

Executive Summary

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

Key Findings and Lessons

Surveillance

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

Decision making

In May 2010, the IMF Executive Board approved a decision to provide exceptional access financing to Greece without seeking preemptive debt restructuring,

even though its sovereign debt was not deemed sustainable with a high probability. The risk of contagion was an important consideration in coming to this decision. The IMF’s policy on exceptional access to Fund resources, which mandates early Board involvement, was followed only in a perfunctory manner. The 2002 framework for exceptional access was modified to allow exceptional access financing to go forward, but the modification process departed from the IMF’s usual deliberative process whereby decisions of such import receive careful review. Early and active Board involvement might or might not have led to a different decision, but it would have enhanced the legitimacy of any decision.

Working with European partners

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

Program design and implementation

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

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

Accountability and transparency

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

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

reviews involving euro area programs on time, as mandated, which led to missed opportunities to draw timely lessons.

Recommendations

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

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

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

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

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