CHAPTER

# I 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<br>(Percent of total in parentheses) | SDR 17.54 billion<br>(66.4) | SDR 10.22 billion<br>(43.0) | SDR 19.466 billion<br>(100.0) | SDR 22.942 billion<br>(96.6) | SDR 792 million<br>(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<br>(canceled) | January 15, 2016<br>(canceled) | December 15, 2013 | June 30, 2014 | March 7, 2016<br>(canceled) |
| Memorandum | | | | | |
| Amount in euros<br>(Percent of total financing) | €30 billion<br>(27.3) | €28 billion<br>(16.2) | €22.5 billion<br>(26.5) | €26 billion<br>(33.3) | €1 billion<br>(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.