PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

POLICY BRIEF

16-13 The IMF and Euro Area Crises: Review of a Report from the Independent Evaluation Office

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The economic and financial crises in euro area countries since 2010 have tested the viability of the euro area and continue to challenge the future of the seven-decade European integration project. Euro area leaders reluctantly brought the International Monetary Fund (IMF) into the management of six of these crises—in Cyprus, Greece, Ireland, Italy, Portugal, and Spain—through the provision of financing and the design of economic and financial rescue programs. The IMF's Independent Evaluation Office (IEO 2016) reviewed the Fund's handling of four of these crises: in Greece (first program), Ireland, Portugal, and Spain.[1] The report is bureaucratically constrained in its language, but the underlying message is distinctly critical of the IMF: Political influence on IMF decision making was excessive, the IMF did not implement a coherent euro area strategy, and the IMF failed to comply with its own standard for transparency and, therefore, accountability.[2]

This Policy Brief first provides some background on the IEO and summarizes the conclusions of the IEO report. It then addresses four aspects of the report and its examination of the IMF's performance in these crises: addressing the crises individually rather than as a crisis for the euro area as a whole, the charge of excessive political intervention in the formulation of IMF policies for these countries, the IMF's lack of transparency and accountability both in these programs and vis-à-vis the IEO, and issues surrounding the Greek debt restructuring and the IMF's policy on exceptional access to Fund financial resources.

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The IEO report is critical, but insufficiently, of the IMF's approach to the euro area's handling of its crises. It also lays bare excessive political intervention in the euro area programs—a criticism that IMF managing director Christine Lagarde has disputed. The report also condemns the mindset at the IMF, before the crises and during the IMF's response to them, that "Europe is different" and accordingly should be treated differently. Perhaps related to political intervention, in compiling the report, the IEO team encountered an unacceptable degree of noncooperation from IMF management and staff, contrary to the

1. The report also touches on the Italian crisis during 2010–13.

2. I participated in a review panel of a near final draft of the main report (www.ieo-imf.org/ieo/files/completedevaluations/EAC__REPORT%20v5.PDF) on April 7, 2016. The full report includes 10 background papers and a summary of the views of the review panel. They do not necessarily reflect the views of the IEO. I have read only four of the background papers.

principles of transparency and accountability underlying the IEO's establishment in 2001 and the Fund's own integrity.

On the Greek restructuring, which is central to ongoing debates about these euro area crises, the report is balanced in its treatment of the decision by euro area officials not to restructure Greek debt at the start of its program in May 2010 and of IMF management's nontransparent acceptance of that decision via the introduction, without prior notice to the executive board, of a systemic test into its policy governing the large IMF financial programs. It pulls its punches, however, about the IMF's failure to push for a restructuring of the Greek debt in early 2011, when it became obvious that doing so was inevitable, desirable, and feasible. The IEO is also to be faulted for implicitly endorsing the elimination of the systemic test in January 2016.

The report yields several lessons. The Fund must be more disciplined and transparent about political interference in its work, redress the errors that have undermined its core values of transparency and accountability, and focus in its future surveillance and programs on the euro area as a whole.

THE INDEPENDENT EVALUATION OFFICE

The IMF established the IEO in 2001 after long and tortuous debates among IMF members and between members and IMF management and staff, who strongly resisted this overdue reform. Its terms of reference[3] mandate the IEO to

> systematically conduct objective and independent evaluations on issues, and on the basis of criteria, of relevance to the mandate of the Fund. It is intended to serve as a means to enhance the learning culture within the Fund, strengthen the Fund's external credibility, and support the Executive Board's institutional governance and oversight responsibilities. IEO has been designed to complement the review and evaluation work within the Fund and should, therefore, improve the institution's ability to draw lessons from its experience and more quickly integrate improvements into its future work.

In the 15 years since it was established, the IEO has conducted almost 30 evaluations of various IMF operations and programs. Many of these investigations led directly to changes in IMF policies and procedures. A substantial number induced changes in IMF policies and procedures in anticipation of the release of the IEO report.

3. The terms of reference are available at www.ieo-imf.org/ieo/pages/TermsofReference.aspx (accessed on August 9, 2016).

The ground rules for the IEO's activities were set at the start. The choice of topic and terms of reference for each IEO review are entirely the responsibility of the IEO and are not set by the IMF management or executive board, as stated in the IEO terms of reference:

> The content of the [IEO] Work Program should focus on issues of importance to the Fund's membership and of relevance to the mandate of the Fund. It should take into account current institutional priorities, and be prepared in light of *consultations* with Executive Directors and management, as well as with informed and interested parties outside the Fund. The Director will present IEO's Work Program to the Executive Board for its *review*. [Emphasis added.]

Thus by design the IEO's focus is on IMF decisions and policies, not those of members. The IMF is, however, an institution that operates at multiple levels—member countries; the representatives of those member countries on the executive board; the IMF management, led by the managing director, who is formally chosen by the members' representatives; and IMF staff at several levels. In most cases IMF staff deal with national authorities on program design and implementation. In general, member countries' principal contacts are with IMF staff, who may be senior staff and occasionally management. Consequently, the distinction between the IMF and its members, and the policies of each, is often blurred, as was the case in the euro area crises.

KEY IEO FINDINGS

The IEO report on the IMF euro area programs yielded six key findings:

- Precrisis surveillance of the euro area generally identified the right issues but fell well short of what would have been required to head off the crises if the analyses had foreseen the scale of the risks involved. The IMF was not alone in missing the buildup of banking system risks in some countries, including both crisis and noncrisis euro area countries, for example. The fact that it was not alone does not excuse the IMF, however (IEO 2016, vii).
- The programs for Greece and Portugal were based on overly optimistic growth assumptions that led to the underfinancing of the programs. The emphasis on fiscal consolidation worsened the debt dynamics of both countries (IEO 2016, viii and 29).
- The causes of the crises in the three principal countries (Greece, Ireland, and Portugal)—as well as Spain, where the IMF played an advisory role, and Italy,

where the IMF was to play a role of enhanced surveillance over the specifics of Italian economic and financial policies that in the end was rejected by the Italian government—were not the same. In particular, the causes were not all mostly fiscal; in Ireland, Portugal, and Spain, the crises had significant financial (banking) system elements. The failure to recognize the nature and dimensions of these problems, in particular in Portugal, contributed to the unspoken justification for underfunding the programs (IEO 2016, 6–15).

- The "troika" arrangement (through which the IMF cooperated with the European Commission and the European Central Bank) was an efficient mechanism for conducting program discussions, but it hampered the IMF's decision-making process in both content and speed of action and facilitated an excessive level of political interference in the technical work on the euro area programs (IEO 2016, vii and 43–44).
- The mindset that "Europe is different" prevented IMF management and staff from treating the euro area crises as a crisis for the euro area as a whole rather than as crises for individual members of the euro area (IEO 2016, vii).
- The program for Ireland was an "unqualified success," the program for Portugal was a "qualified one," and the first program for Greece failed (IEO 2016, 36).[4]

Most observers would agree with the conclusion about the Irish program, but the conclusion about the Portuguese program is too generous. As it rushed to exit its program, the Portuguese government left unfinished business in its economic and financial policies that has yet to be fully addressed.

THE MISSING EURO AREA FOCUS

The IEO report focuses on Greece, Ireland, and Portugal because they were the focus of the IMF. That focus was too narrow, as the IEO report (2016, 43) documents. It recommends that the IMF "clarify how guidelines on program design apply to currency union members" (IEO 2016, 53). As the text (IEO 2016, 53–54) implies less clearly than it should, this clarification should include an examination of both the scope for imposing program conditionality on union-level institutions and the policies of other members that are not asking for IMF financial support.

To support this finding, the IEO should have examined in greater detail the IMF's performance vis-à-vis the euro area as a whole. Circumstantial evidence suggests that the original intent of the report was in fact to examine IMF performance in the euro area crisis—the titles of 4 of the 11 background papers refer to the euro area crisis.

The IEO report does touch on the performance of the euro area as a whole in the context of the three crises. It points to the pledge by European Central Bank (ECB) president Mario Draghi in July 2012 to do "whatever it takes" to save the euro, and the subsequent ECB announcement of the as-yet-unused Outright Monetary Transactions instrument in its operations (IEO 2016, 38).[5] The IMF did not induce the Draghi pledge. It did follow the June 2012 proposal to form a banking union to break the doom loop between national banking systems and fiscal authorities. It had been advocated by the IMF but today remains a less-than-complete construction. The IEO report raises the possibility in this context that the three IMF programs and the engagement with Spain were holding actions before the euro area authorities agreed to needed institutional reforms. But the IMF did not recognize that the crises in the seven euro area countries were symptomatic of a crisis for the euro area as a whole.

The failure of the euro area to achieve sustained recovery from the double-barreled impact of the global financial crisis and the euro area crises is unprecedented.

The failure of the euro area to achieve sustained recovery from the double-barreled impact of the global financial crisis and the euro area crises is unprecedented. Table 1 presents data on economic recoveries in the euro area countries based on the low bar of returning to the precrisis level of real GDP measured in national currency. Among the crisis countries, Ireland enjoyed the fastest recovery, but it took seven years. Two of the crisis countries, Greece and Italy, are not expected to recover until after 2021. Among the noncrisis countries, Finland, Latvia (which had an IMF program before adopting the euro), and Slovenia are projected to take at least a decade to recover.

4. The report also reaches a positive conclusion about the quality and effectiveness of IMF technical assistance to Spain.

5. The IEO report mistakenly attributes the start of a decisive decline in Irish and Portuguese spreads over German 10-year bonds to the Draghi announcement. Irish spreads began to decline and Portuguese spreads dipped in the summer of 2011 with the relaxation of the terms of European lending to Greece as well as to Ireland and Portugal; Portuguese spreads peaked in early 2012, well before the Draghi announcement, which appears to have affected only the Greek spread and only temporarily (IEO 2016, figure 3).

Table 1 Actual and projected recovery to previous real GDP peak in the euro area

Country	Year of precrisis GDP peak	Year in which precrisis peak was or will be reached	Number of years to reach precrisis peak
Crisis countries			
Cyprus	2011	2020(e)	9
Greece	2007	After 2021(e)	14+
Ireland	2007	2014	7
Italy	2007	After 2021(e)	14+
Portugal	2008	2020(e)	12
Spain	2008	2017(e)	9
Other euro area countries			
Austria	2007	2011	4
Belgium	2008	2010	2
Estonia	2007	2016(e)	9
Finland	2008	2020(e)	12
France	2008	2011	3
Germany	2008	2011	3
Latvia[a]	2007	2017(e)	10
Lithuania	2008	2014	6
Luxembourg	2007	2011	4
Malta	2008	2010	2
Netherlands	2008	2015	7
Slovak Republic	2008	2010	2
Slovenia	2008	2018(e)	10
Euro area	2008	2015	7
Other economies			
European Union	2008	2014	6
United Kingdom	2007	2013	6
Canada	2008	2010	2
Japan	2007	2013	6
United States	2007	2011	4

(e) = estimate

a. Latvia had an IMF program before joining the euro area.

Source: IMF, *World Economic Outlook* database, April 2016.

For comparison, in the debt crises of the 1980s, which were also compounded by a global recession, the 11 hard-hit South American countries plus Mexico recovered their previous peak levels of real GDP in an average of 5¼ years. For the 19 euro area countries, the projected average is more than 7 years, assuming that Greece and Italy recover by 2021, which most recent projections indicate they will not. The three large Latin American crisis countries (Argentina, Brazil, and Mexico) recovered on average within 7 years (Argentina in 12 years, Brazil in 5, and Mexico in 4), compared with a projected average of 11 years for the six euro area crisis countries.

For the euro area as a whole, real GDP regained its previous peak in 2015, seven years after the previous peak. Latin America and the Caribbean as a whole achieved the previous peak in three years (1984), and seven years after the crisis GDP was 13 percent above the previous peak. The IMF projects that by 2021 real GDP in the euro area will be 10 percent above the previous (2008) peak. In contrast, for Latin America and the Caribbean real GDP was 34 percent above the previous peak 13 years earlier.

Some observers contend that such comparisons are distorted because they do not take account of what was happening to population, the working-age population, or the labor force. But absorbing an expanding labor force during a recovery is an economic challenge.[6] Moreover, the 1980s are described as the "lost decade" for Latin America and the Caribbean, an underdeveloped region in the 1980s. In contrast, the euro area is composed of advanced countries, and over the past 10 years it has had many more economic and financial policy instruments and much greater capacity to pull out of its crisis.

It is difficult to avoid the conclusion that the economic decision makers in the euro area failed to recognize and act on what was a euro area crisis. Moreover, until late in 2011, the leadership of the IMF had not begun to call for euro area solutions to the collective crisis.

The IEO (2016, 45–46) is excessively coy on what should have been a central focus of its report on IMF policies. It should have been more forceful in holding the IMF accountable for having been late and inadequately imaginative in pressing euro area policymakers to be more aggressive in stimulating economic and financial recovery in the euro area economy as a whole.

The report does note precedents and also hints that the IMF could have been more proactive in advocating policy measures at the union level to support programs in member countries. A useful background paper by Ling Hui Tan (2016) reviews IMF experience with programs for countries that are part of currency unions. She points out that in 2012

6. For the record, during the nonrecovery of the euro area economy, its labor force declined. However, the decline was slight: The working-age population (ages 15–64) declined by 0.2 percent over the three years 2008–11 and by 0.9 percent over the seven years 2008–15. In contrast, for Latin America and the Caribbean, the working-age population expanded by 8.3 percent as the economy reached its previous peak, by 19.3 percent (close to the expansion in real GDP) seven years later, and by 38 percent (again close to the expansion in real GDP) 13 years later. During their recovery phases, the working-age population expanded by 1.4 percent in the United Kingdom, 2.0 percent in Canada, and 1.6 percent in the United States, which is hardly enough to distort the comparison with the euro area. Moreover, in Japan the working-age population declined by 5.8 percent. Data from the World Bank's *World Development Indicator*s, http://data.worldbank.org/data-catalog/world-development-indicators.

IMF staff, to their credit, raised the possibility of imposing union-level conditionality in the context of these euro area programs.[7]

Russell Kincaid (2016) also touches on these issues. He reports that the representatives of the Europeans and their institutions were most concerned about underappreciation of political and policy constraints on the Europeans and spillovers (with respect to sovereign and bank debt restructurings, for example) onto the euro area as a whole; IMF staff were more concerned about the harshness of the economic and financial terms placed on the three members of the euro area. In effect, the parties had different incentives. Both should have been faulted for their positions.

These two papers and the IEO report itself observe that IMF staff (IMF 2015) endorsed an interpretation of the IMF Articles of Agreement that suggests the Fund could impose conditionality on other members of a monetary union via associated policy commitments. The IMF staff and management appear to have acted in anticipation of the IEO report—aided by their lack of cooperation in facilitating the completion of that report (see below)—and moved cautiously to adopt an expanded approach to the application of conditionality in programs that involve currency union members. The IEO should have celebrated this fact in its report rather than burying it in a reference to the IMF (2015) policy paper. The report does raise some legitimate questions—in three paragraphs and two boxes in its 75 pages—about how the policy paper should affect the IMF's operations, but it largely let the IMF off the hook for failing to act more comprehensively during these crises.

EXCESSIVE POLITICAL INTERVENTION

The IEO report concluded that excessive political intervention constrained the options considered by IMF staff, management, and the executive board. Lagarde rejected that conclusion. In doing so, she did the IMF a disservice.

The IEO report's first recommendation is that "the Executive Board and management should develop procedures to *minimize the room for political intervention* in the IMF's technical analysis" (IEO 2016, viii and paragraphs 131–32; emphasis added to highlight that the recommendation/critique does not refer to the elimination of all political influence). In explaining the reason for her rejection, Lagarde said: "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."[8] In fact, the IEO report provides substantial evidence of unusually heavy political interference, primarily by the European authorities and institutions (see below). Lagarde's response reflects an implicit approval of political intervention in the euro area crises by European officials, including her own intervention while finance minister of France, as well as by other major IMF shareholders.

...the IEO report provides substantial evidence of unusually heavy political interference, primarily by the European authorities and institutions.

The IMF is a political institution because its members are governments. All IMF programs are subject to some degree of political influence. But there are shades of influence. The criticism in the IEO report is not that there was political influence in the euro area cases but that the degree of political influence was excessive.

In the negotiation of IMF programs, the political leaders of the borrowing countries try to constrain the depth and breadth of the programs, as they did in each of the euro area cases. IMF executive directors, representing their authorities, also have scope to influence programs in cases of systemic importance when they are briefed on the parameters of programs as they are being developed. The IEO report reveals that in the euro area cases, IMF management and senior staff largely blocked this channel, presumably with the active support of those executive directors who represented euro area countries. Political intervention came from euro area institutions and member countries to constrain the options IMF staff could consider in several aspects of these cases.[9]

7. She also notes that an earlier IEO report (2014) questioned the appropriateness of the ECB participating on both sides of the negotiating table.

8. Statement by the Managing Director on the Independent Evaluation Office's Report on the IMF and the Crises in Greece, Ireland, and Portugal, July 6, 2016, www.ieo-imf.org/ieo/files/completedevaluations/EAC__Statement_by_the_Managing_Director%20v2.PDF. In contrast, as conveyed in the Chairman's Summing Up (Executive Board Meeting 16/69, July 25, 2016, www.ieo-imf.org/ieo/files/completedevaluations/EAC__The_Chairman_s_Summing_Up%20v2.PDF), the executive directors were divided on this point. All accepted the principle. All believe that procedures have been strengthened but that more needs to be done. Some favored stronger procedures to ensure against potential political interference in the staff's technical analysis. Many noted the inevitable political economy considerations. All emphasized the "importance of preserving...[the Board's] ability to make informed decisions, based on the available policy options in a transparent manner."

9. There is no suggestion in the IEO report of disagreement by any European institution or euro area government with euro area

Excessive political intervention in these cases is related to both the fact that "in terms of financing, the IMF clearly was a junior partner" (IEO 2016, 43) and the use of the troika arrangement for coordinating how the cases would be addressed. The issue, however, is not that who pays the piper should call the tune but rather how that tune is played and whether it creates discordant reverberations in other parts of the orchestra.

The IEO report (2016, 43–44) makes three comments on this issue. First, it acknowledges that the IMF was a financial junior partner but declares that the troika functioned effectively as a coordination device.

Second, in terms of technical judgments, the IEO reaches the qualified judgment that the IMF staff did not "too easily" accept the constraints of the other two parties and "often held its ground"—often but apparently not always.

> IEO interviews and some internal documents suggest that political feasibility in *creditor countries* was an important consideration for EC [European Commission] staff and that IMF staff 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. (IEO 2016, 42, emphasis added)

Political feasibility in creditor countries rarely plays such a decisive role in the fundamental design of IMF programs relating to fiscal adjustment, bank restructurings, or sovereign debt restructurings.

Third, "serious conflicts arose at a higher, political, level." The report clearly documents that, in the Greek and Irish programs, authorities other than those in the countries involved prevented the IMF staff from presenting certain options to the executive board either informally or in proposed programs. In the case of Greece, consideration of debt restructuring in May 2010 was ruled out before the IMF was invited to participate in the program, and IMF managing director Dominique Strauss-Kahn accepted that position (see below). In the case of Ireland, a write-down of debt held by senior unsecured bondholders of at least some Irish banks, such as those in resolution, similarly was ruled out.

In both cases, the European position was in accord with the position of the United States and presumptively the other countries in the G-7 (Canada, Japan, and the United Kingdom for most of these purposes). Both decisions may have been right. I was in favor of the decision not to restructure Greek sovereign debt at the start of its program. Moreover, as the IEO report notes, consultation with major shareholders is standard practice. As I used to say when I was a US official offering guidance on IMF programs, "The world is round." The crucial point is that IMF management and senior staff did not follow standard practice in briefing the executive board about these policy constraints or flushing out members of the board whose authorities were seeking to impose those constraints.

The IMF's failure to complete the ex post review of Portugal's program within the timeframe mandated by the Fund's policy on exceptional access to financial resources (discussed below) further suggests political interference by Portugal and acquiescence by IMF management and staff that does not appear to involve encouragement by major IMF shareholders.

The excessive exercise of political intervention in the euro area crises is symptomatic of another central message of the IEO report: Before the crises, IMF staff and management were locked in a mindset that Europe is different. Consequently, members of the European Union—particularly the euro area—received privileged treatment in reviews of their individual and collective policies, including during the design of programs for countries in crisis. Unstated in the report, but obvious to any impartial observer, is the fact that Europe's overrepresentation on the IMF executive board and in voting power in the IMF, along with the fact that the managing director at the time, Dominique Strauss-Kahn, was not only a European but also a presumptive candidate for the presidency of France, led to disproportionate influence on IMF staff and management. One can only hope that, despite Christine Lagarde's unwillingness to acknowledge the evidence in the IEO's report, she and the IMF staff will learn these lessons in their management of attempted and actual, excessive political intervention in IMF decision making in the future.

TRANSPARENCY AND ACCOUNTABILITY

IMF staff and management failed to cooperate with the preparation of the IEO report, almost certainly because of excessive political interference or excessive political sensitivity. Why else would they have not followed standard procedures?[10] This failure, in turn, has undercut the IMF's

decisions, with the possible exception of the countries whose programs were involved and which were excluded from these preprogram deliberations.

10. It is my understanding that the resistance to providing the documentation and information that the IEO received from IMF staff in preparing this report was unprecedented in the IEO's experience.

accountability. The IEO report (2016, viii) documents the agency's struggle to obtain the necessary documentation from the IMF to complete its report in a timely manner:

> 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.

The IEO had prepared a near final draft of its main report, in which it noted the failure of the IMF staff to cooperate in providing requested documentation, presented it to an outside panel for review, and circulated it to the Fund staff for comments before the IMF managing director intervened at the IEO's request to direct the staff to provide additional requested documents to the IEO. However, even after the managing director's intervention, the IEO was unable to attest that it had seen all the relevant documents (IEO 2016, 5).

Consequently, in the section of the IEO report on the decision to provide financial support to Greece, the IEO (2016) report states:

> The IEO has seen some, but not all, of the written documents prepared by these groups [working on various contingencies for a Greek program]. (p. 16)

> 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…. (pp. 16–17)

IMF staff roadblocks to IEO access to documents unnecessarily delayed the completion of the IEO's report and its potential contributions to improving the work of the IMF. Although Lagarde stepped in to aid the IEO inquiry at a late date, she and her management colleagues must share some of the blame for the behavior of the staff, in particular the senior staff, in the failure to provide necessary documentation. Senior staff (department heads) are the only people in the IMF who have the power to sanction such a departure from standard procedures. The IEO report (2016, 50) highlighted this as one of the major lessons in its review:

> 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….

> 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.

The IEO conclusions are cloaked in understatement but the message is clear: The IMF management and staff failed a test of transparency and accountability, which was the purpose for which the IEO was established.

It would be a reasonable surmise that other interested parties (or their representatives) close to but outside the IMF played a part in this sorry story. Wherever the support came from, withholding information from the IEO by IMF management or staff is inconsistent with the terms of reference for the director of the IEO:[11]

> The [IEO] Director may consult with and shall have the right to obtain information from members of Management and staff to carry out the work program of the IEO, except to the extent that the information requested is subject to the attorney-client privilege.

The IMF managing director's response to the IEO's recommendation on this important matter is disturbing: "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."[12] Where is the admission that the commitment to accountability, transparency, and the role of the IEO fell short in this instance? At least the executive directors, in the highly stylized summing up of their views on the IEO evaluation, "noted with concern the difficulty that the IEO had experienced in obtaining confidential

11. IEO Terms of References, ibid.

12. Statement by the Managing Director, ibid.

documents that it deemed necessary for conducting the evaluation in a timely manner."[13]

It is less than clear where the IMF and the IEO will take this matter. A footnote to paragraph 128 on page 50 of the IEO report states that "The IEO is currently working with [IMF] staff to develop a clear protocol [for access to documentation] for future evaluations." This is diplomatic obfuscation. The IMF senior staff appear to be attempting to roll back transparency and accountability at the IMF.

Since the IEO was established, methods of operation of all organizations large and small have changed. In particular, communication that once was primarily by hard copies of memoranda is now by email. Papers that once were generally complete drafts of documents, residing in files, are frequently in electronic flux. For some, this evolution may imply that the definition of a document is ambiguous and underlies the IEO request for clearer guidelines on the definition of records, in particular records of informal meetings of the executive board. But most organizations subject to internal or external scrutiny and associated document retention rules have adopted clear definitions: All communications and drafts are documents and the originators and recipients are obligated to preserve those documents. It follows that independent evaluators should have access to all such records.

In the case of the evaluation of Portugal's program, the IMF is violating one of the core provisions of its policy on exceptional access to IMF financial resources.

Unless the IMF executive board chooses to change the basic terms of reference for the IEO, which would represent a major reversal in IMF transparency and accountability, any clarifying protocol between the IEO and IMF staff should be simple:

- It should reaffirm that the IEO will have access to all relevant documentation in the modern sense of that term.
- If IMF staff want to limit access to any documentation, they should have to request approval from the managing director.
- If the managing director grants approval to such a request or otherwise limits IEO access, the IEO should have the right to appeal to the executive board to which it is responsible for its reports. (The IEO reports to the executive board and is not accountable to the management and staff of the IMF.)
- With respect to documents prepared by other entities, such as representatives of the European Union or the European Central Bank in the euro area cases, those materials, even if regarded as confidential by the originator, should be available to the IEO on the same terms of confidential treatment as any IMF materials, even if those institutions have less progressive policies on transparency and accountability. That should be a sine qua non of cooperation by the IMF with other organizations.

As mentioned above, the IEO report highlighted another area where the IMF failed in transparency and accountability with respect to the euro area crises. It is not likely to attract as much attention but is, nevertheless, serious:

> 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 [International Monetary and Financial Committee]. Preparation of the ex post evaluation of Portugal's EFF [Extended Fund Facility]-supported program, which should have been completed by June 2015, was still ongoing as of May 2016. (IEO 2016, 50)

The IMF staff and management's relationship with the International Monetary and Financial Committee (IMFC) is convoluted and complex. No doubt, some of the same bureaucratic and political forces that impeded the IEO report are relevant to those delays. But failure to respond promptly to a request from the IMFC is a matter internal to the IMF that does not bear as directly on its transparency and accountability as the failure to produce the ex post evaluation of Portugal's IMF program on a timely basis.

In the case of the evaluation of Portugal's program, the IMF is violating one of the core provisions of its policy on exceptional access to IMF financial resources (relative to a member's IMF quota).[14] The policy requires ex post reviews

13. The Chairman's Summing Up, ibid.

14. In the background paper prepared for this IEO evaluation, Susan Schadler (2016, 3), maintains that the policy on exceptional access contained four "relatively uncontroversial" procedural components and four substantive components. Her contention overlooks the fact that all high-profile IMF policies take many years to develop, and the initial decision on this policy took more than three years to develop, involved compromises,

of all programs involving exceptional access within a year of the completion or termination of such a program. This provision is integral to the policy that also enshrines the criteria on exceptional access that are at the center of much of the debate about the programs for the euro area countries, in particular the guideline that a borrowing country's sovereign debt should be judged to be sustainable over the medium term with a high probability (see below).

The ex post review of the first Greek program was completed and released in June 2013, about a year after the program was terminated in March 2012. The Irish program was completed in December 2013 and the ex post review completed and released in January 2015. The Portuguese program ended in June 2014 more than two years ago, and its ex post review is now 15 months overdue.

...on transparency and accountability, which are crucial to the Fund's integrity and credibility, the IMF management and staff have failed.

The IMF is in violation of its policy on exceptional access. To their credit, the executive directors made an oblique reference to this failure in the summary of their discussion of the IEO report: "They also underlined the importance of timely preparation of Ex-Post Evaluations of all exceptional access arrangements."[15]

One can reasonably suppose that the IMF staff and management have bowed to Portuguese political pressure to delay completion of the ex post review. The governor of the central bank of Portugal, Carlos da Silva Costa, wrote a letter to the IEO stating his objections to the background paper to the IEO report prepared by my colleague Nicolas Véron (2016) after it had been circulated to the Executive Board and insisted that his letter be included with the posted copy of the paper.[16]

In summary, on transparency and accountability, which are crucial to the Fund's integrity and credibility, the IMF management and staff have failed. They failed to keep the executive board informed about their thinking. They failed to provide the necessary information promptly and completely for the IEO's review of these programs. They failed promptly to conduct an ex post review of the Portuguese program. One can only hope that the IMF management and staff have learned lessons from this sorry history and in the future demonstrate their commitment to transparency and accountability more persuasively.

THE GREEK DEBT RESTRUCTURING AND IMF POLICY ON EXCEPTIONAL ACCESS

The IEO deserves plaudits for how it addresses the Greek debt restructuring in its report on the crises in Greece, Ireland, and Portugal. The report does not take a position on whether Greece's debt should have been restructured at the start of its program in May 2010 (the fact that press stories on the report have not highlighted this part of it is testimony to the IEO's balanced treatment). This was a wise and understandable approach. The decision not to restructure Greek debt in May 2010 is and will remain controversial, and the IEO report could have added nothing to the debate if it had presented the judgment that the decision was either right or wrong. Instead, the report lays out the process by which the decision, or nondecision, was reached by the IMF management and staff.

According to the IEO report (2016, 16), the IMF staff was "almost evenly split" (whatever an even split means in this context) and describes the three positions on an immediate restructuring: (1) not necessary with a strong program, (2) desirable and feasible to ensure that Greek debt was sustainable over the medium term, and (3) infeasible or too risky given time constraints. Europeans had already taken a position on the issue of restructuring the Greek debt before the IMF was asked to participate in the program for Greece.[17] Managing Director Strauss-Kahn agreed to go along, ending the internal IMF staff debate.[18] The IEO evaluation team consulted experts on this point and they had a similar range

and in the end was accepted only as an integrated package. The requirement of an ex post evaluation was a hard-fought-over mechanism to increase the transparency and accountability of IMF policies and deliberations. As evidence, note that the full furor over the initial decision to not restructure Greek sovereign debt was unleashed only when the report on the first Greek program (IMF 2013) was prepared and released in compliance with this policy.

15. The Chairman's Summing Up, ibid.

16. The Véron paper criticizes the IMF for not including in the Portuguese program a thorough cleanup of its banking system. This problem has continued to plague Portugal.

17. The report does not reveal what the Greek government's position was, but it would not be unusual for a government to oppose debt restructuring at the start of an IMF program. The temptation for governments is to believe that all will be well and they will soon be back in the market. The IMF's ex post review of the first Greek program (2013) also is not definitive on this point, but it reports that the Greek authorities stated on the eve of the program that a restructuring proposal had not been made by the Fund and was off the table for the Greek government.

18. As noted earlier, he also went along with the European and G-7 position not to force a bail-in of unsecured creditors of some of the Irish banks.

of ex post views (IEO 2016, 18). The IEO opines that the diversity of views on this issue is colored by views about the relative weight that political and technical considerations should receive in the design of IMF programs. The implication is that if the weight accorded to political judgment had been lower, the technocrats might have insisted successfully upon a restructuring at the start of the Greek program. Who is to tell?

As I said in congressional testimony at the time,

> Some observers advocate an immediate adoption of an alternative approach that would involve a restructuring in which the stock of Greek government debt would be written down. A restructuring may ultimately be necessary, but it is not a cheap or easy way out. The broader negative ramifications for the world economy and financial system could be severe right now while the recovery is still fragile. Moreover, if there is to be a restructuring of Greek debt, it should be a one-time event, and its appropriate dimensions are obscure right now.[19]

My view was aligned with that of my late colleague Michael Mussa,[20] which had been posted three days earlier.

Susan Schadler (2016, 16–17), who, before being asked to write a background paper for the IEO, had strong, well-known views on questions of substance and procedure with respect to the restructuring Greek debt in May 2010 that are reflected in her paper, reports that "It is not apparent that any analysis [in the Fund] considered an orderly restructuring of the type advocated by restructuring experts outside or inside the Fund." According to her paper, these experts said the restructuring could have been achieved within five to six months.[21] Subsequent history provides a convenient counterfactual. (It took much longer than five to six months and the restructuring was insufficient.)

Consideration of any restructuring of Greek sovereign debt was unnecessarily delayed by the same European forces that prevented consideration of a restructuring in May 2010, a fact that is not even mentioned in the IEO report. The Europeans effectively prevented the IMF from tabling the debt restructuring option until a year later, well after many more observers had concluded it would be necessary. Under IMF prodding, on May 17, 2011, European finance ministers—over the apparent objections of the ECB—accepted that Greece should talk with its bondholders about extending the repayment schedule on its debt. On July 21, 2011, euro area leaders endorsed a German government–fostered restructuring with a 21 percent haircut along with additional official sector financial support. The IMF subsequently reached the judgment that this proposal did not provide adequate financial support. Final official agreement on the outlines of a viable package was, consequently, delayed until October 26 when EU leaders endorsed pursuit of a 50 percent haircut on bonds held by private investors. A final agreement was not reached until February 21, 2012; it took a couple of more months to implement fully.

In light of subsequent developments, and despite further concessions by official holders of Greek debt, the size of the 2012 restructuring has proved in the IMF view to be insufficient to ensure the viability of a Greek recovery with a debt burden that would be sustainable. As of late-2016, the disagreement between the euro area and the Fund has not been resolved. This history demonstrates that an orderly restructuring was next to impossible in five to six months. It also underscores my view in May 2010 that the size of any initial restructuring would have been inadequate.[22]

Returning to the IEO report, it is right to criticize the process that was followed in the decision not to restructure the Greek debt at the start of the program. The report also is right to criticize IMF management and senior staff for how they squared the circle on debt sustainability: In the request to the executive board for approval of the Greek program, they slipped in a substantial modification of the IMF's policy on exceptional access to financial resources (relative to a member's quota) without prior notice to or discussion with the board. This action by IMF management is not news to who have followed this caper closely, but for

19. Edwin M. Truman, The Role of the International Monetary Fund and Federal Reserve in the Stabilization of Europe, testimony before the US House Committee on Financial Services Subcommittee on International Monetary Policy and the Subcommittee on Domestic Monetary Policy and Technology, May 20, 2010, Washington, www.piie.com/commentary/testimonies/role-international-monetary-fund-and-federal-reserve-stabilization-europe (accessed on August 10, 2016).

20. Michael Mussa, "Beware of Greeks Bearing Debt," PIIE RealTime Economic Issues Watch blog, May 17, 2010, Peterson Institute for International Economics, www.piie.com/sites/default/files/publications/papers/mussa201005.pdf (accessed on August 24).

21. A large debt service payment by Greece was due later in May 2010. It might have been paid during negotiations. But if the creditors had granted Greece a waiver, or allowed Greece to declare a standstill with the implicit blessing of the IMF and major shareholders, the result would have been disorderly.

22. The summary in this paragraph is based primarily on the timeline in the IEO report (2016, 56–68) and my memory of press reports during the summer of 2011 about the initial package structured by Deutsche Bank with the blessing of German chancellor Angela Merkel, which was generally interpreted as designed to limit the impact on that bank. My history differs from the account by my colleague William Cline (2014, 186–88). He argues, with some merit, that with sufficient fiscal and reform effort—and, he might have added, a more favorable external environment—the July 2011 package was viable. However, none of those conditions prevailed.

those less deeply involved it is worth quoting the IEO report (2016, 20):

> The proposal to change the exceptional access framework [by incorporating an exception in systemic cases] was embedded in the staff report for the Greek SBA [stand-by arrangement] request, and Executive Directors received no advance notice that such a change was forthcoming. [Footnote in the IEO report: The initial note that was circulated to the Board on April 15, 2010 included a preliminary assessment that the four criteria were not 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.] While several Executive Directors had noticed the two sentences tucked into the text on Greece's overall adherence to the exceptional access framework, few recognized the implications of the decision until one of them raised the issue during the meeting.[23]

The proposed "systemic exception" allowed the staff to say that Greece's debt would not be sustainable with a high probability and allowed the program to go forward without a restructuring. This was a gross failure in transparency and normal processes that the IEO report appropriately criticizes.

What is missing from the IEO report is an assessment of the argument that time was needed to build firewalls against future crises in the euro area associated with a restructuring of the Greek debt in May 2010. The report criticizes IMF management and staff for not having advanced sufficient evidence of potential contagion to other countries from a restructuring event. Given the market impacts triggered by the October 2010 French-German agreement in Deauville—that there should be a framework in future crises requiring sovereign debt restructuring if there was multilateral assistance to a euro area, which the IEO report documents (IEO 2016, p. 28, footnote 49)—this criticism of the May 2010 judgment was not confirmed by subsequent facts. Indeed, although the IEO report fails to mention it, many involved at the time felt that the French-German agreement helped to drive Ireland and later Portugal into their own financial crises (Orphanides 2014).

Moreover, the firewall metaphor has been embraced without semantic precision. Were the construction of the temporary European Financial Stability Facility, the ad hoc European Financial Stabilization Mechanism, and the permanent European Stability Mechanism designed to damp the fire in the country of origin, to manage the fire if it spread to other countries, to prevent its spread, or all three? If to contain the blaze, then the firewalls should have provided more money to Greece on substantially easier terms at the start. If to manage or prevent the spread of the blaze, then the firewall failed. A much larger construction would have been needed, as the United States argued throughout the crisis period, often to the consternation of IMF management, which was intent on bolstering its own resources, largely from European sources but by means that did not require political decisions in those countries. If all three objectives were to be served, then all contingencies should have been adequately covered, but none was. Euro area politicians were trying to address their crises on the cheap and the IMF, which wanted to maintain its own role in the crises, aided in the subterfuge. Unfortunately, the IEO report is silent on the IMF's position on the size and policy purpose(s) of the European firewalls.

To its credit, however, the IEO report does remind readers that the systemic exception also was invoked for Ireland and Portugal. The IMF staff were unable to conclude at the time that their programs were approved that these countries' public debts would prove to be sustainable with a high probability, but for them restructuring was not subsequently required (IEO 2016, 15, paragraph 29).[24] In other words, the systemic exception, which by construction was based on systemic concerns, was clearly not the wrong course to take from the narrow perspective of these two countries that avoided the stigma of a debt restructuring.

On the other hand, the IEO report (2016, 20, paragraph 42) is on less solid ground when it states that "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." The IMF's policy on exceptional access had evolved over more than a decade. It provided executive board guidance to staff and management.[25] The policy was not a provision embedded in the IMF's articles of agreement. It was a constructed interpretation of one of those articles that can be and has been challenged.[26] The executive

23. The US executive director at the time, Meg Lundsager, told me that she was informed. Then-US Treasury undersecretary for international affairs Lael Brainard, who was deeply involved in G-7 discussions at the time, told me later that she thought the IMF staff had concluded that the Greek debt was sustainable. This is consistent with the IEO report (2016, fn 38), which reports that this was the information in the IMF staff communication with the executive board on April 15, 2010. In this case, the US authorities were not party to the decision by the IMF management.

24. As noted above, the revision in terms of European lending (also known as "official sector involvement") played a substantial role in improving the debt profile of Ireland and Portugal.

25. See footnote 14.

26. Edwin M. Truman, "When Should the IMF Make Exceptions:

board had the authority to amend the policy, as it had in the past (for example in 2009), and it did so in May 2010. What was undermined by the action in May 2010 was the decision-making process of the IMF, not the purpose for which the framework had been designed.

The IEO report (2016, 20 and 53) is also on thin ice in appearing to bless the executive board's removal of the systemic exemption from the IMF's policy on exceptional access to the Fund's financial resources in January 2016.

The IMF was effectively blackmailed by the US Congress into repealing the systemic exemption.

The timing of this decision was outside the time period on which the report was intended to focus.[27] Again, the process followed by the IMF was extraordinary although in this case papers had been presented to and discussed by the executive board. The IMF was effectively blackmailed by the US Congress into repealing the systemic exemption. The Consolidated Appropriations Act of 2016 (sections 9002 and 9005)[28] conditioned the US Treasury secretary's implementation of the Congress' approval of the 2010 package of IMF governance reforms, which was required by US law, on the IMF executive board's repeal of the systemic exemption.[29] A majority of IMF executive directors were willing to do so, but this was an unprecedented exercise in political interference. The executive board can be expected to be less willing to submit to the will of the US Congress when it next tries to exert direct influence on a major IMF policy issue.

The authors of the IEO report (2016, 53, paragraph 133) volunteer that the January 2016 decision

> 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.

The authors are right about the room for discretion in the new decision. The discretion is somewhat constrained. Under the January 2016 criteria for exceptional access, the IMF may approve a program only if financing from other sources improves debt sustainability, even if it is not judged to be sustainable with a high probability, as long as it "sufficiently enhances the safeguards for Fund resources" (IMF 2016, 8). Time will tell how much judgmental wiggle room the decision leaves in practice.

Some observers, such as my colleague Olivier Blanchard,[30] have praised the January 2016 decision because it effectively reopens the door for the IMF to use a restructuring tool that was already available and has been used before, an immediate reprofiling of debt as a temporary measure. The problem with this tool is that, depending on the circumstances, its use could trigger the same type of contagion that any other restructuring might produce. Holders of short-term debt in the form of trade credit and money-market lines for countries viewed to be similarly placed are likely immediately not to rollover those claims for fear that they would be next to be caught up in a reprofiling. A run would have been launched by the initial reprofiling decision.

My forecast is that the IMF will not in the next decade approve a program that involves exceptional access to IMF resources with any kind of restructuring, whether a reprofiling or something more aggressive, if the country's public (external and internal) debt is judged not to be sustainable with a high probability. Instead, the IMF will either make a judgment that additional financial support from some other source "safeguards the Fund resources" or make another exception to its access policy, which requires only a majority vote. It is for this reason that I believe the IEO made a mistake in opining at all and, in particular, favorably on the January 2016 decision. It is likely that the IEO will be forced to eat its praise in another report down the road.

Part I," PIIE RealTime Economic Issues Watch blog, March 31, 2015, (accessed on August 25, 2016); "When Should the IMF Make Exceptions: Part II," PIIE RealTime Economic Issues Watch blog, April 1, 2015, (accessed on August 25, 2016).

27. It was clearly outside the terms of reference of the Schadler (2016, 9) paper (on the 2010 stand-by arrangement with Greece that was cancelled in 2012), but she too comments on the matter.

28. Available at www.congress.gov/114/bills/hr2029/BILLS-114hr2029enr.pdf.

29. Edwin M. Truman, "IMF Governance Reform: Better Late than Never," PIIE RealTime Economic Issues Watch blog, December 16, 2015, Peterson Institute for International Economics, www.piie.com/blogs/realtime-economic-issues-watch/imf-governance-reform-better-late-never (accessed on August 24, 20164).

30. Olivier Blanchard, "An Important IMF Reform," PIIE RealTime Economic Issues Watch blog, February 12, 2016, Peterson Institute for International Economics, www.piie.com/blogs/realtime-economic-issues-watch/important-imf-reform (accessed on August 10, 2016).

CONCLUSION

The IEO report on the IMF's handling of four of the six euro area crises to date is important and revealing about both the IMF and the IEO. It is not necessary that I or any other reader consider it perfect.

The report's conclusion that there was excessive political influence exercised in these crises is convincing, despite the denials from Lagarde and others. The IEO's indictment of the IMF management and staff for insufficient transparency in cooperating with the IEO on the timely preparation of the report is devastating and disturbing to anyone who favors transparency and accountability in our institutions. The report is scathing in its indictment of the mindset that prevailed at the IMF before and during—and, one fears, persists after—these crises that Europe is different and deserves different treatment. The report clarifies the circumstances surrounding the IMF's nondecision not to require an initial restructuring of Greek sovereign debt in May 2010.

At the same time, the report pulls its punches on the IMF's failure to recognize at an early date that the debt crises in the six euro area countries (not all of which were covered in this report) amounted to a euro area crisis and required a common euro area program. The report is too easy on the IMF for not promoting substantial restructuring of Greek debt earlier than the middle of 2011. And the IEO was mistaken to bless the January 2016 revision of IMF policies on exceptional access to Fund resources.

In my reading of the report, the principal policy lessons for the IMF are the following:

- The IMF must better constrain political interference in its technical work and coordination of policy options and must respect the role of the executive board in the process.
- The IMF must recognize the errors that it made with respect to transparency and accountability in these cases and take convincing steps to ensure that it does not happen again.
- In the future, if a member of the euro area asks for IMF financial assistance, the Fund must focus on euro area policies in its program response.

Euro area policymakers should derive lessons from the IEO report as well, but they are a topic for another time.

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