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).

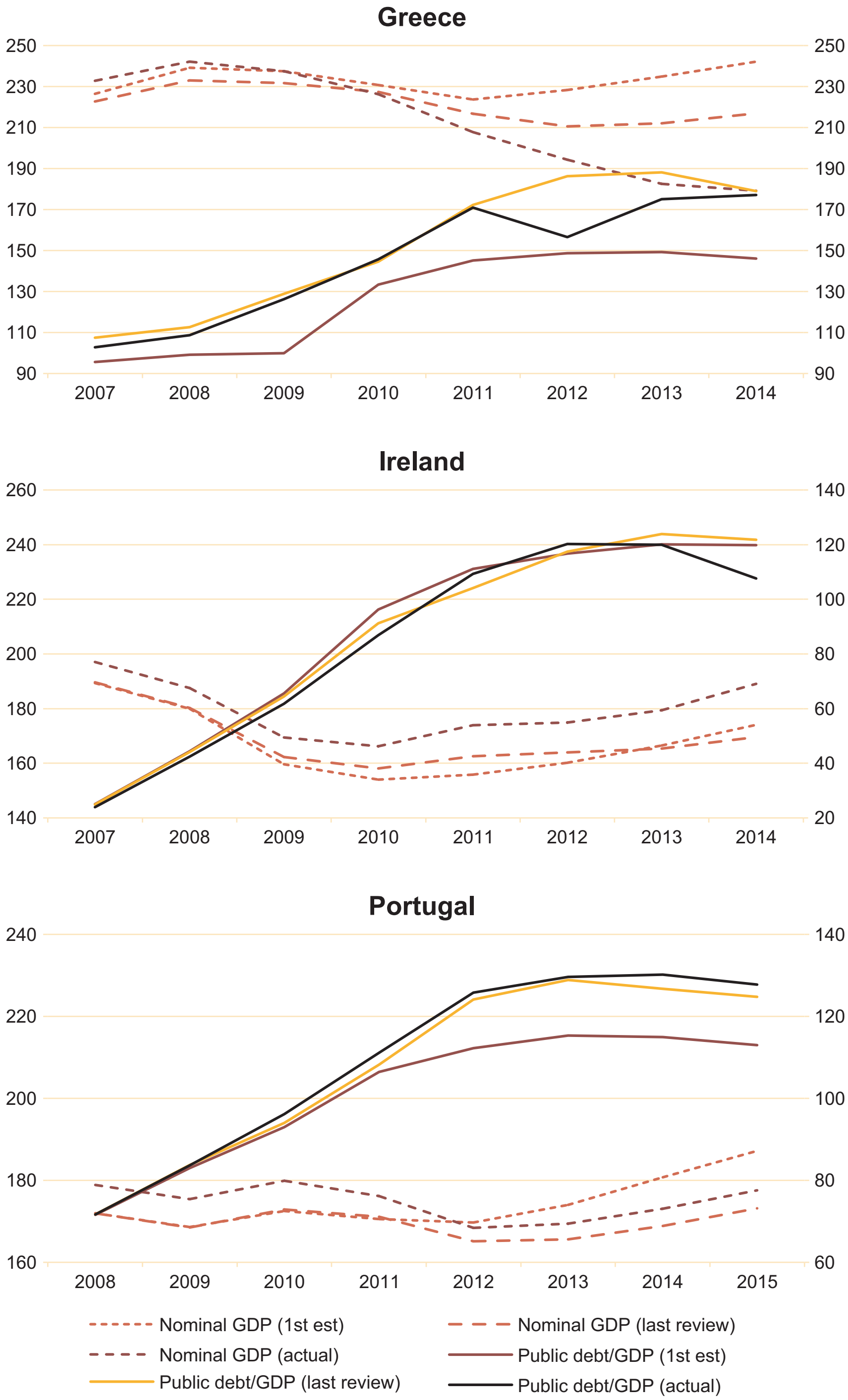
82. On the first count—whether programmed targets were met—the programs achieved considerable success in Ireland and, to a lesser extent, in Portugal. In Ireland, nearly all fiscal and structural targets were met in a timely manner, except for a delay in tackling the problem of mortgage arrears and the 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.