemic stability. In the case of the euro area, debt restructuring was an issue where a conflict could arise between what was good for a country and what was good for the euro area as a whole.

How did ECB participation affect decision making?

107. Another controversial area was the role of the European Central Bank in the troika. Authorities from a number of countries outside the G20 (and Europe) found the arrangement in which the ECB sat on the same side of the table with the IMF inappropriate as "this implicitly took certain policy actions 'off the table' and constituted bad governance" (IEO, 2014c). Likewise, officials from other currency union central banks who were interviewed for this evaluation indicated that they found a conflict of interest in this arrangement—as did the European Parliament (Karas and Ngoc, 2014; Sapir and others, 2014).[70]

108. What kinds of policy actions were taken off the table by virtue of this arrangement? Could the ECB have been made subject to IMF program conditionality for a member country? Establishing the counterfactual would

[70]The European Parliament report recommended that, given the potential conflicts of interest, the role of the ECB should be that of "a silent observer" (Karas and Ngoc, 2014).

Box 7. The IMF and Currency Unions

Besides the euro area, there are three other currency unions in the world: the Eastern Caribbean Currency Union (ECCU), the Central African Economic and Monetary Community (CEMAC), and the West African Economic and Monetary Union (WAEMU); the CEMAC and WAEMU are collectively known as the CFA franc zone. The challenges they pose to the IMF are similar to those posed by the euro area: the IMF's Articles of Agreement contain no provision for joint membership, creating complexities absent in its relationship with non-currency-union members in terms of surveillance and conditional lending.

The ECB's troika role contrasted with the approach usually taken by the central banks of other currency unions when the IMF lends to one of their members. In negotiations involving IMF-supported programs for members of other currency unions, the regional central bank never sits on the IMF's side of the table. As a general practice, officials from the regional central bank, if present, typically sit with or closer to the country authorities; letters of intent are signed only by the country's finance or prime minister. In the euro area programs, the governor of the national central bank sat on the side of the national authorities and across from representatives of the ECB, EC, and the IMF, even though national central banks are part of the Eurosystem, and their governors are members of the ECB Governing Council.

To be sure, some features of the euro area distinguish it from the other currency unions. For example, the other currency unions do not have national central banks. In the euro area, these banks had their own national balance sheets and supervisory responsibilities over their own national banking systems, along with the ability to provide emergency liquidity assistance to national commercial banks. Financial markets are more highly developed and integrated in the euro area, and the euro is a reserve currency.

Source: Tan (2016).

be difficult, especially because the ECB did take a number of measures to help preserve financial stability in the crisis countries, though without formal conditionality placed on it. Even in the context of financing arrangements with members of other currency unions (Box 7), there appears to have been no instance in which conditionality was explicitly placed on union-wide monetary and exchange rate policies. There have been instances of implicit conditionality, however. The most prominent case was the devaluation of the CFA franc in January 1994 (see IEO, 2007a, p. 33), which was applicable to all CFA franc zone members and implicitly considered by IMF staff as a prior action (Tan, 2016).

109. In other currency unions, instances exist of the IMF imposing country-specific conditionality on a regional central bank (Tan, 2016). Until the mid-1990s, IMF-supported programs in CFA franc zone members routinely specified as a quantitative performance criterion a ceiling on the net domestic assets of the program country's national banking system. This practice ceased as it became increasingly infeasible to define a national monetary policy. Programs with euro area crisis countries did not contain conditionality on national monetary policy but, with financial fragmentation in the euro area and the development of new instruments (e.g., SMP, OMT, and macro-prudential tools), the scope for the ECB to shape national monetary conditions increased substantially. Likewise, with the transfer of supervisory powers from national authorities to the Single Supervisory Mechanism in November 2014, associated conditions could now be reassigned to the ECB, as is the case in the other currency unions.[71]

110. In the euro area crisis, the IMF could have been more proactive in advocating policy measures at the union level to help ensure the success of programs in individual countries (Truman, 2013; Dhar and Takagi, 2016). The IMF staff, in its recent review of IMF-supported programs following the global financial crisis, interprets the Articles of Agreement as "establish[ing] the Fund's inherent ability to call for the adoption of union-level measures where such measures are necessary for the success of a member's Fund-supported program" (IMF, 2015c). As the staff further notes, such measures need not take the form of formal conditionality; they could take the form of surveillance or policy commitments, which the Board seems to prefer.[72] Such policy commitments could involve not only monetary and bank supervision policies but also other policies whose competency is held by union-level institutions. Providing advice on the general stance of fiscal policy at the union level, when some union members

[71]For example, the SBAs for Antigua and Barbuda (in 2010) and for Saint Kitts and Nevis (in 2011) included program conditions requiring direct action by the Eastern Caribbean Central Bank in the financial sector.

[72]The summing up of the Executive Board discussion in part states: "Directors also noted that where changes in currency union-wide policies are important for program success, the Fund should provide advice through surveillance as warranted. Some Directors considered that the Fund could also seek commitments on union-wide policies if necessary for program success or financing assurances" (IMF, 2015d).

are experiencing a collapse of domestic demand, could be another such example.

B. How Well Did the Executive Board Perform Oversight?

111. The Executive Board played only a perfunctory role in key decisions related to the IMF's engagement in the euro area crisis (De Las Casas, 2016). This is not surprising. The weakness of the Board in exercising its oversight responsibilities has been a recurring issue in the governance of the IMF (IEO, 2008; IEO, 2014b). In the case of the euro area crisis, the Board's absence was particularly problematic in two respects. First, the IMF's exceptional access policy explicitly highlights the role of the Board. While the letter of the framework was complied with, the spirit was not fully respected. Second, earlier and more active involvement by the Board, even in situations where it would not have changed the decisions, could have lessened the public perception that the IMF was giving unfairly favorable treatment to the euro area.

112. In particular, the IMF's exceptional access policy was followed only in a perfunctory manner. The policy requires that management consult the Board early on an informal basis, in order to provide a basis for consultation with national authorities and to reinforce "careful and systematic decision-making" (IMF, 2003a). However, the information provided to the Executive Board prior to the announcement of the programs did not contain important details, including on quantified estimates of the financing requirements, expected European financing, or possible access to Fund resources. The IEO has found no evidence to show that such information was even orally communicated to the Board, though that information was available to IMF management and staff as well as to the Eurogroup (Kincaid, 2016; De Las Casas, 2016). Nor was the Board consulted on three key policy issues: (i) in Greece, the absence of a high probability for sovereign debt sustainability; (ii) introduction of the systemic exemption clause; and (iii) in Ireland, whether to apply haircuts to senior unsecured bondholders (management's consultation took place with G7 finance ministers, not with the Board).

113. The informal briefings, during which staff informed the Board of the details of the program, took place on the same day as the announcement of the staff-level program agreement in the cases of Greece and Ireland and three days ahead in the case of Portugal (De Las Casas, 2016). By not providing the Board with key information early on a timely basis, management and staff undermined the ability of Executive Directors to consult effectively with their authorities and to perform their duties. From late 2009 through the first months of 2010, the Board was not fully kept informed of internal discussions that took place regarding possible IMF participation in a joint lending operation for Greece. An early, open consultation with the Board might have pushed management and staff to consider all available options, as noted previously.

114. The lack of Board involvement was an ongoing feature throughout the euro crisis period. Most members of the Board were not kept informed of ongoing developments that concerned the IMF's role in the euro area; some who were interviewed for this evaluation complained to the IEO that they had learned more from the press than from informal Board meetings. There was no Board discussion of the role of the IMF in the 2012 Treaty Establishing the European Stability Mechanism. No formal discussion took place in the Board on cooperation principles between the IMF and regional financing arrangements (RFAs), even though the IMFC called for such a discussion in April 2011. By not consulting more fully with the Board, management effectively excluded at least a part of the IMF membership from key decisions. As a result, the legitimacy of what the IMF did in Europe has been challenged, with a lingering perception that the Fund treated Europe differently (Park, 2016).

115. In terms of IMF governance, the experience with the euro area crisis posed two fundamental problems (De Las Casas, 2016; Kincaid, 2016). First, at least some Executive Directors representing euro area countries may have had information that was not available to other Directors, creating an information asymmetry within the Board. Information asymmetry is always present whenever the Board discusses issues related to the use of Fund resources, as Directors representing the borrowing countries inevitably possess an informational advantage. In the case of the euro area crisis, this informational advantage extended to all Directors representing euro area countries (including creditor countries) and not just the Director representing the borrowing country. Given the conditional lending by euro area governments, their information requirements may have been warranted. But this situation should have placed upon IMF management and staff a greater responsibility to share information more frequently and completely with the entire Board than was customary. Second, in all instances, decisions by the European partners preceded IMF Executive Board meetings on the use of Fund resources. This sequencing ensured that the IMF-supported program was fully financed by the time the Board met, but it caused some to view the Board as faced with a fait accompli and created the perception that the IMF Board merely rubber-stamped decisions already taken in Europe.

CHAPTER 6

Key Findings and Recommendations

116. This chapter presents a summary of key findings and draws lessons from the evaluation, and proposes five recommendations to help improve the IMF's effectiveness.

A. Key Findings and Lessons

Surveillance

117. While the IMF's pre-crisis surveillance for the most part identified the right issues, it did not foresee the magnitude of the risks that would become paramount in the crisis to follow. Lack of analytical depth, rigor, or specificity and the failure to highlight sufficiently the need for stronger remedial action in a currency union were among the factors that undermined the quality and effectiveness of surveillance. At the euro area level, IMF staff's position was often too close to the official line of European officials, and the IMF lost effectiveness as an independent assessor. The IMF's surveillance of the euro-area financial regulatory architecture was generally of high quality, but, along with most other observers, IMF staff missed the overall build-up of banking system risks in some countries. Following the onset of the crisis, however, IMF surveillance successfully identified many unaddressed vulnerabilities, pushed for aggressive bank stress testing and recapitalization, and articulated a vision of banking union.

118. The weaknesses of IMF surveillance in the euro area echoed the larger problem of IMF surveillance in advanced economies identified by the IEO's 2011 evaluation of IMF Performance in the Run-Up to the Financial and Economic Crisis. That evaluation identified several factors at play, including "a high degree of groupthink, intellectual capture, a general mindset that a major financial crisis in large advanced economies was unlikely, and incomplete analytical approaches" (IEO, 2011). These factors were compounded in the case of the euro area by a "Europe is different" mindset that encouraged the view that surveillance was largely the responsibility of euro area institutions and authorities, that large national current account imbalances were little cause for concern, and sudden stops could not happen within a currency union that issues a reserve currency.

Decision making

119. In May 2010, the IMF Executive Board approved a decision to provide exceptional access financing to Greece without seeking preemptive debt restructuring, even though its sovereign debt was not deemed sustainable with a high probability. In coming to this decision, there was no open and early discussion of the pros and cons of all options available to the IMF. While the risk of contagion was an important consideration, contagion outcomes under different scenarios, especially the adverse consequences of not restructuring debt, were neither rigorously quantified nor thoroughly discussed within the institution. Irrespective of the merit of the final decision, weaknesses in the decision-making process created the perception that the IMF treated Europe differently. The procedure used for Greece was essentially repeated for Ireland and Portugal. In these decisions, the role of the Board was at best perfunctory. While this lack of Board involvement is not a new finding, it was more problematic in these cases.

120. The revision of the 2002 exceptional access framework, also made in May 2010, did not receive the customary careful review and deliberation by the Board. A modification of the framework was necessary to allow exceptional access financing to go forward, but the modification process was not transparent. Staff did not forewarn the Board, and the proposed amendment was embedded in the SBA request document. There was no follow-up on the revision until 2014 (IMF, 2014b), even though at least one Executive Director during the May 2010 meeting requested an early return

to a thorough discussion of the implications of the systemic exemption for the IMF's work. This was a departure from the IMF's usual process of deliberation, where decisions of such import receive careful review so that intended and unintended consequences as well as implications for the future work of the IMF are clearly understood.

Working with European partners

121. The troika arrangement in most instances proved to be an efficient mechanism for conducting program discussions with national authorities at the staff level in a situation where there was more than one conditional lender. Even so, given the multiple layers of decision making in the euro area, the IMF lost its characteristic nimbleness and agility as a crisis manager. Because the European Commission represented the Eurogroup (and thus euro area governments), the troika arrangement potentially subjected the IMF staff's technical judgements to political pressure from an earlier stage than is normally the case. The IMF had no established principles for joint lending operations. Nor was there a clear demarcation of responsibilities, an agreed policy on the sharing of confidential information, a mechanism to address differences of view, or a unified analytical or conditionality framework.

122. Lack of preparation was part of the problem. The IMF, having considered the possibility of the use of Fund resources by a euro area member as "extremely unlikely" (IMF, 1998), had never articulated how currency union considerations should be incorporated in program design. There had been no discussion of how the IMF could address macro-critical policies that were under the control of regional institutions like the ECB or whether it could set conditionality on such an institution. Had IMF management and staff discussed the implications of euro area membership for program design with the Executive Board at an earlier stage—in early 2009 when staff first informally explored the idea of a precautionary arrangement with the Irish authorities, or even in the six months prior to Greece's request—staff would have had a better understanding of specific constraints that they would, or should not, have to accept in an IMF-supported program for a euro area member.

Program design and implementation

123. The IMF-supported programs in Greece and Portugal incorporated overly optimistic growth projections. While these have been a feature of many IMF-supported programs (IEO, 2014a), more realistic projections would have made clear the impact of fiscal consolidation on growth and debt dynamics. They would have also allowed the authorities to prepare accordingly, or persuaded the European partners to consider additional and more concessional financing, while preserving the IMF's credibility as an independent, technocratic institution.

124. Lessons from past crises were not always applied. For example, the lesson from earlier capital account crises—that it is difficult to reassure private creditors with a high-risk program—was not applied in the SBA for Greece, as the IMF staff came to acknowledge more than five years later (IMF, 2016). Another lesson from the capital account crisis programs of the late 1990s was the need for a contingency plan. Although some in the staff internally raised the issue, the SBA for Greece, high-risk as it was, included "no Plan B" (IMF, 2010e). Structural conditionality is an area where the IMF staff did not prevail over the European partners in applying lessons learned from the Asian crisis: namely, that imposing a long list of structural conditions without prioritization in defiance of the crisis countries' implementation capacity would be counterproductive.

125. There were instances where IMF staff shone technically, and many officials have expressed a positive assessment of the Fund's overall contribution to crisis management. Even so, the IMF's performance was uneven. For example, program design and implementation (including the pace of fiscal adjustment and flexibility for the operation of automatic stabilizers) was close to exemplary in Ireland but severely wanting in Greece. Financial sector work was first-rate in Spain but inadequate in Portugal. The patchy availability of staff with germane experience and expertise may have been among the reasons for this uneven performance.

Accountability and transparency

126. The IMF's handling of the euro area crisis raised issues of accountability and transparency, which helped to create the perception that the IMF treated Europe differently. The fact that a good fraction of the Executive Board—and more broadly of the IMF's membership—was not fully kept informed during the crisis undermined the Board's oversight function and only served to reinforce this perception.

127. Delays in completing internal reviews involving euro area programs did not help dispel the perceived lack of transparency. Preparation of the Board paper

reviewing IMF-supported programs during the global financial crisis (including the euro area programs) was delayed for well over a year despite repeated requests by the IMFC. Preparation of the ex post evaluation of Portugal's EFF-supported program, which should have been completed by June 2015, was still ongoing as of May 2016.

128. As noted at the beginning of this report, the IEO, in conducting this evaluation, faced a lack of clarity in its terms of reference regarding what it could or could not evaluate. Lack of documentation was a serious problem (as some sensitive documents were prepared outside the regular, established channels), while it took the IEO more than a year to obtain some available documents. The evaluation was also hampered by the lack of a clear protocol on the modality of interactions between the IEO and IMF staff.[73]

B. Recommendations

129. The IMF has drawn many lessons from the recent experience (Box 8). New initiatives related to surveillance and program design are underway, including through the established periodic surveillance and conditionality review processes.

130. Table 3 lists five recommendations for Board consideration, which are expounded with examples in this section. The recommendations are focused on broad governance issues, which the IEO believes were at the root of the problems identified by this evaluation. Many of the problems were caused by procedural inadequacies, which prevented the IMF's crisis management experience and best technical judgments from being fully applied in the face of political pressure or expediency. Internal documents clearly indicate that many on the staff and the Executive Board were aware, at the time, of the issues raised in this evaluation.

Recommendation 1: The Executive Board and management should develop procedures to minimize the room for political intervention in the IMF's technical analysis.

131. A similar recommendation was found in the very first evaluation completed by the IEO in 2002, on the prolonged use of IMF resources (IEO, 2002), indicating that the problems identified by the present evaluation are not new. While a range of views exist on the role political judgments should play in the IMF's decision making, there is a broad consensus that, if political judgment is to be exercised at all, it should take place at the level of the Executive Board in a transparent manner. The credibility of the IMF comes from the technical competence and independence of its staff, and the Managing Director must ensure that its technical work is protected from political influence.

132. Such procedures could involve several elements. For example, the staff could be incentivized to produce rigorous analyses based on realistic program assumptions, and to be transparent in explaining how it came to a particular conclusion. When analytical concepts (e.g., the risk of adverse systemic effects) are placed at the center of decisions, there must be a presumption that they are supported with a clear analytical framework for assessment. When high risk programs are presented for approval, the Executive Board might be provided with alternative options and tradeoffs or an explanation of why a proposed decision was preferred to the other alternatives. Likewise, when the IMF is collaborating with another conditional lender, the Board might be informed as to whether there are areas of disagreement and, if so, how the differences are being (or proposed to be) resolved.

Recommendation 2: The Executive Board and management should strengthen the existing processes to ensure that agreed policies are followed and that they are not changed without careful deliberation.

133. The Board should strengthen the existing processes to ensure that agreed policies are adhered to, that those policies are not changed without full and formal deliberation, and that any necessary corrective action is taken in a timely manner. Management, on its part, should consult the Board early when changes in policy are warranted and should not wait until a formal review is scheduled to discuss needed changes. The reformed exceptional access framework adopted in January 2016 leaves room for discretion in circumstances where debt is assessed to be sustainable but not with a high probability, allowing for a range of options that could meet the prescribed requirements. This puts a greater onus on the Board to ensure that all future requests for exceptional access, particularly where debt is not assessed to be sustainable with a high probability, are properly justified and that financing commitments from other sources can be credibly substantiated.

[73] The IEO is currently working with staff to develop a clear protocol for future evaluations.

Box 8. Selected Lessons Drawn by IMF Staff on Recent Crisis Management in the Euro Area Crisis[1]

Sovereign Debt Restructuring (IMF, 2013b)

- Debt restructuring has often been too little too late and failed to reestablish debt sustainability in a durable way.
- While the costs of delaying restructuring are well recognized, authorities' concerns about financial stability and contagion could exert pressures to delay; delays were sometimes caused by the incentives of official creditors who have interest in accepting, and pressuring the Fund to accept, sanguine debt sustainability assessments.
- Providing large-scale financing without debt relief would only postpone the need to address the debt problem; the appropriate response would be to deal with the contagion effects of restructuring head-on, for example by establishing adequate safeguards.
- Action is likely required to increase the rigor and transparency of debt sustainability assessments, explore ways to prevent the use of IMF resources to simply bail out private creditors, and alleviate the costs associated with restructuring.

Ex Post Evaluation on Greece (IMF, 2013c)

- Better tailoring of Fund lending policies to the circumstances of monetary unions, given the large structural component of programs when exchange rates are fixed.
- Avoiding undue delays in debt restructuring.
- More attention to the political economy of adjustment.
- More parsimony in fiscal structural reforms, and a more hands-on approach to technical assistance.
- More streamlining in the troika process to reduce the burden on the authorities.

Ex Post Evaluation on Ireland (IMF, 2014b)

- Country ownership is key.
- Set realistic targets and meet them. While always an important objective, meeting program targets is particularly relevant for reassuring private capital markets.
- In a banking crisis, take strong actions upfront—credible asset quality and liquidity assessments and a well-capitalized banking system are critical.
- Focus conditionality on key challenges.
- Communicate effectively. While technical expertise is vital for the right diagnosis and in identifying the appropriate policy response, communicating the strategy is also of critical importance.
- Be proactive and closely engaged.

Crisis Program Review (IMF, 2015c)

- The systemic exemption provided the euro area with time to build firewalls, but it could not on its own prevent contagion.
- Internal devaluation, which relies on domestic price adjustment, proved hard to achieve within a short period, and the desired recovery in growth and exports did not materialize for most countries.
- Concerns about bank–sovereign linkages and cross-border contagion sometimes delayed or limited public debt restructuring, adversely affecting growth and credit intermediation; where public debt is high, timely debt restructuring may also be needed.
- The growth payoffs from structural reforms in the near term appear to have been modest and less than envisaged; this should be reflected in realistic and prudent program assumptions.
- Clearer operational guidance for the IMF's interaction with regional financing arrangements would be helpful for delineating responsibilities; when necessary, commitments on prospective implementation of necessary union-wide policies should be sought; alternatively, program design would need to be based on larger adjustment and financing, or IMF involvement be postponed.

[1] While some of these papers draw a number of lessons from a broader set of crisis experience, only those relevant to the euro area are noted here.

Table 3. IEO Recommendations for Board Consideration

Recommendation 1	The Executive Board and management should develop procedures to minimize the room for political intervention in the IMF's technical analysis.
Recommendation 2	The Executive Board and management should strengthen the existing processes to ensure that agreed policies are followed and that they are not changed without careful deliberation.
Recommendation 3	The IMF should clarify how guidelines on program design apply to currency union members.
Recommendation 4	The IMF should establish a policy on cooperation with regional financing arrangements.
Recommendation 5	The Executive Board and management should reaffirm their commitment to accountability and transparency and the role of independent evaluation in fostering good governance.

134. In this connection, the Executive Board should draw lessons from the implementation of the exceptional access policy during the euro area crisis, especially the extent and timeliness of the information provided and the policy issues presented during informal sessions. The Board should consider why and how it came to be that there were gaps in information provided, and whether any information asymmetry among Executive Directors would be an issue of concern should similar lapses occur in the future.

Recommendation 3: The IMF should clarify how guidelines on program design apply to currency union members.

135. The IMF has long recognized that program design and conditionality for countries that are members of currency unions need to differ from that for countries with a flexible exchange rate and an independent monetary policy (see IMF, 1994a). Policy responsibilities in a currency union are split between national and union-level authorities. The implications of this split for the conduct of Article IV consultations are explicitly considered in the various IMF surveillance decisions and corresponding guidance notes to staff. But the 2002 Conditionality Guidelines (IMF, 2002b) and the Revised Operational Guidance Note to IMF Staff (IMF, 2014a) do not explain how IMF-supported programs will approach the split of policy responsibilities in a currency union from the standpoints of program design and conditionality.

136. The IMF should conduct a comprehensive review and formal discussion of its lending approaches to members of currency unions. Issues that need to be clarified include the following: (i) To whom does/should the IMF owe its primary responsibility in lending to a currency union member—the borrowing country alone, the union as a whole, or the global financial system? (ii) How should the IMF balance the objectives of lending in the member's best interests and avoiding measures that harm systemic stability? (iii) Is there a scope for lending directly to a currency union without amending the Articles of Agreement? (iv) What would be the circumstances and modalities for setting conditionality on union-level institutions? (v) What is the appropriate role of the regional central bank or other union-level institutions during program discussions with a member country? (vi) What options are available to the IMF to effect changes in union-level policies that may be necessary for the success of the member's program?

137. Introducing an explicit treatment of issues germane to countries in a currency union would bring existing conditionality guidelines into conformity with surveillance policy and practices and would also promote more evenhanded treatment of members in different currency unions.

Recommendation 4: The IMF should establish a policy on cooperation with regional financing arrangements.

138. Such a policy could be expected to protect the IMF's technical judgements from political influence. With respect to its engagement in the euro area, the 2012 Treaty Establishing the European Stability Mechanism (ESM) provides for the ESM to "cooperate very closely" with the IMF in providing support to a euro area member.[74] Written principles on joint lending operations agreed by the IMF Managing Director with the Head of the ESM, and endorsed by the

[74] "Treaty Establishing the European Stability Mechanism between the Kingdom of Belgium, the Federal Republic of Germany, the Republic of Estonia, Ireland, the Hellenic Republic, the Kingdom of Spain, the French Republic, the Italian Republic, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Grand Duchy of Luxembourg, Malta, the Kingdom of the Netherlands, the Republic of Austria, the Portuguese Republic, the Republic of Slovenia, the Slovak Republic, and the Republic of Finland" (http://esm.europa.eu/about/legal-documents/ESM%20Treaty.htm).

respective Boards, would provide clarity for all parties and enhance the legitimacy of IMF–ESM cooperation.

139. Areas where clarity could be provided include: (i) sharing of confidential information; (ii) procedures to address differences of view at the mission level and up; (iii) avoidance of cross-conditionality and inconsistent conditionality, especially in overlapping policy areas such as fiscal policy, financial sector restructuring, and structural reforms, and, in the event one institution were to decide to proceed without the others, mutual understanding of the conditions for such action including the scope for informal communication prior to taking the formal decision; (iv) efforts to reduce the burdens placed on country authorities by large mission teams and duplication of information requests; (v) implications for the actions of the other institution of overdue obligations, or arrears, to one institution by a borrowing country;[75] and (vi) conditions for requests to the IMF to provide technical assistance, such as took place in the case of Spain, and the modalities to be used by the IMF.

140. Similar agreed cooperation principles adapted to the circumstances of each regional financing arrangement (RFA) would also prove useful for the IMF's possible program involvement with such arrangements. The IMFC called for the development of such principles in the spring of 2011 (IMFC, 2011) and the G20 endorsed six nonbinding broad principles for cooperation in the fall of that year, but no related formal discussion has taken place at the Executive Board.[76] In October 2014, Executive Directors, in discussing the IEO evaluation of the IMF Response to the Financial and Economic Crisis (IEO, 2014c), "generally supported the [IEO] recommendation to develop guidelines for better structuring engagements with other organizations and clarifying the IMF's roles and accountabilities, to further safeguard the IMF's independence and help ensure uniform treatment to all member countries," while noting the need to remain "flexible and pragmatic to allow adaptation to specific circumstances" (IMF, 2014c). As noted by the staff (IMF, 2015c), this is an opportune time for the Executive Board to discuss formally the G20 principles for cooperation between the IMF and RFAs and to develop principles tailored to each RFA. Any agreed collaboration principles would usefully be supplemented by operational guidelines for IMF staff to help promote their consistent application.

Recommendation 5: The Executive Board and management should reaffirm their commitment to accountability and transparency and the role of independent evaluation in fostering good governance.

141. Management, staff, and the Board should avoid actions that could be seen as hindering evaluation efforts; this could lead to missing valuable learning opportunities as well as potentially damaging the IMF's credibility. Ex post evaluations under the Fund's exceptional access policy should continue to be prepared in accordance with the guidelines and on time. In addition, the Board should establish or reaffirm clear guidelines on: (i) how to keep records of the process by which important program-related decisions are made at the staff and management levels; (ii) the preparation and retention of the records of informal Board meetings; (iii) the IEO's access to confidential documents when there is ongoing sensitivity and with what time lags such documents should be made available; (iv) the modality of interactions between the IEO and IMF staff; and (v) how the IEO could assist the IMF to draw timely lessons by providing greater clarity on its terms of reference regarding what it can or cannot evaluate. In this connection, the IEO is already working with staff to address some of the problems it has faced in conducting this evaluation. The IEO welcomes the staff's initiatives to develop a clear protocol for its engagement with IMF staff in future evaluations.

[75]The ESM Treaty accepts "preferred creditor status of the IMF over the ESM."

[76]In 2013, the staff prepared a paper (IMF, 2013a) taking stock of the IMF's engagement with regional financing arrangements and exploring options for future cooperation. The paper was prepared for a G20–IMF seminar held on the margins of the Spring Meetings and was discussed by the Board in an informal session.

APPENDIX

I

An IMF-Centric Timeline of Key Events During the Euro Area Crisis, September 2008–December 2014

2008

September 30
Irish government unveils a two-year blanket guarantee to safeguard the deposits and debts at six financial institutions.

2009

January 14
Standard & Poor's (S&P) downgrades Greece's sovereign debt. In the following days, Spain loses its AAA sovereign credit rating, and Portugal's credit rating is downgraded.

March 30
Ireland's AAA sovereign credit rating is downgraded by S&P and Fitch Ratings, and is cut further in the following weeks by S&P and Moody's.

October 4
George Papandreou leads the Socialist (Pasok) Party to a landslide victory in Greek elections. Weeks later, the new government announces that the fiscal deficit in 2009 is likely to be 12.8 percent of GDP, more than three times the previous forecast.

December 8–22
Fitch, S&P, and Moody's downgrade Greece's sovereign credit rating.

2010

February 11
EU leaders, following their first emergency summit on Greece, announce that they "will take determined and coordinated action, if needed, to safeguard financial stability in the euro area." IMF offers to provide "expertise and support as necessary."

March 25
Euro area leaders announce their readiness to contribute to coordinated bilateral loans to Greece "[a]s part of a package involving substantial IMF financing and a majority of European financing."

April 11
Euro area member states agree on the terms of financial support to Greece. IMF, in liaison with the EC and the ECB, begins discussions with Greek authorities.

April 21
Greece's ten-year borrowing costs reach 8.7 percent. On April 23, the government requests a Stand-By Arrangement (SBA) with the IMF.

April 27
S&P cuts Greece's credit rating to speculative-grade status. Spain and Portugal have their credit ratings lowered.

May 2
IMF mission, in consultation with representatives from the EC and the ECB, reaches agreement with Greek authorities on a three-year €30 billion SBA as part of a cooperative package of financing with the EU. IMF Executive Board approves the SBA a week later on May 9, under the Fund's fast-track Emergency Financing Mechanism.

May 7–9
ECB announces its decision to suspend minimum credit rating thresholds for Greek government debt used as collateral in Eurosystem refinancing operations. Euro area finance ministers announce the creation of the European Financial Stability Facility (EFSF) and the

European Financial Stabilization Mechanism (EFSM), with a combined volume of up to €500 billion. At the same time, ECB announces exceptional measures including secondary-market sovereign debt purchases within the framework of the Securities Market Program (SMP); initial purchases mainly focus on Greek government bonds.

July 23
The results of the first pan-European stress tests of the banking system are published. Only seven banks fail the stress tests, with an aggregate capital shortfall of €3.5billion.

September 7
Irish government announces an extension of the state blanket guarantee for short-term bank liabilities to end-December 2010. A few weeks later, Irish Finance Minister says there will be "a very substantial spike" in Ireland's general government deficit in 2010 as a result of the capital support being provided to the banking system.

September 10
IMF Executive Board completes the first review of Greece's performance under the SBA-supported program and approves disbursement of €2.57 billion.

September 29
EC presents a package of six legislative proposals aimed at reforming economic governance and strengthening the framework for preventing excessive imbalances and excessive deficits.

October 18
German Chancellor and French President agree, in Deauville, France, to create a permanent crisis resolution mechanism that provides for the possibility of sovereign debt restructuring.

November 4
Ireland's borrowing costs rise to 7.7 percent as the government announces record budget cuts.

November 21
Irish government requests financial assistance to safeguard financial stability.

November 28
IMF mission reaches agreement with Irish authorities on a financing package totaling €85 billion, of which the Fund would contribute €22.5 billion through a three-year arrangement under the Extended Fund Facility (EFF).

December 7
IMF Managing Director visits Greece to discuss economic developments with Greek authorities, members of parliament, and the opposition.

December 9
Irish Parliament votes to approve the EU-IMF financial assistance program for Ireland.

December 16
IMF Executive Board approves the three-year €22.5 billion Extended Arrangement for Ireland under the Fund's fast-track Emergency Financing Mechanism.

December 17
IMF completes the second review of Greece's economic performance under the SBA-supported program and approves disbursement of €2.5 billion. *On the same day, EU leaders agree to create a permanent debt-crisis mechanism—the European Stability Mechanism (ESM)—in 2013.*

2011

February 11
Greek government accuses the EU and IMF of interfering in its domestic affairs after staff teams from the IMF, EC, and ECB on the third review mission to Greece conclude that "major reforms still need to be designed and implemented."

February 25
Ireland holds general elections. The ruling Fianna Fail party is swept from power and Enda Kenny (Fine Gael) is sworn in as the new Prime Minister.

March 11
Euro area leaders agree to lower the interest rate on the emergency loans to Greece to 5 percent and to increase the maturity of the loans to 7.5 years. Leaders agree to make the EFSF's €440 billion lending capacity fully effective, and to allow the EFSF and ESM to intervene in the primary market for sovereign debt "in the context of a program with strict conditionality."

March 14
IMF completes the third review of Greece's performance under the SBA-supported program and approves disbursement of €4.1 billion.

March 23
Portugal's Prime Minister Jose Socrates resigns after opposition parties reject the fourth package of austerity measures in a year; his resignation leads to the calling of a snap election two years ahead of schedule.

April 8
After further credit downgrades by Fitch and Moody's, the Portuguese government requests financial assistance from the EU and IMF.

May 5
IMF mission reaches agreement with Portuguese authorities on a three-year €26 billion arrangement under the EFF, as part of a financing package with the EU. IMF Executive Board approves the arrangement two weeks later, under the Fund's fast-track Emergency Financing Mechanism.

May 16
IMF completes the first and second reviews of Ireland's performance under the EFF-supported program and approves disbursement of €1.58 billion.

May 17
European finance ministers float the idea of talks with bondholders to extend Greece's debt-repayment schedule. ECB says it will not accept Greek bonds as collateral if maturities are extended. IMF confirms that the Fund will be unable to provide additional financing to Greece without assurance that the next year's financing gap would be filled.

May 18
IMF Managing Director Strauss-Kahn resigns.

June 5
Center-right Social Democrats win a conclusive victory over the center-left Socialists in Portugal's general elections.

June 21
Pedro Passos Coelho is sworn in as the new Prime Minister of Portugal.

June 29
Greek parliament backs a five-year austerity plan and approves implementation laws.

July 5
IMF Executive Board selects French Finance Minister Christine Lagarde as IMF Managing Director for a five-year term.

July 8
IMF Executive Board completes the fourth review of Greece's performance under the SBA-supported program and approves disbursement of €3.2 billion.

July 11
IMF publishes a staff paper on "Lessons from the European Financial Stability Framework Exercise," highlighting a need to strengthen the effectiveness of existing institutions; adopt a consistent design across all elements of the financial stability framework; and fill in an important gap in the existing framework by ensuring effective crisis management and resolution.

July 15
The results of the second round of pan-European stress tests are made public. Eight out of 906 European banks fail (five in Spain, two in Greece, and one in Austria) and another 16 banks are considered in the danger zone.

July 21
Euro area leaders and EU institutions decide on a new package of measures to end the crisis and prevent contagion, including: a new program for Greece; voluntary private sector involvement, with a net contribution corresponding to a 21 percent haircut, to strengthen Greek public debt sustainability; a secondary market debt buy-back program for Greece; and a lowering of the interest rate on assistance loans (to about 3.5 percent) and a lengthening of their maturities (from 15 to 30 years). The agreement also includes measures to expand the powers of the EFSF/ESM.

August 4
ECB reactivates secondary market purchases and starts purchasing Italian and Spanish bonds.

August 12
Italian Prime Minister announces a new austerity package to shore up strained public finances.

August 29
IMF Managing Director calls for an "urgent," potentially mandatory, recapitalization of Europe's banks in a speech at Jackson Hole.

September 2
IMF/EC/ECB team suspends Greece's fifth review after finding delays in the implementation of the medium-term fiscal plan and structural economic reforms.

September 2
IMF completes the third review of Ireland's performance under the EFF-supported program and approves disbursement of €1.48 billion.

September 12
IMF completes the first review of Portugal's performance under the EFF-supported program and approves disbursement of €3.98 billion.

September 14
Italian parliament gives final approval to a much-altered austerity plan after the government wins a confidence vote on the package earlier in the day.

September 21
IMF *Global Financial Stability Report* estimates that losses due to exposures to sovereign bonds of "high-spread" euro area countries could potentially reach €200 billion for EU banks.

October 4–18
Spain and Italy are hit by a wave of rating downgrades by three main rating agencies.

October 11
Staff teams from the IMF, EC, and ECB conclude their fifth review mission to Greece and note that: "The success of the program continues to depend on mobilizing adequate financing from private sector involvement (PSI) and the official sector."

October 26
EU leaders hold yet another crisis summit. After a night of tense negotiations, leaders agree to a 50 percent haircut on Greek bonds held by private investors and to extend a new financial assistance package worth €130 billion to Greece. Leaders also agree to leverage the resources of the EFSF to boost its firepower to €1 trillion.

November 3
Greek Prime Minister Papandreou calls for a new coalition to negotiate the new €130 billion financing package. Lucas Papademos is chosen to lead an interim coalition government, following Papandreou's resignation.

November 4–16
Italian government requests monitoring of its economic policy implementation by the IMF as part of the commitments made to its euro area partners in October. Italian Prime Minister loses his majority in Parliament and resigns four days later. Mario Monti is appointed to head a new government.

December 5
IMF Executive Board completes the fifth review of Greece's performance under the SBA-supported program and approves disbursement of €2.2 billion.

December 9
Twenty-five EU leaders agree on a new "fiscal compact." Leaders also agree to deploy the EFSF's leverage options; bring forward the entry into force of the ESM to July 2012; reassess the overall ceiling of the EFSF/ESM; increase the IMF's resources by up to €200 billion; and reaffirm the "unique and exceptional" nature of the decisions concerning private sector involvement in Greece.

December 8
ECB announces additional measures to support bank lending and liquidity, including by increasing collateral availability and by conducting two longer-term refinancing operations (LTROs).

December 15
IMF Executive Board completes the fourth review of Ireland's performance under the EFF-supported program and approves disbursement of €3.9 billion.

December 19
IMF Executive Board completes the second review of Portugal's performance under the EFF-supported program and approves disbursement of €2.9 billion.

December 22
Italy adopts an emergency ("Save Italy") austerity budget. IMF staff team visits Italy to discuss the modalities for future monitoring missions.

2012

February 21
After long negotiations, euro area leaders agree on the terms for a second financial assistance program for Greece, involving elements of private sector involvement (PSI) aimed at reducing Greek public debt to around 120 percent of GDP by 2020. Greece launches a bond swap offer to private holders of its bonds on February 24.

February 27
IMF Executive Board completes the fifth review of Ireland's performance under the EFF-supported program and approves disbursement of €3.2 billion.

March 2
EU member states (except the U.K. and the Czech Republic) sign the Treaty on Stability, Convergence, and Governance in the Economic and Monetary Union (the "fiscal compact").

March 9
Greek Finance Ministry announces an 85.8 percent participation rate in the PSI operation, cutting the debt by about €105 billion. Euro area finance ministers formally approve the second financial assistance package for Greece in the following days.

March 15
IMF Executive Board approves a four-year €28 billion arrangement under the EFF for Greece.

March 30
Euro area finance ministers agree to expand their financial firewall to €700 billion by combining the resources of the EFSF and ESM.

April 4
IMF completes the third review of Portugal's performance under the EFF-supported program and approves disbursement of €5.17 billion.

April 25
IMF FSAP mission to Spain announces that stress tests covering more than 90 percent of the domestic banking sector identify ten banks as "vulnerable."

May 6
In Greek legislative elections, the two dominant parties—the center-right New Democracy and the Socialists (Pasok)—fail to secure enough votes for a majority in Parliament. A second snap election is called.

June 8
IMF Executive Board discusses the 2012 Financial System Stability Assessment for Spain. FSAP stress tests indicate that several banks would need €40 billion in extra capital.

June 9
Spain requests financial assistance from the EU to recapitalize its banking sector. Eurogroup agrees to provide assistance to the Spanish government of up to €100 billion, and announces that the IMF would help monitor reforms in Spain's banking sector.

June 13
IMF completes the sixth review of Ireland's performance under the EFF-supported program and approves disbursement of €1.4 billion.

June 17
The New Democracy party ekes out a narrow victory in Greek elections and forms a coalition government. Antonis Samaras is sworn in as the new Prime Minister.

June 25
Cyprus requests financial support from the euro area through the EFSF/ESM and invites the IMF to participate in the financial assistance.

June 27
IMF sends a team to Cyprus to prepare for discussions on an economic program.

June 29
Euro area leaders endorse the concept of banking union and open the door to possible direct bank recapitalizations by the ESM once an effective single supervisory mechanism is established.

July 16
IMF completes the fourth review of Portugal's performance under the EFF-supported program and approves disbursement of €1.48 billion.

July 20
Eurogroup agrees on the details of the financial assistance to Spain.

July 26
ECB President announces the ECB's willingness to do "whatever it takes to preserve the euro."

July 26
Ireland returns to international bond markets with the sale of a five-year bond, its first new issue of long-dated debt since September 2010.

August 5
Staff teams from the IMF, EC, and ECB visit Greece to discuss the implementation of the program and agree on the need to "strengthen policy efforts to achieve its objectives."

September 5
IMF Executive Board completes the seventh review of Ireland's performance under the EFF-supported program and approves disbursement of €0.92 billion.

September 6
ECB announces a new framework, Outright Monetary Transactions (OMT), for intervention in sovereign bond markets of countries accepting EFSF and ESM support for their macroeconomic adjustment programs and adhering to the associated structural and fiscal reform efforts.

September 7
Portuguese government announces a fiscal devaluation to be included in the 2013 budget, involving lowering employers' social security contributions and raising workers' contributions.

September 21
Following a street protest by hundreds of thousands of demonstrators, Portuguese government abandons the proposed fiscal devaluation.

October 8
ESM is formally inaugurated in Luxembourg.

October 9
IMF's *World Economic Outlook* shows that fiscal multipliers have been underestimated, resulting in the negative short-term effects of fiscal cutbacks being larger than expected.

October 11
At the 2012 IMF-World Bank Annual Meetings, IMF Managing Director urges countries to refrain from new austerity measures and argues that struggling European countries should be given more time to reduce their budget gaps. In her report to the IMFC the Managing Director calls for the ESM and the OMT to be deployed and for banking union to be advanced.

October 24
IMF Executive Board completes the fifth review of Portugal's performance under the EFF-supported program and approves disbursement of €1.5 billion.

October 26
IMF conducts first financial sector monitoring mission to Spain and concludes that all deadlines established in the EU Memorandum of Understanding have been met.

November 26
Euro area finance ministers reach agreement with the IMF to complete the first EFF-supported program review for Greece. The deal includes Greek debt buybacks, return of SMP profits to Greece, reduction of interest rates, significant extension of maturities, and the deferral of interest rate payments.

December 3
Greek government launches a debt buyback scheme seeking to retire about half of the €62 billion in debt owed to private creditors.

December 17
IMF Executive Board completes the eighth review of Ireland's performance under the EFF-supported program and approves disbursement of €0.89 billion.

December 20
IMF mission announces conclusions of the first-ever EU-wide financial system stability assessment. The mission recommends: further steps towards banking union; reinvigorating the single financial market in Europe; improved and expanded stress testing; measures to separate bank and sovereign risk; and development of an effective crisis management framework to minimize costs to taxpayers.

2013

January 16
IMF Executive Board completes the first and second reviews of Greece's performance under the EFF-supported program and approves disbursement of €3.24 billion. IMF Executive Board also completes the sixth review of Portugal's performance under the EFF-supported program and approves disbursement of €838.8 million.

January 24
Portugal sells €2.5 billion of five-year bonds through banks, the first offering with that maturity in almost two years.

February 4
IMF conducts the second financial sector monitoring mission to Spain.

February 14
IMF publishes a Staff Discussion Note, "Banking Union for the Euro Area," and three background technical notes

which elaborate the case for, and the design of, a banking union for the euro area.

February 24
Nicos Anastiades wins the presidential election in Cyprus. He is expected to conclude negotiations with international lenders over the rescue package that Cyprus had applied for in June 2012.

March 13
Ireland sells €5 billion of new benchmark ten-year bonds to meet nearly all its funding needs through the next year.

March 22
IMF Executive Board completes the ninth review of Ireland's performance under the EFF-supported program and approves disbursement of €0.97 billion.

April 3
IMF reaches a staff-level agreement with the Cypriot authorities on an economic program that would be supported by the IMF jointly with the EU and the ECB.

April 5
Portugal's Constitutional Court rejects four out of nine contested austerity measures in this year's budget.

April 16
IMF *World Economic Outlook* urges ECB to keep monetary policy very accommodative and to make "OMTs . . . available to countries with programs that are delivering on adjustment."

May 7
Portugal issues its first new government bonds in two years, in a heavily-oversubscribed offer of ten-year debt that raises €3 billion.

May 15
IMF Executive Board approves a three-year €1 billion arrangement for Cyprus under the EFF as part of a cooperative package of financing with the ESM.

May 31
IMF Executive Board completes the third review of Greece's performance under the EFF-supported program and approves disbursement of €1.74 billion. The Board also discusses the IMF's ex post evaluation of the 2010 SBA with Greece.

June 3
IMF conducts the third financial sector monitoring mission to Spain.

June 12
IMF Executive Board completes the seventh review of Portugal's performance under the EFF-supported program and approves disbursement of €657.47 million.

June 17
IMF Executive Board completes the tenth review of Ireland's performance under the EFF-supported program and approves disbursement of €0.95 billion.

July 1
ESM becomes the sole and permanent mechanism for responding to new requests for financial assistance by euro area member states; EFSF remains active in financing the ongoing programs.

July 29
IMF Executive Board completes the fourth review of Greece's performance under the EFF-supported program and approves disbursement of €1.72 billion.

August 29
Portugal's Constitutional Court rejects a bill that would effectively allow the state to fire public sector workers.

September 16
IMF Executive Board completes the first review of Cyprus' performance under the EFF-supported program and approves disbursement of €84.7 million.

September 26
IMF Executive Board completes the eleventh review of Ireland's performance under the EFF-supported program and approves disbursement of €770 million.

September 30
IMF conducts the fourth financial sector monitoring mission to Spain.

November 8
IMF Executive Board completes the eighth and ninth review of Portugal's performance under the EFF-supported program and approves disbursement of €1.91 billion.

November 143
Euro area finance ministers agree to let Spain exit the financial assistance program for its banking sector in January 2014 without drawing more European funds.

December 13
IMF Executive Board completes the twelfth and final review of Ireland's performance under the EFF-supported program and approves disbursement of €0.65 billion. The extended arrangement expires on December 15.

December 16
IMF conducts the fifth and final financial sector monitoring mission to Spain.

December 18
EU finance ministers agree on the design of the Single Resolution Mechanism.

2014

January 22
Greece's highest administrative court reverses wage cuts that were imposed by the government in 2012 on police and armed forces to comply with the terms of the country's EU/IMF program.

February 12
IMF Executive Board completes the tenth review of Portugal's performance under the EFF-supported program and approves disbursement of €0.91 billion.

April 9
Greece returns to global capital markets for the first time since 2010, raising €3 billion in a five-year bond deal with a lower-than-expected yield of 4.95 percent.

April 17
IMF Executive Board completes the eleventh review of Portugal's performance under the EFF-supported program and approves disbursement of €851 million.

May 30
Portugal's Constitutional Court strikes down some austerity measures imposed at the start of the year, thus requiring the government to implement compensatory measures in order to reach its fiscal targets.

May 30
IMF Executive Board completes the fifth review of Greece's performance under the EFF-supported program and approves disbursement of €3.41 billion. In light of the delays in program implementation, the Board also approves the authorities' request for rephasing three disbursements evenly over the remaining reviews in 2014.

June 12
Portuguese government decides to allow the EFF-supported program to expire at the end of June without completing the twelfth and final review and without receiving the final tranche.

September 12
Euro area finance ministers approve Ireland's plan to repay its IMF loan ahead of schedule.

October 31
ECB takes over the role of banking supervisor for the euro area's 120 largest banks under the Single Supervisory Mechanism.

December 18
Irish government completes the early repayment of almost half of the loans it received from the IMF under its 2010 Extended Arrangement.

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Statement by the Managing Director

Chairman's Summing Up

Statement by the Managing Director on the Independent Evaluation Office's Report on the IMF and the Crises in Greece, Ireland, and Portugal: An Evaluation by the Independent Evaluation Office

Executive Board Meeting
July 19, 2016

I welcome the report of the Independent Evaluation Office (IEO) on the Euro Area crisis programs. Their work provides an independent and in-depth account, which I have no doubt will make an important contribution to understanding the Fund's approach to the crisis. As I have emphasized repeatedly, the IEO plays a vital role in enhancing the learning culture within the Fund, strengthening the Fund's external credibility, and supporting the Executive Board's institutional governance and oversight responsibilities.

Overall, the conclusion I draw is that the Fund's involvement in the Euro Area crisis programs has been a qualified success. The crisis in the Euro Area was unprecedented. Coming against the backdrop of the global financial crisis, the risks of broader contagion were high. Key challenges included the abrupt loss of market access; the need for orderly adjustments in countries with deep imbalances and no recourse to exchange rate policies; and the absence of Euro Area firewalls. In the face of this unprecedented systemic challenge, Fund-supported programs succeeded in buying time to build firewalls, preventing the crisis from spreading, and restoring growth and market access in three out of four cases (Ireland, Portugal, Cyprus). Greece, however, was unique: while initial economic targets proved overly ambitious, the program was beset by recurrent political crises, pushback from vested interests, and severe implementation problems that led to a much deeper-than-expected output contraction. On the other hand, Greece undertook enormous adjustment with unprecedented assistance from its international partners. This enabled Greece to remain a member of the Euro Area—a key goal for Greece and the Euro Area members.

The IEO's report offers many useful suggestions for the way forward. The Fund has also continually evaluated its own performance during the course of the 2010/11 programs and has taken action to incorporate lessons learned. That work will continue, and will benefit from the IEO's evaluation.

I. Perspective on the Unprecedented Euro Area Crisis

With the passage of time, it may be too easy to forget what the world looked like in 2010, especially the uncertainty, market volatility, and fear of yet another Lehman-like systemic shock. Integrated financial markets and the lack of a Euro Area-wide crisis management framework and firewall meant that problems in countries in crisis could have spilled over to other vulnerable Euro Area members, posing potentially severe systemic risks. There was a need to build firewalls in a short time, amid great uncertainty and within the Euro Area's consensus-based governance framework which required political agreement among 17 sovereign nations. Designing the adjustment programs was challenging as these Euro Area members faced abrupt loss of market access and deep imbalances—including structurally rooted competitiveness problems in some cases—without recourse to exchange rate flexibility.

Viewed in this context, the Fund-supported programs in the Euro Area were a success, albeit a qualified one. First and foremost, they succeeded in stemming systemic risks by, among other things, buying time to mobilize political support among Euro Area members to build firewalls and a crisis management framework. With the world economy fragile in the wake of the global crisis and financial markets still reeling from the collapse of Lehman only 18 months earlier, systemic concerns inevitably were paramount—and major contagion was avoided. Moreover, three of four programs—in Ireland, Portugal, and Cyprus—were successful in helping restore growth and market access.

Still, recessions in some of these cases were deeper and longer than expected. Fiscal multipliers were initially underestimated (though later adjusted) and, importantly, both the global and European recoveries were weaker than expected.

Greece, however, posed additional and unique challenges. With unparalleled international support, Greece undertook major fiscal adjustment. But Greece was afflicted to a much greater degree than other countries by pushback from vested interests, severe implementation problems, and recurrent political crises. The attendant deep confidence crises—and repeated episodes of fears about Grexit—led to a much deeper-than-expected output contraction. Of course, none of these impediments was foreseen in advance and, with the benefit of hindsight, the initial assumptions about program ownership and growth proved much too optimistic. However, Greece remained a member of the Euro Area—a key objective for both Greece and other Euro Area members.

The IEO's reports echo many of the lessons that we have drawn from our own internal assessments. We undertook rigorous self-assessment in the course of the 2010/11 programs and, as a result, have already made changes to aspects of the Fund's operational and policy work. Early lessons were adopted in the context of the programs' quarterly reviews: for example, fiscal multipliers were adjusted; and greater realism was applied to the likely pace of structural reforms. The Fund's frameworks for debt sustainability analyses and dealing with debt overhangs were strengthened—including reform of the exceptional access policy and elimination of the systemic exemption. Under its program, Greece benefitted from substantial haircuts on private sector claims in 2012, as well as refinancing on highly concessional terms from its official creditors, and the IMF is currently calling for further official debt relief. Given the "troika" experience, work is underway to improve the effectiveness of the Fund's collaboration with regional financing arrangements. Regarding surveillance, we have undertaken major initiatives to reflect the more globalized and interconnected world. These initiatives include revamping the legal framework for surveillance through a new Integrated Surveillance Decision, deepening analysis of risks and spillovers, strengthening macro-financial and financial sector surveillance (including of systemic risk), and upgrading the assessment of external positions.

In summary, the crisis in the Euro Area was extraordinary. It posed unprecedented challenges that, with the global financial crisis providing tinder, could have rapidly spread through Europe and beyond. The Fund, in conjunction with our membership, our partners in Europe, and the wider global community, took steps that averted what could have been a much more severe European and even global crisis. As we reflect upon this extraordinary time and upon our work to restore stability and quell a potentially larger crisis, we will continue to strive to do even better and to further refine our responses as we evolve as an institution. We must constantly aspire to do better in avoiding crises, managing crises, and learning from the past. And, I assure you, we will continue to be a learning institution in our endeavor to foster global monetary cooperation, secure financial stability, and promote sustainable economic growth with high employment and shared prosperity around the world.

II. Response to IEO Recommendations

The IEO makes five recommendations in this report. Below is my proposed response to each of these.

Recommendation 1. *The Executive Board and management should develop procedures to minimize the room for political intervention in the IMF's technical analysis.*

I support the principle that the IMF's technical analysis should remain independent. However, I do not accept the premise of the recommendation, which the IEO failed to establish in its report, and thus do not see the need to develop new procedures.

Recommendation 2. *The Executive Board and management should strengthen the existing processes to ensure that agreed policies are followed and that they are not changed without careful deliberation.*

I broadly support this recommendation. I concur that policy changes should be based on careful consideration by the Board. This, indeed, is standard practice. Even though all rules were followed, the process surrounding the creation of the systemic exemption took place under extraordinary circumstances, and I am committed to handling such circumstances better in the event of a future emergency situation of the kind the Fund faced in May 2010. The IEO also suggests that the Board independently "reviews the experience with the implementation of the exceptional access policy during the Euro Area crisis." This kind of review is already being undertaken in the context of the Ex-Post Evaluations of Exceptional Access Arrangements for the crisis countries, including the one currently underway for Portugal, and thus an additional process is not warranted. Finally, I of course support the principle that we follow existing policies. However, I consider that

Table 1. The Managing Director's Position on IEO Recommendations

	Recommendation	Position
(i)	The Executive Board and management shoud develop procedures to minimizie the room for political intervention in the IMF's technical analysis	Qualified Support
(ii)	The Executive Board and management shoud strengthen the existing processes to ensure that agreed policies are followed and that they are not changed without careful deliberation	Support
(iii)	The IMF should clarify how guidelines on program design apply to currency union members	Support
(iv)	The IMF should establish a policy on cooperation with regional financing arrangements	Support
(v)	The Executive Board and management shoud reaffirm their commitment to accountability and transparency and the role of independent evaluation in fostereing good governance.	Support

existing checks and balances are adequate and commit to ensuring that they are diligently applied.

Recommendation 3. *The IMF should clarify how guidelines on program design apply to currency union members.*

I support this recommendation. It would help to establish agreed "rules of the road" with our membership and demonstrate evenhandedness across currency unions, while recognizing the considerable heterogeneity among them (as articulated in the corresponding IEO background paper).

Recommendation 4. *The IMF should establish a policy on cooperation with regional financing arrangements.*

I support this recommendation. Moreover, I am pleased to note that a paper on regional financing arrangement (RFA) cooperation is already in the Executive Board's work program (available at: http://www.imf.org/external/pp/longres.aspx?id=5045, see paragraph 16).

Recommendation 5. *The Executive Board and management should reaffirm their commitment to accountability and transparency and the role of independent evaluation in fostering good governance.*

I support this recommendation. Indeed, I would like to emphasize that management and staff have been and will continue to be committed to accountability, transparency, and the role of the IEO. I also appreciate the specific suggestions under this recommendation to further strengthen cooperation with the IEO, which will be considered as part of the Management Implementation Plan.

The Chairman's Summing Up
The IMF and the Crises in Greece, Ireland, and Portugal—An Evaluation by the Independent Evaluation Office

Executive Board Meeting
July 19, 2016

Executive Directors welcomed the report by the Independent Evaluation Office (IEO) on the IMF and the Crises in Greece, Ireland, and Portugal, and appreciated the accompanying statement by the Managing Director. They agreed that the report's findings provide valuable insights and lessons for handling crises in members of currency unions. Directors underscored that the work of the IEO continues to play a vital role in enhancing the learning culture within the Fund, strengthening the Fund's external credibility, and supporting the Executive Board's oversight responsibilities. Directors broadly shared the general thrust of the IEO's main findings and broadly endorsed its recommendations, with some caveats.

Directors recognized that, while the Fund needs to learn from the experience of the three euro area crisis programs, it is important to acknowledge the difficult and unprecedented circumstances prevailing at the time. Key challenges included the abrupt loss of market access, the need to address deep imbalances without recourse to adjustment in the nominal exchange rate, and the absence of euro area firewalls. Directors also noted that the uncertainty and fear of contagion were acute given the backdrop of the global financial crisis. They emphasized that the Fund's performance in these crisis cases must be assessed in this broader context as it navigated uncharted territory.

Against this background, Directors considered that the Fund-supported programs had succeeded in buying time to build European firewalls, preventing the crisis from spreading, and restoring growth and market access in Ireland and Portugal. They observed that the political economy of the Greek crisis was unique and complex. Directors generally viewed the unprecedented Troika arrangement as efficient overall, noting in particular how the Fund's engagement had evolved over time. Nevertheless, the need to coordinate and reach common ground with the European partners might have affected the Fund's agility as a crisis manager, and gave rise to criticism that its decision-making process lacked transparency.

Directors broadly agreed with the principle underlying Recommendation 1—that the IMF's technical analysis should remain independent. They noted that procedures currently in place have been strengthened substantially in recent years in the direction recommended by the IEO. That notwithstanding, they recognized that there remains scope for further improving the analytical underpinnings of both surveillance and program design, especially in the areas of economic forecasts, external sector assessment, and integrated surveillance. Some Directors saw merit in developing procedures to ensure the independence of the Fund staff's technical analysis in the face of any potential political interference. Many Directors noted that political-economy considerations, as with any legitimate differences of views, could offer relevant perspectives and help serve to ensure the program's feasibility and success. Given the fiduciary duty of the Executive Board, Directors emphasized the importance of preserving its ability to make informed decisions, based on the available policy options and in a transparent manner.

Directors supported the principle underlying Recommendation 2—that existing policies should be followed and that they should not be changed without careful deliberation by the Board. Directors noted that the systemic exemption to the exceptional access criteria, which had been introduced under extraordinary circumstances, should have been considered more carefully and transparently by the Board. They appreciated the Managing Director's commitment to handle similar circumstances better in the future and follow existing policies diligently. Most Directors considered that checks and balances are adequately in place, while a number of Directors saw scope for further strengthening existing procedures to enhance transparency and information symmetry within the Board.

Directors supported Recommendation 3—that the Fund should clarify how guidelines on program design apply to currency union members. They emphasized that, while such guidelines would help ensure evenhandedness

across the membership, it will be important to take due account of heterogeneity across different currency unions. A number of Directors also saw merit in the IEO's suggestion that the circumstances and modalities for setting conditionality on union-level institutions should be clarified. A number of other Directors took the view that union-level policy recommendations should be made in the context of surveillance discussions with currency union institutions. A number of Directors stressed that evenhanded surveillance across the membership would help dispel the perception that euro area countries, and advanced economies more broadly, are treated differently by the Fund.

Directors supported Recommendation 4—that the Fund should establish a policy on cooperation with regional financing arrangements (RFAs). In doing so, they emphasized the need to maintain flexibility, given the different mandates, policies, and institutional arrangements of RFAs. They looked forward to discussing the forthcoming paper on RFA cooperation, as part of the ongoing work to strengthen the global financial safety net.

Directors supported Recommendation 5—that the Executive Board and Management should reaffirm their commitment to accountability and transparency, as well as the role of independent evaluation in fostering good governance. Directors underscored their strong support for the independent evaluation and the IEO's critical role in the Fund. They noted with concern the difficulty that the IEO had experienced in obtaining confidential documents that it deemed necessary for conducting the evaluation in a timely manner. They therefore appreciated the IEO's specific suggestions under this recommendation to further strengthen Fund cooperation with the IEO, including with regard to the modality of interactions between the IEO and Fund staff and the IEO's access to information. Directors welcomed the Managing Director's strong commitment to ensure smooth collaboration between the IEO and the Fund, and to consider the IEO's specific suggestions as part of the Management Implementation Plan, especially the Managing Director's proposal to develop an IEO/Fund staff protocol. They also underlined the importance of timely preparation of Ex-Post Evaluations for all exceptional access arrangements.

In line with established practices, management and staff will give careful consideration to today's discussion in formulating the implementation plan, including approaches to monitor progress.