

LESSONS FROM THE IMF'S BAILOUT OF GREECE

HEARING BEFORE THE SUBCOMMITTEE ON MONETARY POLICY AND TRADE OF THE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED FIFTEENTH CONGRESS FIRST SESSION

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LESSONS FROM THE IMF'S BAILOUT OF GREECE

Thursday, May 18, 2017

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONETARY
POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Andy Barr [chairman of the subcommittee] presiding.

Members present: Representatives Barr, Williams, Huizenga, Hill, Davidson, Tenney, Hollingsworth; Moore, Foster, Kildee, Vargas, and Crist.

Ex officio present: Representative Hensarling.

Also present: Representative Maloney.

Chairman BARR. The Subcommittee on Monetary Policy and Trade will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Lessons from the IMF's Bailout of Greece."

I now recognize myself for 5 minutes to give an opening statement.

This morning's hearing, "Lessons from the IMF's Bailout of Greece," will examine the International Monetary Fund's financial assistance to the country of Greece, one of the largest and most controversial rescues in the Fund's history.

Under normal access rules, the IMF had traditionally lent up to 200 percent of a country's quota per year. When the eurozone crisis hit, the Fund in 2010 approved an exceptional access program for Greece worth 30 billion euros or 3,200 percent of quota to supplement the eurozone's own contribution of 80 billion euros.

In 2012, the Fund approved a second program worth over 2,000 percent of Greece's quota with more than 18 billion euros in new money.

Many observers, including on this committee, were critical of the Fund's use of a so-called systemic exemption which was created in order for Greece to tap exceptional access lending. This exemption claimed that potential spillover effects from a Greek meltdown compelled the Fund to waive its requirement that a member's debt be sustainable with a high probability before the Fund lent money.

Thanks to pressure from Congress, the systemic exemption has since been repealed, but this shouldn't obscure the fact that the

Greek bailout has made a mockery of other IMF lending rules, too, as findings from the IMF's own Evaluation Office have made clear.

Despite receiving exceptional access, Greece remains mired in recession with youth unemployment approaching 50 percent. The IMF likes to speak of the catalytic role its financing can play in borrowing countries, but in Greece at least, the Fund's resources have catalyzed nothing. Seven years after the IMF's first program, Greece's debt has worsened and is judged by the Fund as down-right unsustainable.

Today, the eurozone has set up its own bailout fund, the European Stability Mechanism, or ESM. It possesses more resources for just 19 eurozone countries to borrow than the IMF can deploy for the entire world.

At the same time, Greek capacity remains as doubtful as ever with falling rates of tax collection, government arrears to domestic firms, and even the prosecution of the former head of Greece's statistical office, something widely viewed as a politically motivated witch hunt.

In light of these facts, it is shocking that the IMF is now considering a third bailout for the country as a junior partner to the ESM. No one, not even the Europeans, pretends that the Fund's financial assistance is needed. Rather, it is meant to protect eurozone politicians as they head to elections this year.

It is common knowledge that the IMF's contribution would be symbolic. But if that is the case, the Fund may be on its way to becoming a symbolic institution. So make no mistake, if the IMF goes forward with a third Greek bailout, it will suggest that the Fund has learned little from past experience, that its role as a lender of last resort is in jeopardy and that its decision-making has been hopelessly politicized.

The Fund will have no one to blame but itself if Congressional scrutiny of its activities tightens accordingly, including through future consideration of IMF governance reviews.

As for those who claim that any IMF member including Greece retains at least some right to borrow, we should refer to the IMF's Articles of Agreement which contain explicit provisions to limit loans or render a member ineligible to receive them. The articles stipulate that assistance shall be temporary and designed to meet balance-of-payments problems provided that there are adequate safeguards.

I would submit that 7 years and counting does not qualify as temporary, and that having the IMF and ESM hand money back and forth to each other is not the kind of balance-of-payments crisis that IMF members pay their quota for.

As for adequate safeguards, Greece is the first and only advanced nation to ever default on the IMF. And last year's alleged wire-tapping of IMF officials in Athens suggests that good-faith agreements are unlikely. With the eurozone attempting as we speak to force the IMF to water down its demands for debt relief, another safeguard is at risk of being made meaningless.

In short, nothing less than the Fund's integrity and adherence to its foundational principles is at stake here. I look forward to our witnesses' testimony and I thank them for their participation at this hearing.

I yield back the remainder of my time.

And the Chair now recognizes the ranking member of the subcommittee, the gentlelady from Wisconsin, Ms. Moore, for 5 minutes for an opening statement.

Ms. MOORE. Good morning, Mr. Chairman, and my colleagues.

Today is yet another exceptional day where we are going to be taken to school with our distinguished panel of experts, including our own Dr. Nelson from the Congressional Research Service.

I want to thank you for appearing.

And I think we are going to learn, Mr. Chairman, about the important role of the International Monetary Fund. This work is neither straight, nor is it easy. We are seeking here on this committee to evaluate the IMF's roughly \$32 billion contribution to the first Greek rescue package in 2010 through the exceptional access framework, the largest fund in history aimed at avoiding a Greek default and stemming contagion in the eurozone and more broadly.

The eurozone crisis has revealed flaws in the architecture of Europe and whether Greece is in or out makes a compelling case for further economic integration, flaws that include flaws created for the benefit of European banks.

Moreover, how the crisis is handled may speak volumes for the future of Europe and the eurozone with important economic, political, and security implications, both in the United States and globally.

I realize that these are complicated issues, and I have my thoughts and opinions, but I will reserve those because I am truly interested in hearing from our expert witnesses.

There are two things I would like to say: the role of the IMF in these situations is vital; and ongoing analysis and research that they provide is irreplaceable. And so I hope that we can evaluate the facts surrounding these events that were made looking forward through the fog of economic uncertainty when there are no perfect answers and not with the full benefit of hindsight.

And with that, Mr. Chairman, I yield back the balance of my time.

Chairman BARR. Thank you.

Today, we welcome the testimony of Paul Blustein, senior fellow at the Centre for International Governance Innovation. He is an award-winning journalist and author. His most recent book is, "Laid Low: Inside the Crisis That Overwhelmed Europe and the IMF." Mr. Blustein earned his undergraduate degree from the University of Wisconsin, and his master's degree from Oxford University.

Meg Lundsager is—

Ms. MOORE. Can I—do you yield?

Chairman BARR. Sure, Wisconsin.

Ms. MOORE. Come on now, this is a well-educated panelist. I just want to point that out.

[laughter]

Chairman BARR. You have a fellow Badger in the house.

Meg Lundsager is a public policy fellow at the Woodrow Wilson International Center for Scholars, and a former U.S. executive director and alternative executive director at the International Monetary Fund. Additionally, she is a former Deputy Assistant Sec-

retary for Trade and Investment at the U.S. Treasury Department. She has a master's degree from the University of Maryland, and a bachelor's degree from American University.

Anna Gelpern is a professor of law at Georgetown University Law Center, and a non-resident senior fellow at the Peter G. Peterson Institute for International Economics. She earned her bachelor's degree from Princeton University, her J.D. from Harvard University, and her master's degree from the London School of Economics and Political Science.

Dr. Rebecca Nelson is a specialist in international trade and finance at the Congressional Research Service where she focuses on the International Monetary Fund, the multilateral development banks, and other policy areas related to international economic affairs. Dr. Nelson earned her bachelor's degree from Johns Hopkins University, and her Ph.D. from Harvard.

Each of you will be recognized now for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Mr. Blustein, you are now recognized for 5 minutes.

**STATEMENT OF PAUL BLUSTEIN, SENIOR FELLOW, CENTRE
FOR INTERNATIONAL GOVERNANCE INNOVATION**

Mr. BLUSTEIN. Thank you very much, Mr. Chairman, Ranking Member Moore, and members of the subcommittee. Thank you very much for the opportunity to provide my perspective at this hearing about a complex, but very important topic.

The IMF's role in the bailout of Greece is rich in lessons about the workings or non-workings of the international financial system and has immense implications for the future of the global economy.

I have made something of a career of writing books, behind-the-scenes books, journalistic narratives about the IMF and financial crises. And when I wrote a book about the Argentine crisis of 2001–2002, I thought I had chronicled the IMF's greatest debacle ever. But financial crises are kind of a gift that keeps on giving to people like me and along came the Greek crisis, which has, I would argue, been even worse, both for the country and for the Fund's reputation.

So I got to write another book, the title of which you kindly mentioned, Mr. Chairman. I will mention it again, if you don't mind. It is, "Laid Low: Inside the Crisis That Overwhelmed Europe and the IMF."

Let me begin with a tidbit from that book. I think we are going to get this thrown up on the slide here. Yes, okay. And I know we have time constraints, so this will be my only tidbit, I promise. But this is a memo, a confidential memo that was written by Olivier Blanchard who was then the IMF's chief economist. And he wrote this in May 2010 as the first bailout of Greece was nearing finalization. So this memo may be a little hard to see on the screen, I don't know, but the essence of it is he is saying this isn't going to work.

The bailout, just some details, was the largest in history at that time, 110 billion euros in emergency loans, 30 billion of which was to come from the IMF, the purpose being so that Greece could pay off all its obligations coming due over the next couple of years, re-

assure markets on that point, and avoid a catastrophic default on its debt.

And in return, Greece was expected to drastically cut its government spending and budget deficit. And to get itself out of recession and growing again, the Greeks were supposed to implement a very large number of structural reforms, for example streamlining the notoriously inefficient state-owned enterprises, the state railways for example.

So I have underlined sort of the money bits of Blanchard's memo. He says the degree of budgetary belt-tightening required of Greece has never been achieved by any other country. Furthermore, "even with full policy compliance, there is nothing that can support growth against the negative contribution of the public sector. The recovery would likely be L-shaped with a recession deeper and longer than projected."

It then goes on to say the program is likely to go, "off track, even with perfect policy implementation." So to put that in a bit plainer English, what he was saying was that even if Greece did everything that was being asked of it, fulfilled all the conditions, the Greek economy would sink further and the rescue program wouldn't work.

Now, Blanchard doesn't say so explicitly in this memo, but the clear implication is that Greece would need a large amount of debt relief much sooner rather than later. But powerful European policymakers were vehemently opposed at that time to giving Greece any debt relief and the rescue went ahead as per the original plan, a gigantic loan with conditions. And when Greece finally did get debt relief in 2012, it was too little, too late.

And this was typical of a syndrome that plagued the IMF during the eurozone crisis. The Fund joined in several rescues despite grave misgivings among top economic and legal officials there and also some of the members of its executive board. And it did so under pressure from European policymakers who maintained heavy influence over the Fund's levers of control.

And some of these emergency loan packages you would have to say worked out pretty well. But all too often, debt was piled atop debt in excessively harsh conditions imposed on the crisis-stricken countries. And Greece was, I think, the canonical case in this regard.

And this is a real problem in view of the IMF's mission. This is a mission I really believe in. The Fund provides a global public good, a benefit that no single nation can provide by itself, but which all nations gain from, the global public good of global financial stability.

And the crisis in Europe showed us that this is more important than ever because previously we thought that international bailouts were for countries in the emerging world, countries like Thailand and Indonesia, for example, and the eurozone crisis showed us that advanced countries need bailouts, too. So the world has really been put on notice about the importance of a muscular and effective IMF.

But the eurozone crisis, I think the Greek crisis above all, was a bruising and enfeebling experience for the IMF. Fund economists, to their credit, as this memo shows, perceived serious flaws in

these bailouts, but they often yielded to the crowd of people in capitals such as Berlin and Frankfurt and Brussels and Paris.

Now, the IMF was more independent in the latter stages of its crisis. But in my view, it didn't use the greater leverage that it had to the extent that it should have. And this sapped the IMF of its most precious asset, its credibility as an independent, neutral arbiter. And this has disheartening implications for the management of future crises.

So I am out of my time, Mr. Chairman. I will be happy to elaborate on these points in the Q&A. And I appreciate your incorporating my written statement in the record.

Thanks very much.

[The prepared statement of Mr. Blustein can be found on page 34 of the appendix.]

Chairman BARR. Thank you, Mr. Blustein.

Ms. Lundsager, you are recognized for 5 minutes.

**STATEMENT OF MEG LUNDSAGER, PUBLIC POLICY FELLOW,
WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS**

Ms. LUNDSAGER. Thank you very much, Chairman Barr, Ranking Member Moore, and members of the subcommittee.

I spent much time discussing these issues while I was at the IMF and continue to focus on it at the Wilson Center. And my testimony today reflects my personal views.

Over many decades, IMF policies and lending have underpinned the global economic and financial stability that we all seek. The IMF's early response to the eurozone crisis was key in containing the spread of the crisis, which benefited all members. But IMF lending to eurozone countries also strained IMF principles and weakened the IMF's lead role in designing economic adjustment programs and financing packages for countries facing a balance-of-payments crisis.

IMF lending programs that normally encompass all aspects of macroeconomic and financial sector policy have been shaped more by European needs than by IMF standards. This eroded the IMF's commitment to treat its members uniformly in terms of the types of policy adjustments demanded in lending programs.

Furthermore, eurozone governments have created their own 500 billion euro financial rescue fund, the European Stability Mechanism, and therefore do not need IMF funding.

With little likelihood that Europe will adjust its internal rules and regulations to accommodate the IMF, the preferred future approach is that eurozone countries do not seek IMF lending. Eurozone members nonetheless retain their right under the IMF Articles of Agreement to request IMF financing. The IMF should therefore have in place a defined policy establishing its primacy in program design and its seniority among all creditors in lending to currency union members.

The IMF requires that borrowing countries implement economic reforms designed to restore financial stability and balance-of-payments viability. Programs include conditions on monetary, fiscal, financial sector and exchange rate policies. If a country is a member of a currency union and cannot adjust its exchange rate, domestic

macro economic policies will be tightened further to restore competitiveness.

The IMF will also work closely with bilateral and multilateral partners as aid and credit programs provide technical assistance and critical funding. Debt relief from official and private creditors may also be included in the financing package if the IMF assesses that the country will be unable to meet its debt servicing commitments or borrow new funds from private markets.

Greece is the only eurozone member now seeking IMF assistance. European partners reaffirmed they are committed to providing additional future debt relief to Greece if needed and if Greece adheres to its reform program through 2018. The IMF has stated that European assumptions are too restrictive and the IMF continues to demand more clarity now from European partners regarding the extent of additional future debt relief European entities will provide. European finance ministers will meet on Monday to discuss their response to the IMF.

Greece's outstanding debt to the IMF has dropped to less than \$14 billion while its debt to European partners remains over \$200 billion. With little financial need for a parallel-aligned program, the eurozone should assert its lead role in addressing its internal economic challenges and move forward without an IMF program for Greece. The IMF cannot fix the eurozone's internal inconsistencies, only Europe can.

However, as I mentioned, under the Articles of Agreement each country is entitled to request IMF financial assistance. Therefore, the IMF should establish a policy governing how it will lend to members in a currency union, particularly those in a reserve currency union, such as the euro. Recognizing this need, the IMF is planning to discuss conditionality in currency unions this summer, according to the IMF's work program.

The approach should include a process for the IMF to participate in designing the country's economic reform program and monitoring its performance without necessarily providing financial assistance. If the country requests IMF financing, the monetary union should respect the IMF's lead role in all elements of program design and debt sustainability assessments. The currency union's institutions should share the information on their policy requirements and defer to IMF program requirements.

The IMF contribution should be relatively small and shorter term than some of the recent programs have been with eurozone countries. The currency union's members and leading institutions should explicitly recognize the preferred creditor status of the IMF, including with regard to their earlier disbursements. An IMF policy along these lines would clarify respective institutional roles and help point eurozone countries towards addressing their own internal imbalances.

I look forward to your questions. Thank you.

[The prepared statement of Ms. Lundsager can be found on page 88 of the appendix.]

Chairman BARR. Thank you.

Professor Gelpern, you are recognized for 5 minutes.

**STATEMENT OF ANNA GELPERN, PROFESSOR OF LAW,
GEORGETOWN UNIVERSITY LAW CENTER, AND NON-RESI-
DENT SENIOR FELLOW, PETER G. PETERSON INSTITUTE
FOR INTERNATIONAL ECONOMICS**

Ms. GELPERN. Chairman Barr, Ranking Member Moore, thank you very much for including me. And thank you to the members of the subcommittee.

I am especially honored to share this panel with people I respect tremendously. So it is a special pleasure for me to be here today.

I write about financial regulation and sovereign debt restructuring, so I am really looking at this very much from the perspective of a global sovereign debt restructuring regime rather than the EU or Greek equities in particular.

My main message is that the IMF remains indispensable in the sovereign debt restructuring. It is absolutely true, I agree with my colleagues, that Greece has tested it like no other. However, like no other actor, the IMF has shown capacity to learn from its mistakes, has undertaken substantial reforms and paradoxically now probably has more policy sway with less money on the line than it did earlier on. I think we should encourage this trajectory, reinforce the Fund's independence. In other words, I think the lesson of Greece is that we need a stronger IMF, not a smaller, weaker IMF.

As you know, sovereign governments that run out of money cannot file for bankruptcy. This is not just a problem for the borrowing country and its citizens, but also for its creditors who are doomed to scramble for bits and scraps in a crisis because most of the sovereign's property is immune.

Against this background, the IMF plays a vital coordinating role. It is literally the only actor capable of bringing together diverse domestic and external constituents around a reform program. It has developed unparalleled expertise in crisis management, to be sure nourished by its many mistakes in the past, including some of the ones that Paul has written about so beautifully.

My written testimony outlines in painful, excess detail the sovereign debt restructuring context, focusing on the role of the Fund, and summarizes recent restructuring experience and how this role has come to be.

Now, sovereign debt restructuring reform is not all about the IMF, far from it, but it cannot happen without the IMF. I believe that in the wake of Greece in particular, reform should have three objectives: outcomes should be sustainable; the process should be comprehensive and collective; and the regime as a whole must be intelligible and accountable to its constituents, both debtors and creditors.

Greece does illustrate, again, painfully, the risk of entangling analysis, money, and politics. I think that when those three come together, analysis always loses, and that is a big problem.

With respect to the first objective, sustainable outcomes, the IMF should be applauded for reforming its approach to assessing countries' debt sustainability, opening up its methodology to outside scrutiny. In Europe, the IMF has been, despite all of the stumbles and mistakes, a force for good. The question is, where would we be without the IMF? What would European Union assumptions be

and where would Greece be if the IMF were out of the picture completely?

I believe the Fund has pushed EU authorities to be more realistic in their projections. And Paul's "smoking gun" memo is actually one example of internal debates yielding results over time, even in the face of political constraints.

As I elaborate in my written statement, I continue to believe that debt sustainability analysis should be further open to debate and competing views. And also, in order to reduce the pressure on analysis, I believe that we need a credible story for how the international financial system deals with contagion because contagion, you know, the "C word," has this magical effect of killing all analytic effort.

Without bankruptcy, we have piecemeal official, private sector, domestic, and external restructuring and default. And I think, again, the IMF alone has shown capacity to bring together these various parties. I am particularly delighted that the Fund has begun to address the role of official creditors, including central banks. The ECB was paradoxically the biggest holdout in the Greek debt restructuring in 2012. There are other, even more difficult examples of official sector holdouts around the world.

Finally, while there is no bankruptcy for sovereigns, there has developed a pretty regular and discernible sovereign debt restructuring regime. With this regime, the sequencing of debt restructuring, what the different actors do, is completely unintelligible and inaccessible to ordinary people. The IMF is ideally positioned to promote more transparency and intelligibility. It can easily require uniform, comprehensive disclosure of debt and debt restructuring terms. And I think it should use its power to advance this goal.

To close, the IMF is in a peculiar position. It is doomed to be small relative to global capital flows. But the fact that it has more clout in Greece now with less money on the line I think is instructive. Credibility is immensely important. We should help the Fund hold the line, continue to rebuild its credibility, and be a force for good in sovereign debt management, including in Europe.

Thank you.

[The prepared statement of Ms. Gelpert can be found on page 58 of the appendix.]

Chairman BARR. Thank you for your testimony.

And, Dr. Nelson, you are now recognized for 5 minutes.

STATEMENT OF REBECCA M. NELSON, SPECIALIST IN INTERNATIONAL TRADE AND FINANCE, CONGRESSIONAL RESEARCH SERVICE

Ms. NELSON. Chairman Barr, Ranking Member Moore, and members of the subcommittee, thank you for the opportunity to testify on lessons from the IMF's bailout of Greece.

My testimony focuses on the policy implications of the Greek crisis for the IMF as an institution. I will summarize my statement with these brief remarks.

The IMF has decades of experience responding to economic crises around the globe. The Greek crisis, however, took the IMF into uncharted territory. Greece was the first advanced economy to borrow

from the IMF in decades and the IMF committed significant financing in two back-to-back programs.

The IMF entered an unusual co-financing arrangement for Greece with European creditors. It was also the first time that the IMF had designed a program for a country in a major currency union.

The IMF's record in Greece is mixed. IMF programs helped limit spillover from Greece to the global economy, which was struggling to recover from the global financial crisis. But 7 years after the first program, Greece's economy remains in crisis.

The IMF's experience in Greece raises a number of broad policy questions about the IMF that continue to be relevant in Greece and are likely to arise in future crises. I will talk about four such questions.

The first question relates to the size and length of IMF financing. Although Greece is an extreme example, there is a broader trend towards larger IMF programs and for some countries to require repeated IMF programs. This raises questions about whether there are or should be limits.

On one hand, long-term financing veers from the IMF's mandate to provide temporary financial support. Additionally, there is the potential for moral hazard. Governments may be less likely to adopt prudent economic policies if they believe that the IMF will step in regardless of the cost. On the other hand, limiting the resources that the IMF can deploy during crises may pose risks to the broader global economy.

The second question relates to co-financing. In Greece, IMF co-financing with European creditors limited IMF exposure to the crisis. It also limited the IMF's independence in designing programs for Greece. The IMF does not have a clear policy on co-financing arrangements. There are questions about whether co-financing is desirable and, if so, how co-financing arrangements can be designed to maximize their effectiveness. The issue of co-financing is likely to remain salient. Regional financing arrangements have proliferated in the global economy.

The third question relates to IMF policy flexibility and accountability. The IMF revised its lending safeguards in 2010 to allow the Greek program to go forward despite misgivings about Greece's debt. The IMF believed that the risks from Greece to the global economy justified the policy change. The policy change was controversial and eventually repealed.

Going forward, this raises questions about the appropriate balance between IMF flexibility and adherence to safeguards. Providing the IMF discretion to make policy changes allows the IMF to respond to unforeseen and time-sensitive crises. The risk is that the IMF may adopt policy changes that donor governments do not support and may also make the IMF less predictable as an institution.

The fourth and last question relates to currency unions. A currency union is where two or more sovereign states adopt a common currency. Greece belongs to a currency union, the eurozone. The crisis in Greece was fundamentally tied to structural problems in the eurozone. The IMF, however, does not design programs for currency unions. The IMF designs programs for specific countries.

For Greece, this meant that IMF programs were focused on a relatively narrow set of policy issues and tools. Arguably, the IMF programs required a broader scope that addressed the eurozone crisis as a whole. How the IMF should respond to crises and currency unions remains a challenge for the institution.

In conclusion, the IMF is an institution that has evolved over time. After a number of major crises, the IMF has adapted policies based on lessons learned. Greece is another pivotal crisis that raises questions about IMF policies and the IMF's role in the global economy. Congress plays a critical role in shaping U.S. policy at the IMF and Congress may want to consider these policy issues.

Mr. Chairman, this concludes my brief remarks. Thank you for the opportunity.

[The prepared statement of Dr. Nelson can be found on page 96 of the appendix.]

Chairman BARR. Thank you all for your testimony.

And the Chair now recognizes himself for 5 minutes.

As many of you all alluded to, the Greeks still suffer from the eurozone's highest unemployment rate. It has been around 25 percent for the past several years. And instead of helping to reduce Greece's public debt-to-GDP ratio to 110 percent as planned, the Fund has witnessed the debt-to-GDP ratio climb to nearly 180 percent despite a major restructuring of debt in 2012. So the logical conclusion is that the IMF's involvement has done little to improve the lives of the Greeks, in part because Greece's leaders have slow-walked reforms for years.

In December 2015, Greek Prime Minister Alexis Tsipras was unapologetic, criticizing the Fund's "unconstructive attitude on fiscal and financial issues." He indicated the IMF should stay out of any future bailouts and was quoted by The Financial Times as saying, "After 6 years of managing an extraordinary crisis, Europe now has the institutional capacity to deal successfully with intra-European issues."

I would ask unanimous consent that this Financial Times article with the headline, "Alex Tsipras Pushes for IMF to Stay Out of Next Greek Bailout" be entered into the record.

I would also ask unanimous consent to enter into the record a Reuters article from January of this year noting that the Greek government would welcome the IMF's being excluded from the Europeans' bailout.

Without objection, it is so ordered.

So for Dr. Nelson, according to the IMF's Articles of Agreement, assistance can only take place at a member's own initiative. If the leaders of a member like Greece believe that the country's crisis can and should be resolved by Europe alone, shouldn't the IMF take Greece at its word?

Ms. NELSON. As you say, the IMF provides financing to countries that request it. And if Greece isn't requesting financial assistance, the IMF shouldn't be providing financial assistance.

Chairman BARR. Mr. Blustein, would you agree with that?

Mr. BLUSTEIN. I think the Greeks will probably, under such circumstances, have their arms twisted and told that they should request IMF help if there is a deal. Of course, there is a big meeting expected on Monday, the euro group. So, Tsipras does score polit-

ical points by attacking the IMF because the IMF has been, in many ways, tougher than the European creditors in insisting on various structural reforms and insisting that targets be met and so he lashes out at them and then I think it is to his political advantage to do so.

But I would bet that if there is such a deal, he will—

Chairman BARR. Is your microphone on, sir?

Mr. BLUSTEIN. I am pressing “talk.” Can you not hear me, sir?

Ms. MOORE. Pull the microphone up to your mouth.

Mr. BLUSTEIN. Oh, okay. Sorry.

Chairman BARR. Pull your microphone towards you, sir. Thank you very much.

Mr. BLUSTEIN. Okay, thank you.

Chairman BARR. That is better.

Mr. BLUSTEIN. Okay. I can hear myself. But anyway, sorry.

So my basic point was that I think, although Tsipras loves to beat up on the IMF for political reasons, if there is a deal that the IMF can live with, my guess is that the European creditors will twist his arm and tell him that he has to ask for aid from the IMF. So that formal request would be forthcoming. But we don’t know what is going to be happening next week.

Chairman BARR. One of you referred to moral hazard. And it does sound like the IMF is creating moral hazard. If the IMF were to move forward with a third bailout, the IMF would be giving Greece a third credit card to max out and incentivizing the very behavior that got Greece into trouble in the first place with little or no meaningful prospect for a long-term, sustainable solution.

It seems to me that Greece needs to enact some tangible reforms that would lead to growth and increase revenue.

So, Ms. Lundsager, do you agree that a third bailout would create that moral hazard?

Ms. LUNDSAGER. Mr. Chairman, I have a hard time dealing with moral hazard because when I see what countries have to go through I never felt that the IMF created the incentive for countries to mismanage their economy and then come to the IMF for help. Because we have seen, especially in the case of Greece, how painful that is and how Mr. Tsipras has had to walk back from earlier claims of, “Well, we are not going to invite the IMF in.” He must already have approached the IMF and said, “I want another program,” because the IMF has been part of the teams that have been in Athens negotiating the policy package.

So on the moral hazard side, perhaps there is some moral hazard on the part of the private sector that thinks they will be able to get out before a debt restructuring happens. But at this point, there isn’t too much private sector debt left. It has all been turned into official debt Greece owes to European partners.

Chairman BARR. Thank you.

My time has expired, but I would invite, as the questions continue, the other panelists to comment on that issue of moral hazard.

And with that, I will now recognize the ranking member of the subcommittee for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman.

Of course, I have more questions than answers as we see the evolution of this. And I was really interested in what seemed to be a consistent theme with all of you that there are structural reforms that were needed.

But, Mr. Blustein, you talked about the belt-tightening not having been achieved. And I guess I want you to share with me briefly why you thought that hadn't occurred. Was the conditionality too great? In particular, I want to know if there was some conditionality with regard to requiring Greece to collect taxes aggressively from the oligarchs there.

Mr. BLUSTEIN. There was conditionality of that sort. I think on the fiscal conditionality, it is fair to say that Greece delivered on a lot of that. That was kind of part of the problem. The belt-tightening part of the program worked, and it had a very dampening effect on the economy.

The theory of the first program was, Greece had an exploding debt-to-GDP ratio. That was what everyone was worried about. So if you tighten fiscal policy and the country can run big surpluses as they were projecting, then the country would be able to pay down its debt. The trouble is, that takes money out of people's pockets.

Ms. MOORE. Austerity.

Mr. BLUSTEIN. So then GDP falls. So the theory was, well, how are we going to get this economy to grow to get out of this trap that it is in? Now, Greece is a member of the eurozone. They are not allowed to cut interest rates, they are not allowed to pump up the money supply, they are not allowed to devalue their currency as many countries do when they are in situations like that.

So the theory was, we will have structural reforms and that will increase the efficiency of the economy and that will help pump up growth. And I think a lot of the structural reforms made very good sense. You can't argue—I think most economists wouldn't argue—with the value of making state-owned enterprises more efficient, liberalizing a lot of the professions that had been kept closed to help special interests.

Ms. MOORE. But in the long run, austerity was just not the answer to it; that didn't work.

Mr. BLUSTEIN. I would put it slightly differently. The idea of, and I guess this is the main point of Blanchard's memo in a way, is that the structural reforms will take so long to work—they will have beneficial impacts eventually, but the effects of the austerity dampening the economy will be so great. And the structural reforms actually in the short run often have a negative impact on the economy.

Ms. MOORE. You are interesting. We are going to have to have lunch.

But I want to hear from Dr. Nelson and the ladies here because you have all talked about the importance of the IMF having been there in the beginning to prevent the contagion from spreading.

And so, Dr. Nelson, Professor Gelpern, let us just have a dialogue for the next minute and 43 seconds. Go for it.

Ms. NELSON. I do think the IMF's programs were successful in stemming contagion of the crisis. I think it is important to remember that when the first program for Greece was approved in 2010,

it was on the heels of the global financial crisis. And there was broad consensus among the international community.

Ms. MOORE. Right. And Secretary Paulson came and asked for \$700 billion, not \$32 billion.

Ms. NELSON. Right.

Ms. MOORE. Just saying.

Ms. NELSON. And I think the IMF programs did contribute to preventing another Lehman-style shock to the system. However, I don't think anyone believes that the economic situation in Greece has been successful or that there is even a long-term plan for restoring economic viability in Greece.

Ms. MOORE. Dr. Gelpern, the intellectual benefits of the IMF's intervention are what?

Ms. GELPERN. They are the only ones that literally have the methodology that has been tested, that can tell a credible story. And they also have an internal organization that enables some kind of debate. And they have a board, including the United States, that can exercise checks and balances.

I did want to return and connect this to the topic of moral hazard.

Ms. MOORE. Yes.

Ms. GELPERN. I think the one type of moral hazard we are not talking about is political moral hazard. And there are two types of political moral hazard that we see in Greece. One is exemplified by—I guess “trash talking” is not a very polite way to describe Mr. Tsipras's occasional comments on the role of the international community, but they are free to say that when they know it will have little impact on what is going to happen behind closed doors.

He was saying that the IMF should stay out after the IMF had stopped disbursing for almost a year and less than a month before the program was formally done.

So while I think that it is absolutely true that the IMF should not be financing countries that are not truly committed to the program, I am not sure that this commitment necessarily follows from the leader's public words.

But the other one, and I will just mention it briefly and I am happy to elaborate later is, the moral hazard of European leaders telling their own citizens that they are going to be repaid in full. The fact is that over 200 billion euro in government-to-government debt is now on Greece's back for decades to come.

Chairman BARR. The gentlelady's time has expired.

Ms. GELPERN. I'm sorry.

Ms. MOORE. I thank you for your indulgence, Mr. Chairman. This is fascinating. We have other Members here, so maybe we will get a chance to get to Ms. Lundsager and hear more.

Thank you so much. You guys are so brilliant, you gals and guy.

Chairman BARR. Thank you.

The Chair now recognizes the vice chairman of the subcommittee, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

And for all the witnesses, thank you for your testimony today.

I think it is safe to say, Mr. Chairman, that in business, the private sector, you want to make sure you get the best deal for your company and your shareholders. In this case, the shareholder, the

American taxpayer, should be confident that their money is being spent wisely. And just like any business deal, when a deal goes bad, sometimes you have to walk away and cut your losses.

According to some of our testimony today, Greece's outstanding debt to the IMF has dropped to less than \$14 billion. Greece is currently paying 3.8 percent lending rate to the IMF. The interest rate to the European creditors is only .72 percent on roughly \$200 billion. The European Stability Mechanism's (ESM's) 2015 annual report proudly underlines that its financing is a fraction of the cost of the Fund's.

My first question is for Mr. Blustein. If the ESM provides cheaper financing than the IMF, why should the Greeks be forced to take on the Fund's pricier loans? If an individual is facing financial disaster and only had two credit lines, wouldn't we advise them to go with the lowest interest rate possible?

Mr. BLUSTEIN. The problem is that countries like Germany, the Netherlands, Finland, members of the eurozone that would be endorsing the provision of ESM money for Greece, those countries are insisting that the IMF be there, putting some of its own money on the line and providing its seal of approval. So it is a bit of a Catch-22.

But in theory, you are right. If the Europeans want to do it themselves, and particularly if the IMF feels that Greece is not being put in a sustainable debt position, whatever Greece wants, whatever Germany wants, the IMF should say no.

Mr. WILLIAMS. Ms. Lundsager, could you talk about that please?

Ms. LUNDSAGER. Thank you, Congressman. We will get a bit of an answer to your question on Monday when the European ministers meet to discuss this. But I would be delighted if they decided to use the ESM funding to basically clear off Greece's obligations to the IMF. I think it would be a benefit to Greece.

It is, as Mr. Blustein said, the other European capitals which want the IMF involved for credibility of the adjustment program. But my concern is that Europe itself needs to do more to develop its own internal unity to become more of a union. And bringing in the IMF may not necessarily help them do that when they have to grapple with the changes they need internally to make themselves function more as a union.

And, of course, we saw the meeting between the new French president and Angela Merkel earlier this week get off to a very good start, but there are still wide divergences between those two key economies. If they can agree on some of the reforms needed, perhaps then there will be a way forward. But I still do not believe the IMF is the one that ultimately can fix this monetary union.

Mr. WILLIAMS. Okay, thank you.

Dr. Nelson, why would we take the IMF's concerns about debt seriously if the Fed doesn't insist on the Greeks receiving the least expensive financing available? And if the Fund is serious about Greece's debt burden, shouldn't it step aside and let the ESM provide cheaper financing?

Ms. NELSON. I think that is certainly an option that the IMF could pursue. If debt sustainability is the issue, go with the cheapest source of funding.

I think one issue that people are talking about is, is there a role for the IMF to play in responding to the Greek crisis through sort of technical assistance and helping Europeans design the program without putting forward money itself? And so that might be one option that people are exploring.

Mr. WILLIAMS. Okay.

Dr. Lundsager, the IMF has concluded that Greece needs significant debt relief. Would you agree that debt relief is required for Greece's debt to become sustainable and to prevent further bailouts past 2018?

Ms. LUNDSAGER. Absolutely, Congressman. And my preference would be for an outright haircut on the principal, the outstanding principal, so that the Greek population, the private sector, wouldn't face this 180 percent of GDP debt out there. But that is not what the Europeans are prepared to do. What they are prepared to do is greatly—well, we will find out how far they will extend grace periods and maturities to basically have the equivalent of having a reduction in the outstanding principal.

But restoring incentives to invest, to hire in Greece, I think, is a real challenge. And we are not quite getting there yet. Thank you.

Mr. WILLIAMS. Really quickly, Dr. Blustein, could you say something about that?

Mr. BLUSTEIN. I completely agree. It certainly would be preferable if Europe would agree to outright forgiveness. And the moral hazard that Professor Gelpern referred to before, that you need to say to Europe, look, you lent money foolishly to Greece in 2010 and thereafter, and if we keep sort of enabling you to do that, we understand that you have political problems explaining this to your citizens that you are not going to be repaid in full and you can go on doing what Meg Lundsager referred to as the extending the maturities.

But that is, I think, a poor way to go about really helping the Greek people get some hope of some getting out of the trap that they have been in now for the past 7, 8 years.

Chairman BARR. The gentleman's time has expired.

Mr. WILLIAMS. Thank you for the time.

Chairman BARR. And the Chair now recognizes the gentleman from Michigan, Mr. Kildee, for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman, and Ranking Member Moore, for holding this hearing.

And to the panelists, thank you very much for your participation.

I do have to say, I noted with a little chuckle that the comment about Mr. Tsipras engaging in trash talk in the effort to pander to a domestic political base that might also degrade the standing that he and the nation he serves might have is a lesson that could be applied to a number of countries, including the one that we are all sitting in right now.

So you don't have to comment on that unless you want to.

I would be interested in pursuing a little bit more where Ms. Moore left off on the question of austerity and other conditions.

And starting with Mr. Blustein, you mentioned, I think you said anyway, that your analysis, that the belt-tightening essentially worked. I wonder if you could just explain that in a little more de-

tail and also expand that to touch on the other sort of systemic reforms that have a longer curve to them and what your assessment, and perhaps each of you could manage a point on this, what you think the balance of those might be.

And secondly, whether or not additional measures in either category would apply in order to follow up on Ms. Lundsager's notion that you might all comment on also on whether or not principal reduction would come with pretty significant other conditions in order to achieve that.

If you could each comment, I would appreciate it.

Mr. BLUSTEIN. Just to clarify, when I said that the austerity worked, I guess what I mean is, to a large extent, it was delivered on. Greece did undergo a tremendous amount of fiscal consolidation on both the spending and tax sides. So it worked too well; it killed the Greek economy.

Mr. KILDEE. That is where I was going.

Mr. BLUSTEIN. Yes, okay.

Mr. KILDEE. Because when you said it worked, you meant it worked in that they complied.

Mr. BLUSTEIN. They delivered on that. And a lot of the structural reforms they actually didn't deliver. And one of the arguments that is made in defense of the original program is, well—and this is the IMF, I am sorry to say, they often do this. When programs don't work, they say, well, the country didn't deliver, they didn't do what we asked, they didn't fulfill the conditions. And it is, you know, you can't say, you have to admit that Greece didn't deliver on quite a number of the structural reforms.

I would argue that even if Greece had delivered on those structural reforms, as I would argue that Blanchard in retrospect was absolutely right, even if they do all that stuff, those structural reforms are not going to help, they are not going to offset the effects of the austerity because those things take a long time to work.

In the short run, they actually have a dampening effect on the economy. If you are streamlining an inefficient state-owned enterprise, you are laying people off, and those people have less money in their pockets. So, now, it may be a good thing to do in the long run because those jobs are inefficient and you need to, you need to make the economy work better.

So when I said the austerity "worked," I don't mean to suggest that it "worked."

Mr. KILDEE. Okay, that makes more sense because I was curious as to how much of what Mr. Barr referred to in terms of the now increased debt-to-GDP ratio could be attributable to the lag in the economy that was precipitated by some of those austerity measures.

I wonder if the other panelists might also comment on this general subject.

Ms. LUNDSAGER. No. I do think that Mr. Blustein is absolutely correct. The austerity in terms of contracting the economy made it even more difficult to then address the debt. But the other side of the coin is Greece has lagged on the structural reforms that it needs and they are very difficult. They are the kind of labor market reforms in order to get employers to hire more workers. They need

to be able to actually occasionally fire workers and there are very stringent worker protections in Greece.

Additionally, pensions and other benefits were increased substantially after Greece joined the eurozone because they had access to very low interest rates as part of the eurozone and basically made a lot of promises that the real side of their economy couldn't deliver, didn't have the productivity, the competitiveness to deliver the real output that could then satisfy those pensions and the other commitments they made.

Greece is now struggling to try and do some of that. But in the meantime, the Europeans are demanding very tough austerity for a number of years to get Greece back to debt sustainability. The IMF is pressing back and saying no, that is not going to happen, you Europeans need more up-front debt relief. Therefore, I do think it is going to be very difficult to generate the kind of confidence in the Greek private sector that will create jobs, will increase production, will revitalize that economy. Thank you.

Mr. KILDEE. Thank you very much.

Chairman BARR. The gentleman's time has expired.

The Chair now recognizes the gentleman from Indiana, Mr. Hollingsworth.

Mr. HOLLINGSWORTH. Good morning. Thank you, everybody, for being here. I really appreciate all of the insights that have been shared so far.

I wanted to turn our attention to something that I think Dr. Nelson and Ms. Lundsager brought up, which is the IMF's effectiveness operating inside a currency union.

Today, I think a quarter of IMF membership is made up by countries that are involved in some sort of currency union. So I think this is a problem that we are going to see in the future. So for a moment, setting aside primacy of repayment, but focusing just on the economic issues themselves and the challenges that the IMF may face in responding to a crisis for a country that is in a currency union, could you start, Dr. Nelson, and talk about the economic challenges associated with that?

Ms. NELSON. Sure. So the IMF designs programs for countries. It doesn't design programs for currency unions. And I think how that played out in Greece was the crisis was tied to fundamental imbalances across the eurozone, but the IMF program, by focusing only on policies, regulations, things under the authority of the Greek government, it was only looking at one piece of a bigger puzzle.

Mr. HOLLINGSWORTH. Correct.

Ms. NELSON. And so I think some of the problems that we are seeing play out in Greece now are tied to this sort of narrow look at the crisis as it played out.

Mr. HOLLINGSWORTH. Right.

Ms. Lundsager, would you like to add to that?

Ms. LUNDSAGER. Yes, thank you. In dealing with the currency union the IMF had to take monetary policy as a given, interest rate policy, exchange rate policy as a given, so that greatly narrowed the tools available.

Mr. HOLLINGSWORTH. Right.

Ms. LUNDSAGER. And, of course, those policies were set for the entire eurozone or for the entire currency union, not for the country itself. So monetary conditions were too tight for Greece, they could be looser. And you see that tension still within the monetary union right now, within the eurozone, as some countries, for example, Germany, complain that monetary policy is too loose.

The policy measures that would normally be in an IMF program and help a country recover would include monetary policy and exchange rate policy, meaning the country would need less of the fiscal contraction. Thank you.

Mr. HOLLINGSWORTH. Right.

Mr. Blustein?

Mr. BLUSTEIN. This is a really great question and it is something that I wrote about with some I guess you could say passion or maybe even sort of starry-eyed, crazy idealism in my book.

The IMF was coming to the rescue not only of Greece, it was coming to the rescue of the euro or the European Monetary Union. And the IMF had been put, at the outset of the crisis, in a position of junior partner in the troika with the European Commission and the European central bank.

I would argue that the IMF should have played a senior partner role. In fact, I argue that it should have played a super-senior role. Meaning I think the IMF should have been in the position where it was able to say to all of Europe the following things are going to happen, not only in Greece, but in Europe. The ECB is going to do this and Germany is going to do that and you all are going to be doing this on banking, union and what not.

I think the crisis would have been solved a lot sooner, I think it would have been a lot easier to have a debt restructuring in Greece or in—

Mr. HOLLINGSWORTH. So I think, like you said, kind of wrong tools for the situation or an inability to be able to diagnose and treat all of the symptoms at the same time, instead focusing on a single symptom, in hopes that that would migrate to other aspects.

So I guess I would start again with Dr. Nelson. Is this a permanent defect or inability of the IMF to handle a currency union crisis? Or given the players that you probably know, you have seen more than me, do you think the IMF will be able to effectively work with the currency union as a whole to be able to get at some of the other symptoms?

Ms. NELSON. Sure. The IMF's Articles of Agreement doesn't talk about programs for currency unions. It is not something that is sort of by design. The IMF has started grappling with this issue. For example, in its surveillance programs, it started having Article IV consultations for the eurozone as a whole.

I do think there is a mismatch still between with the programs, is that, is it appropriate to design programs for specific countries? Or do they need to address the broader currency union as a whole? And it is not clear that sort of the founding document, the governing document of the IMF addresses that issue.

Mr. HOLLINGSWORTH. It is clear that the problem exists. It is not clear whether the IMF can solve that. Right?

Ms. NELSON. Right. And I would also add that through design by focusing on specific countries rather than the broader eurozone as

a whole, it imposes all the costs of adjustment on the weaker members of the currency union. It exempts the stronger sort of members from playing any part in the adjustment process.

Mr. HOLLINGSWORTH. Correct. Which they certainly had a part in creating the problem. Correct?

Ms. NELSON. Right, right.

Mr. HOLLINGSWORTH. My time is almost expired. But again, I want to reiterate my deep concern that the IMF's inability to get at all of the symptoms of the disease will lead to a poor outcome, both for the Greek economy and, ultimately I worry about, for the IMF as well, that they don't have the tools to be able to tackle the problem when we expect them to do so and asking them to do more than they can do and then holding them accountable for the failure to do so is probably inappropriate for both the institution and for the Greek economy itself.

Chairman BARR. The gentleman's time has expired. The Chair now recognizes the gentlelady from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you, Chairman Barr and Ranking Member Moore, now represented by Mr. Foster, for allowing me to participate in this hearing.

I am a strong advocate for Greece. I believe that it is critically important that Greece remains in the European Union. And I believe they have been strong allies to the United States and our relationship remains strong as Greece endures an unprecedented economic crisis. It has been a strong pillar of democracy and stability in the West and plays a vital role in protecting U.S. security interests in Europe. One of our major bases is placed there.

So I thank the chairman and the ranking member for holding the hearing.

And I would like to ask Ms. Lundsager about debt relief for Greece. You noted in your testimony that debt relief could provide additional fiscal resources for Greece, which could be used to invest in her economy and for additional social services which are badly needed. In other words, the less money that they have to pay to the European creditors, the more money it will have to get its economy going again.

And I recall in our own financial crisis, one of the ways that we dug our way out was not through austerity, but through really stimulus packages and ways to stimulate the economy and investing in our infrastructure and really investing with resources into our own economy.

So my two questions for you are, first, do you believe that debt relief is a necessary component of a new lending program, whether or not the IMF is involved in the new lending program?

Ms. LUNDSAGER. Yes, Congresswoman, I do believe that no matter what, whether the IMF is involved or not, debt relief needs to be part of the future relationship the Europeans have with Greece.

Mrs. MALONEY. What about the other panelists? How do you feel? How would you respond? I will invite anyone who would like to respond to respond.

Ms. GELPERN. If I may, Congresswoman, I agree entirely that debt relief is essential. And I also want to second Ms. Lundsager's point that principal reduction, I think, is not just economically, but politically important.

And in this picture, the IMF stands for relief and reform, which are two things that are critical for Greece. The European Union is a bit of a question mark on both. So I have no religion about whether the IMF puts in money. In fact, I am delighted that they are able to exercise influence without it, I think it is great for us. But I do think that it is advocating the right thing, debt relief foremost among them, and I think it should stand firm. Thank you.

Mrs. MALONEY. Okay.

And second, Ms. Lundsager, do you think the best form of debt relief would be a reduction in principal as some have advocated? Or would simply extending the loans and lowering the interest rate be sufficient?

Ms. LUNDSAGER. Thank you. I continue to believe that outright principal reduction would be best. And I come back to my earlier comments that this would be a signal to the Greek economy that there would not be a future, very heavy burden of debt repayment, even if it is far in the future, because what Greece needs is investment, it needs job creation, it needs internal growth.

The Europeans have been very clear that they will not do principal reduction. The IMF has therefore pushed them to have such very long grace periods and maturities on the outstanding debt that, for all practical purposes, for decades Greece would be paying very little back to its European partners. So that is certainly a second or third or fourth-best option.

But Greece is part of this eurozone, they have chosen to be part of this eurozone, and so that means they have to work it out within the eurozone, too. The IMF is not in a position to dictate how the eurozone undertakes its internal deliberations and agreements. Thank you.

Mrs. MALONEY. Do you think it would be better for Greece to just leave the European Union and the debt and just go on their own? Are there any comments on that from, starting first with you, Ms. Lundsager, and then Ms. Gelpert?

Ms. LUNDSAGER. If Greece had dropped out of the eurozone, perhaps not the EU, the European Union, but had dropped out of the eurozone years ago, ultimately in the long run it probably would have been better off because it would have had a very large devaluation of its currency, let us say the drachma, and that would have helped restore competitiveness and bring jobs back.

With that said, that is not what the Greek population wanted. The one thing that has been clear year after year after year is that they want to stay in the eurozone, which at times I have found a little bit remarkable. So in that case, it is their own choice, too, to undertake the reforms that they need to stay in.

Chairman BARR. The gentlelady's time has expired.

The gentleman from Arkansas, Mr. Hill, is recognized for 5 minutes.

Mr. HILL. I thank the chairman and the ranking member for holding this hearing.

I agree with Mrs. Maloney's comments that Greece is certainly an important, long-term partner in Europe and a longtime friend of the United States. But the structural differences that we have about the role of the IMF in the EU are really illustrated in this hearing today.

Dr. Nelson, I noted in your testimony that you noted how the IMF's first bailout socialized much of the private debt that Greece had owed. And much of this debt was held by German and French financial institutions. And back in 2010, the former head of Germany's central bank said in an interview, "The bailout was about protecting German banks, but especially the French banks from debt write-offs."

On the same day that the rescue package was agreed upon, shares of French banks rose by 24 percent. Looking at that, you can see what this was really about, which was rescuing banks and rich Greeks, he says.

And I ask that this interview be entered into the record, Mr. Chairman.

Chairman BARR. Without objection, it will be made a part of the record.

Mr. HILL. Thank you.

So Germany and France are two of the richest countries in the world. And if you believe that their banks needed to be propped up, is it really the IMF's job to recapitalize rich-country banks? Doesn't this just present a conflict of interest on the part of the IMF's board of directors? What are your thoughts on that?

Ms. NELSON. I think one thing people have talked about after the experience of 2010 was, would it have been better to let Greece default in 2010 and use the European money to recapitalize French and German banks? Would that have made the banks better off, would that have addressed the contagion issues? And would Greece be better off today without this sort of large, outstanding debt?

However, it is not clear that there was a mechanism in place to do that. We didn't have a European Stability Mechanism at the time, we didn't have a process for recapitalizing banks. But in hindsight, this is something that I think people have talked about.

I also think it gets at the issue of moral hazard. We have talked a lot about political moral hazard or moral hazard by governments that borrow from the IMF. But there is also moral hazard from private investors who make investments, but may not bear the full consequences of investments that they have made when it goes bad.

Mr. HILL. This committee knows something about that from watching Puerto Rico.

So what is the lesson?

Mr. Blustein, just a moment, I will come to you.

Just what is the lesson for the ECB and Europe on—the European mechanism is one item. What other reforms should Europe take into account to kind of solve their own internal currency zone issues like this?

Ms. NELSON. I think two of the issues that have been discussed are greater coordination of fiscal policies and the creation of a European banking union, both of which are in progress, but it is not clear to me, have those policies been completely harmonized and coordinated across the eurozone or the broader EU.

Mr. HILL. You think we would still have faced a similar challenge that we have even if they had been harmonized? Or do you think it would have been a different policy outcome?

Ms. NELSON. I don't know. I don't know how it would play out if we had a similar situation today. There are certainly institutions that have been created, like the European Stability Mechanism, that could help address a crisis, that didn't exist in 2010. But it is not clear if they would do something to address the issues in the banking system rather than address the issues of a debtor government who owes money to French and German banks.

Mr. HILL. Right.

Mr. Blustein, let me let you comment.

Mr. BLUSTEIN. Yes. I just wanted to come back to your point about what the motive was for the original bailout and whether it was saving German and French banks.

I spent a lot of time interviewing people for my book and that was one of the questions that I looked into a lot. And I would have loved to have found a smoking gun indicating that this was a major motive for the key players either in Europe or at the IMF.

And there there is no question that French officials in particular were keenly aware of the exposures of banks, like Societe Generale and Paribas and so forth, that they had large exposures to Greece. And I don't doubt for a minute that this was a consideration for them.

But I take people at their word when they say that their main concern, the main reason why they adopted the approach that they did was fear of contagion. If Greece was either going to default or be allowed to restructure its debt, this was going to have knock-on effects, people would dump the bonds of other vulnerable countries in the eurozone.

This was certainly the thinking of Jean Claude Trichet, the president of the European central bank. I am very critical of Jean Claude Trichet, a lot of the positions that he took during the crisis. But I do think he was sincere in his concerns and a lot of the policymakers were, and that was the key reason why the approach that was taken was taken.

I am aware of the interview you are referring to—

Chairman BARR. The gentleman's time has expired.

Mr. BLUSTEIN. —but I don't think that was the prime motive.

Chairman BARR. Thank you.

The gentleman from Illinois, Mr. Foster, is now recognized.

Mr. FOSTER. Thank you, Mr. Chairman.

And thank you to all the witnesses here.

There are a number of very interesting lessons that the world, as well as our country, I think should learn from this. In general, there seem to be three possible futures here. There is one possibility where Greece just leaves the union, repudiates the debt. So if we go down that route, what would the immediate impact be on banks around the world, on bondholders and so on? Has that actually been worked out in any detail so that people have an idea of what that would look like?

Ms. LUNDSAGER. Congressman, Greece's debt for the most part is owed to European official creditors, to governments, to European institutions that they set up, both the European Stability Mechanism, but more to the earlier mechanisms they had set up. So it is not really owed to banks so much and so I don't think the impact would reverberate around the world.

I think there is a bigger concern within Europe, especially after the U.K. vote to leave the European Union, that if Greece were to leave, it is showing that the continental system, the political system that they have struggled so hard to build could start to fracture. I think that is why it is so important that the German-French let's say amity or the good start to the new relationship be cemented and that they move forward on the internal reforms that they need.

Mr. FOSTER. It would also presumably have a bad impact on the creditworthiness of other southern European countries that are in roughly comparable situations.

Ms. LUNDSAGER. Yes. I think that could be a concern because there is a quite a bit of concern about Italy and its banking system and, of course, what those banks, what they owe to other creditors is not necessarily to official creditors, it is to other financial institutions within Europe. So there is, I think, a deeper worry there.

Mr. FOSTER. Right. So the other class of solutions, just a big haircut, both to the debtors, and also the pensioners, I guess, are another potential entity in a position to take a big haircut.

Ms. LUNDSAGER. Yes, they are going to have to pare back their pensions and take the kind of reforms that the IMF actually recommends to many countries. As you know, older retirement ages mean contributions for longer periods and a smaller pension. And this comes back to what I said earlier that Greece ended up, once it joined the eurozone and benefited from very low interest rates, ended up spending more on pensions, promising more to its citizens than it could deliver based on the real productivity of its economy.

Mr. FOSTER. Right. This is the problem with having a monetary union without a fiscal union.

Ms. LUNDSAGER. Exactly, yes.

Mr. FOSTER. Which has been pointed out by many people, even at the time it was made.

And that then, a future where you have potentially repetitive bailouts like that or haircuts like that, ends up looking like I guess they call it a transfer union where there is just a systematic—it is sort of like what is going on in the United States where there is a limited number of States, generally the large-population States, that write a huge check to the rural and Southern and Western States. I know in my State of Illinois, we lose about \$40 billion a year, which is very comparable to the Greek subsidy, because we pay a lot more in Federal taxes than we get back in Federal spending. And these checks are largely written to rural, southern States.

But this is the way we have lived for at least 40 years in the United States and it has real, long-term impacts. And so that is a possible future, that the Germans will just continually write checks to subsidize the pensioners in Greece. And I guess that is one of the things that makes it so difficult politically.

The third possibility is just a massive increase in taxes and tax compliance in Greece. If Greece could solve the tax compliance problem, what fraction of the problem would that solve?

Ms. LUNDSAGER. It would go part way towards helping Greece with its own internal resources for its own internal needs, but it wouldn't be enough to address their debt servicing requirements over the many decades of the future. They couldn't possibly—

Mr. FOSTER. And would, for example, a principal write-off followed by a much higher rate of tax compliance actually solve the problem?

Ms. LUNDSAGER. That, I think, could give them a clean slate and perhaps make it easier then to generate the domestic support for these kind of reforms that would make the economy more competitive and would broaden tax compliance and help them enforce better their own internal laws.

I was in Greece a couple of years ago and I was stunned at how difficult it is for them to even get compliance, to get effective enforcement of their own laws and regulations.

Mr. FOSTER. There is that famous aerial photograph of, I guess it is the suburbs of Athens, with all the swimming pools.

Ms. LUNDSAGER. Yes.

Mr. FOSTER. And in an area that there were three registered swimming pools and hundreds of visible swimming pools.

I guess my time is up at this point.

Chairman BARR. Thank you. The gentleman's time has expired.

The Chair now recognizes the gentleman from Ohio, Mr. Davidson.

Mr. DAVIDSON. Thank you, Mr. Chairman.

And thank you to our guests. I appreciate your expertise and your presence here today.

When solving problems, it is vitally important to address cause and effect and to understand what are indeed the root causes if we are to see a lasting solution. So as we have sat here and talked about haircuts to debt, I think we are glossing over, how did we get here in the first place?

Ms. Lundsager, has Greece addressed the root causes that led to their need for this new debt?

Ms. LUNDSAGER. I think they have made quite a bit of progress in doing that, but no, they still have a number of structural reforms to undertake to make their economy more competitive, to make their workers able to work, to make their citizens willing to share in the responsibility of financing their government and accepting that they will be getting somewhat, everybody, reduced benefits over time. So they still have a ways to go on that and I think it has been very difficult, especially for countries like Germany where they have managed to undertake labor reforms and managed to make many of the improvements over time, to then continue with the prospect of supporting Greece. But that is going to be the likely outcome.

Mr. DAVIDSON. Yes, thank you. You touched on a number of things there that I think are important. One is, some countries in the EU have stronger economies than others. Some have reformed their economies and found themselves able to steer clear of a debt crisis in the first place. But even countries that did find themselves in heavy debt burdens have taken action to change course.

I would like to show a chart which shows the idea of debt in the EU. So this isn't something that, as a few folks have alluded to, this is what that looks like and how Greece is, but it is certainly not alone. And the concern is, we mentioned it as a moral hazard, that once countries realize that they are seen as too big to fail, do you create the hazard that people don't change course?

I have another data point that just shows workforce participation. And this is a particularly acute problem in Greece. They are not the only country with this problem. But when you look at how few people are paying in and you look at the debt, isn't the root cause just as simple as the "goes-out-tos" are bigger than the "goes-intos?" And what do we see as the systemic solutions to fixing that problem in Greece and, frankly, if the EU is to survive as an intact entity, broadly?

Ms. LUNDSAGER. I think, Congressman, that you have highlighted one of the real challenges facing the European Union, the eurozone in particular, which is, how to understand that, yes, they are all in it together. They have all benefited from having this very attractive euro, this currency, especially Germany because it has had a more depreciated currency than the Deutsche mark would have been had Germany stayed with a separate, individual currency.

Yet that entails being partners with weaker countries. And how do you then enforce internally the kind of reforms that will bring more workers back into the labor force or bring debt levels down? And that is one thing Europe has not effectively been able to do internally.

Mr. DAVIDSON. Thank you.

And Dr. Nelson, if you could comment on that. This is a question that you see internationally. The IMF is supposed to be able to ratchet leverage with the loan, just like most creditors of last resort. If you go out into the private equity market, companies that find lenders of last resort find lots of warrants, clawbacks, tools that will effectively result in loss of control of the company.

In a country, a country is a sovereign entity and you have this complexity here where you have a currency misaligned, and we talked about this piece. How can the IMF participate in Greece as part of this currency, multi-country currency agreement in the EU, and yet if we are to participate in the IMF apply enough teeth to get the reforms that the EU themselves have not been able to show broadly?

Ms. NELSON. Right. I think the IMF conditionality that attaches to its loans has been a challenge. I think something that has come out from the panel is that there has been a real difference between the fiscal adjustment that has happened in Greece versus the structural problems that continue to plague Greece.

Some of the discussions right now are on taxes, pensions, unemployment, things that have been on the table for the past 7 years and have been subject to IMF conditionality, but there are questions about, after 7 years, how much progress has been made and/or how much progress was reasonable to expect.

Mr. DAVIDSON. Thank you.

My time has expired. And I just would add briefly that this is a challenge we are dealing with in the United States. And so as a participant in the IMF, the idea that the Americans are going to come to the rescue when we have our own crises to deal with domestically is increasingly dubious with our vote in the IMF.

Mr. Chairman, I yield back.

Chairman BARR. The gentleman's time has expired.

And without objection, the subcommittee will move to a brief second round of questioning. The Chair recognizes himself for 5 minutes.

Ms. Lundsager, you have written that not only can Europe tackle Greece by itself, but further IMF involvement would only postpone reforms in the eurozone.

And I would ask unanimous consent to submit for the record Ms. Lundsager's Reuters piece entitled, "The IMF Must Walk Away From Greece."

And Ms. Lundsager is not alone. I would ask unanimous consent to enter into the record an op-ed from February by Princeton Professor Ashoka Mody, a former deputy director of the IMF's Research and European Departments. His piece is entitled, "The IMF should get out of Greece, the Fund's involvement has been an unmitigated disaster."

The views of Ms. Lundsager and Professor Mody have been echoed in Europe as well. The head of ESM, Klaus Regling, said in an interview last year, "At this point in time, it is really not a question of IMF funding, but of using the IMF's technical expertise."

Leaders in both Germany's conservative CSU Party and left-leaning Social Democratic Party have also been quoted as saying that Europe can stand on its own two feet and no longer needs IMF's money in Greece.

I would also submit for the record a Reuters article from February 16th, headline, "German Conservative Euro-MP Breaks Ranks Over IMF Role in Greek Bailout," as well as another piece, "German SPD Says Europe Can Back Athens Without the IMF."

Without objection, it is so ordered.

My question is as follows for Ms. Lundsager, since I quoted your Reuters piece. Is there any reason to believe that the IMF couldn't just limit itself to a purely advisory role as opposed to a financing role? And if the Europeans, including Regling, are saying that it is IMF's expertise that is needed in Greece as opposed to money, is there anything that would prevent the Fund from just providing monitoring and technical assistance?

Ms. LUNDSAGER. No, and that is my preferred option.

Chairman BARR. Yes.

And, Dr. Nelson, it is often reported that Germany and others in the eurozone want the IMF in Greece because they don't have confidence in the European Commission. As Mr. Blustein's work has shown, this lack of trust among Europeans has been a running theme since 2010. The question would be, doesn't taking advantage of the IMF in this way just let Germans and other leaders off the hook?

Ms. NELSON. I think Europeans did want the IMF involved, to have the IMF stamp of approval that the program design would be sound, would be safe. However, there are questions about the co-financing arrangement and whether or not the IMF had the independence to do what it needed to do in the program.

Chairman BARR. And, Mr. Blustein, if the Europeans lack confidence in European institutions, isn't it up to the Europeans to reform them?

Mr. BLUSTEIN. That is an interesting way of looking at it. I guess my preferred option would be something like the following. The IMF should be involved if it sees, using its best technocratic judgment, that the program has been fixed so that Greece's debt is sustainable and, I agree with Meg, that it would be preferable if that involved a debt write-off.

But that shouldn't just stop there by making a technocratic judgment about a specific deal that is struck in Brussels. There ought to be a lot of conditions imposed because the IMF's credibility has been damaged by basically being dragged and, as Ashoka Mody wrote, its reputation affected in the process.

One way of doing that would be to say from now on for this program and for any other, if we have to get involved in Italy, whatever, Portugal is not completely out of the woods, then from now on when we are lending money to a country in a currency union like the euro, the countries that are on the IMF board that represent those countries, they don't get to vote, we are going to leave it up to the rest of the board to handle.

And by the way, we want the members of those countries that are in this currency union to guarantee that the IMF will be paid back in full for sure if this doesn't work out, in other words if Greece ends up defaulting on what it owes to the IMF, to protect the IMF's preferred creditor status.

So the way you look at it is, sure, it would be great if Europe could handle this problem by itself. They have understandably gone to the IMF and said we need your expertise. And to comfort ourselves that you are really comfortable with what we are doing, we want you to have some skin in the game. And that is another way of doing it.

But if there is not complete comfort and if these other conditions can't be met, then I would agree with Ms. Lundsager that the IMF should walk away.

Chairman BARR. Thank you.

My time has expired. And the Chair recognizes the gentleman from Illinois, Mr. Foster.

Mr. FOSTER. Thank you.

There is an amusing calculation that has, I think, been done by many people, that if you just go region to region around the world, you conclude that the world as a whole is a net debtor, which cannot mathematically occur. And so the reason, of course, is that various people are stashing money that is off the books in offshore accounts.

And so I was wondering, what fraction of—and there are estimates, I think, for the EU as to how much money is actually stashed offshore. How does that compare to the total shortfall that you are seeing in Greece? And would that be included with estimates for the amounts stashed off the books? Is the EU and Greece as big a debtor as actually you would conclude from the raw numbers? Do you have any feeling for how those numbers compare as possible sources of money to try to settle things here? It is in the multiple trillions of missing offshore accounts.

Ms. LUNDSAGER. Congressman, I don't know the numbers, and I don't have a good sense of how much it is. But clearly, as you point out, this is the case. The problem is governments getting access to

that, establishing the kind of policies that will bring that money back into the limelight, back into the sunshine so that it can be taxed, it can be utilized. We saw how long it took to negotiate an agreement with the Swiss government in terms of data and information sharing.

Mr. FOSTER. Oh, yes, this will be politically very, very difficult.

Ms. LUNDSAGER. Yes.

Mr. FOSTER. In no small part because of assets that may or may not be held by those in power in all of the European countries.

Ms. GELPERN. If I may add very briefly, Congressman, this is a multilateral problem that requires a multilateral solution. This is not something that the IMF can fix with Greece. And I think that is what Ms. Lundsager's comment highlighted.

Mr. FOSTER. Right. But a solution to that problem could actually at least be a partial solution to this.

Ms. GELPERN. It would do the world a whole lot of good.

Mr. FOSTER. That is right. And actually, the IMF may have a role in encouraging that globally.

Another possible endpoint that various wags have pointed to is that the way this will all end is that German investors will each have their own private Greek island at the end of this, or perhaps a 99-year lease on a Greek island. And there is a lot of real estate with a very high potential market value under the control of the Greek government and a very big political problem even in, say, getting a 99-year lease that could be sold.

But is the market value of that kind of real estate the same order of magnitude as the debt problem here? And is that at least a partial solution to this? Have there been serious efforts to make estimates of that?

Ms. LUNDSAGER. Again, I don't have the numbers at my fingertips. It could perhaps help. But if they were to try and sell it all at once, a fire sale, I think it would be very difficult to get the kind of returns that they were looking for.

Nonetheless, in every program with Greece, the effort has always been to push on the privatization, the inefficient state-owned companies or even some of the better off ones, to sell them to private entities to raise several billion euros for the government. Between that and perhaps some of the real estate holdings—but any mention in Greece of selling the Parthenon or the—

Mr. FOSTER. But large government-owned hotels, I guess, are a perfect example of something that would have an immediate market value.

Ms. LUNDSAGER. Right.

Mr. FOSTER. And those are difficult politically because they are paying salaries higher than would be justified by a peer-market solution?

Ms. LUNDSAGER. That has been part of the problem, that they do need to get back to competitiveness. But wages and prices have fallen in Greece, meaning there has been some internal devaluation, which has helped make Greece a little bit more competitive. And, of course, tourism continues to do pretty well. But otherwise, the productive sector is still languishing.

Mr. FOSTER. Mr. Blustein?

Mr. BLUSTEIN. This is one of the great mistakes the IMF made in the early stages of the crisis. It was actually after the first bailout, it was in the spring of 2011, that the IMF became kind of enamored of the idea that huge proceeds could be reaped by privatizing Greek state-owned assets. And the numbers were in the hundreds of billions of euros, so it was sort of concomitant with the size of the debt.

One of the problems was that there were, particularly involving real estate, which you mentioned, Congressman, so many squatters who had moved into these state-owned properties that it was politically just impossible for the government, people who had built homes and to sort of sell that property off and evict those people was going to be a—and that was one of the—there were many, many problems that arose as—

Chairman BARR. The gentleman's time has expired.

Mr. BLUSTEIN. Okay. So 50 billion was the first number that was used. They have ended up being able to reap about a billion euros, I think, maybe from privatization.

Chairman BARR. Thank you.

The gentleman's time has expired.

And finally, the vice chairman, Mr. Williams, is recognized.

Mr. WILLIAMS. Thank you, Mr. Chairman.

Earlier this month, the Slovak finance minister was reported as saying the amount of IMF assistance in Greece is not important. Instead, "It is really symbolic."

So for Dr. Nelson and Ms. Lundsager, my question would be, what are the implications for the IMF if its lending becomes symbolic? Wouldn't symbolic assistance mean that the Fund is straying from its traditional functions?

Ms. NELSON. The traditional function of the IMF is to lend to countries facing temporary balance-of-payments crises. It doesn't really say anything about the amount. But I do think we have veered from temporary. We are 7 years into the crisis, and Greece is still reliant on financing.

Mr. WILLIAMS. Ms. Lundsager?

Ms. LUNDSAGER. Congressman, symbolic perhaps isn't the best word to use because IMF participation can be very, very close in terms of recommendations on the policy formulation, the monetary, fiscal, financial sector policies, exchange rate, if needed, and then can be part of the team that monitors performance and assesses how the country is doing in meeting its fiscal targets or its inflation target. And IMF lending doesn't have to be part of that at all.

And we have seen that work pretty well with a number of low-income countries where the IMF actually established a policy support instrument which does exactly that, has an engagement with the country, the country invites the IMF in, but there is no IMF funding included in that, it is more of a partnership.

So absolutely, the IMF can be there. Its catalytic role used to be it would lend small amounts and then you would bring in other creditors. It doesn't really need to lend anything if other creditors view the IMF assessment, its mark of good progress, as sufficient for them to participate.

Mr. WILLIAMS. Okay. Just a quick follow up. So if people think the IMF loan is symbolic rather than necessary, how do you assess

the effectiveness of a program? And how would the Fund's evaluation officer or anyone else for that matter evaluate symbolic lending?

Ms. LUNDSAGER. For example, with the low-income countries, there is actually a board review. Staff go out for periodic reviews, assessments, and it comes before the IMF board. So it is, in that case, a formalized process. It doesn't necessarily have to be that formal, but the IMF prepares all sorts of papers all the time, if nothing else the annual Article IV, the annual review of an economy. And that can form the basis as well for monitoring.

But if the country invites the IMF in and asks the IMF to prepare a report, and share it with the board, and publish the report, then that is a way of reinforcing that role of the IMF as a designer of the policies and monitoring them as well.

Mr. WILLIAMS. Ms. Nelson?

Ms. GELPERN. Let me augment that.

Mr. WILLIAMS. Go ahead, please. No, go ahead, that is fine.

Ms. GELPERN. I'm sorry. The IMF's traditional role was to support the gold exchange standard. It has evolved since its founding to become a big player in crises, in debt restructuring. Today, the task is precisely to make the Fund effective in a world where it can never be or it can very rarely be a huge financial player, as well as being effective on the regional scale.

It did manage to go to Article IV for the eurozone. That is a good thing. Whether it is able to stay effective with no money or very little money on the line, I think, is a task for them and for us.

Mr. WILLIAMS. Dr. Nelson?

Ms. NELSON. I think it would be difficult to assess the symbolic sort of contribution of the IMF. However, I do think any sort of IMF involvement in a country can be judged against metrics of, is the country able to reenter capital markets at the conclusion of the program? Is the economy stabilized at the conclusion of the program? These sorts of metrics, I think, can be assessed regardless of the amount of money contributed.

Mr. WILLIAMS. We only have a short time left.

Dr. Blustein?

Mr. BLUSTEIN. I think you have gotten brilliant answers from my three colleagues here. I can hardly think of anything to add to it.

Mr. WILLIAMS. Okay.

Mr. Chairman, I yield back.

Chairman BARR. Thank you. And I would like to thank our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And this hearing is now adjourned.

[Whereupon, at 11:42 a.m., the hearing was adjourned.]

A P P E N D I X

May 18, 2017

TESTIMONY TO THE SUBCOMMITTEE ON MONETARY POLICY AND TRADE
OF THE HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES
"LESSONS FROM THE IMF BAILOUT OF GREECE"

MAY 18, 2017

PAUL BLUSTEIN
SENIOR FELLOW, CENTRE FOR INTERNATIONAL GOVERNANCE INNOVATION

Chairman Barr, Ranking Member Moore, Members of the Subcommittee on Monetary Affairs and Trade:

I have attended many hearings on Capitol Hill as a newspaper reporter, but this is my first time as a witness—an honor for which I sincerely thank the Subcommittee. I mention this because the expertise I bring to the subject of this hearing is that of a journalist, my main research technique being extensive interviewing as well as examination of countless documents, both publicly available ones and those which remain confidential but which interviewees kindly furnish to me, including memoranda, notes of meetings and the like. This sort of material provided the basis for my book, *Laid Low: Inside the Crisis That Overwhelmed Europe and the IMF*.

The Subcommittee's hearing on the IMF's bailout of Greece is welcome evidence of Congressional interest in a complex topic of profound importance to the future of the global economy. The Fund's involvement in Greece is rich in lessons about the workings—and failings—of the international finance system. It's a saga of many twists and turns, which I spell out at length in my book and am presenting in summarized form in this testimony.

The phenomenon of countries laid so low by financial crises as to require international bailouts was once thought confined to the emerging world—Mexico, Thailand, and Indonesia for example. The euro-zone crisis showed that advanced economies may be equally susceptible to the vagaries of globalized finance, and may need rescues too.

The importance of a muscular IMF, wielding power and authority commensurate with the strength of world markets, is thus greater than ever. The Fund, after all, is the chief guardian of global financial stability. By seeking to prevent financial crises from occurring and managing crises when they erupt, the Fund provides a global public good—that is, a good from which all nations broadly benefit and which no single nation can deliver alone.

But the IMF's involvement in the euro zone was a bruising and enfeebling experience for the institution. During the euro-zone crisis, the Fund joined in several rescues despite grave misgivings among members of its Executive Board and top economic and legal officials—and it did so under pressure from top European

polymakers, who maintain heavy influence over the Fund's levers of control. Some of these emergency loan packages worked out well, but all too often debt was piled atop debt, and excessively harsh conditions were imposed on crisis-stricken countries. This approach, taken in conjunction with the Europeans, suited nations such as Germany and France, whose banks were anxious to stave off losses and whose voters were incensed at paying to bail out countries they perceived as irresponsible. It also suited the European Central Bank (ECB), because it helped preserve the international status of the euro and the ECB's independence—principles on which the central bank's leaders attach supreme importance.

The approach that was taken was not entirely misplaced; it was based on fears that the crisis would spread, via financial "contagion," to the rest of Europe and elsewhere around the world. But the legitimate interests of the crisis-stricken countries were sacrificed in the process—and I believe the crisis was more prolonged, painful, and near-catastrophic than it ought to have been. Although IMF economists—to their credit—perceived serious flaws in these bailouts, they often yielded to the clout of policymakers in Berlin, Frankfurt, Brussels and Paris. Especially in the early years of the crisis, the Fund was relegated to the role of junior partner in the tripartite arrangement known as the Troika, which consisted of the Fund, the European Commission and the ECB.

The result sapped the institution of its most precious asset—its credibility as an independent, neutral arbiter of how to address economic and financial problems in countries around the world. Heavy damage was thus inflicted on the IMF's ability to serve as a crisis-fighter and fixer of economic problems—and that raises concerns about the management of future crises.

Given its weighty duties, the IMF has consistently strived to maintain an image as a technocratic institution, free of gross political interference. Although it has often fallen short, there are sound reasons for hewing as close as possible to the ideal. The Fund stands the best chance of success when, in both appearance and reality, it represents the interests of the world community writ large rather than any single power or region. In the case of financial emergencies, one of the Fund's primary goals is to help a country that has lost the confidence of investors regain access to

financial markets. The money the Fund lends is only a part, and perhaps a relatively unimportant part, of its value. Equally crucial, if not more so, is its seal of approval—its signification that the country is adopting policies conducive to economic fitness. If the Fund's seal of approval is severely tarnished, especially by the perception of manipulation by forces from on high, its effectiveness at restoring market confidence will be eroded. Cynicism among market players about the Fund's susceptibility to political meddling makes its job much harder—an unwelcome development at a time when financial crises have become so pervasive.

The Greek crisis was where the damage was greatest, both to the country and to the IMF. In retrospect, Greece was saddled with an excessively high debt and should have gotten relief from its indebtedness much earlier than it eventually did. Although we will never know whether earlier debt relief might have made a difference, it seems quite reasonable to surmise that the Greek economy would have undergone a significantly less wrenching collapse than the 25% contraction in GDP that occurred between 2008 and 2015. And in retrospect, the IMF should not have submitted as readily as it did to European political exigencies; reputation-wise, the Greek crisis has been perhaps the worst debacle in the Fund's history.

In my book, I use the term “Faustian bargain” to describe how the IMF became involved in Greece in the spring of 2010. This bargain is crucial to understanding much of what happened as the crisis unfolded.

THE ORIGINS OF THE IMF'S INVOLVEMENT IN GREECE

In January 2010, a secret meeting took place in a hotel kitchen in Davos, Switzerland, during the annual meeting of the World Economic Forum. There were three participants—Dominique Strauss-Kahn, then the IMF's managing director; George Papanadreou, then the newly-elected prime minister of Greece; and George Papaconstantinou, who was Papandreou's finance minister. They met in a kitchen, with waiters bustling back and forth carrying trays, to make sure they wouldn't be seen by the many reporters who cover the Davos gathering.

Here's the background to this meeting: Greece had borrowed its way into deep trouble—its government debt totaled more than

€300 billion, which was a bit more than the country's annual GDP. Worse yet, the Greek government had done so without properly disclosing the degree of its profligacy. The budget deficit for 2009 was turning out to be several times higher than previously reported, and the ratio of debt to GDP—then estimated at 115%—was clearly on the rise. Financial markets were worried that Greece would fall prey to what economists call “exploding debt dynamics,” which refers to an ever-increasing debt-to-GDP ratio as higher interest rates, a sluggish economy and chronic deficits drive the ratio inexorably upward with the passage of time. (This phenomenon is analogous to an individual who, having borrowed an excessive amount from credit card companies, gets hit with much higher interest rates at the same time as his or her income falls, and keeps trying to borrow more until eventually being overwhelmed by mushrooming demands for interest and principal.) The nightmare scenario was that Athens would default on its debt obligations, leading ultimately to the country's abandoning or effectively being expelled from the euro zone, with hellish chaos certain to ensue.

Papandreou's government was doing what any over-indebted entity is supposed to do—cut spending and raise income. But the markets were highly skeptical that Athens could or would go far enough, and interest rates on Greece's borrowing were soaring, which of course increased the threat of exploding debt dynamics.

So Papandreou and Papconstantinou had a question for Strauss-Kahn: Suppose Greece couldn't borrow money at anything like an affordable rate. Would the IMF provide the money the government needed to continue paying its obligations? At that point, in early 2010, Greece's European partners—especially Germany—were balking at the idea of lending to Athens, on the grounds that the rules of the European Monetary Union contain a “no bailout” clause. The European position would later change, but at that point it appeared that Greece's only recourse might be the IMF.

Strauss-Kahn's answer to the Greeks was not as comforting as they had hoped. He said that of course the IMF would try to help any member country requesting aid, but there were two problems: First, Greece would need a lot more money than the Fund alone could provide; and second, the Fund would not be able to provide a loan without the support of Europe, because European countries held a large (and disproportionate) share of the votes on the IMF.

board.

At that point, the overwhelming majority of top European policymakers were vehemently opposed to an IMF rescue for Greece. This aversion resembled the denial syndrome that afflicts leaders of pretty much any government facing the need for an international bailout. They believed that Europe could—and should—handle its own internal problems, and that seeking help from the Fund would be tantamount to admitting that their monetary union was weak and ineffectual. According to Papaconstantinou, who has written a memoir, French president Nicolas Sarkozy told him: “Forget the IMF. The IMF is not for Europe. It’s for Africa—it’s for Burkina Faso!”¹

But the IMF was eager to play a part—Strauss-Kahn most of all. One big reason was that the world had gone for many years after 2002 with no major financial crisis for the Fund to manage, and the Fund’s very relevance and *raison d’être* had been called into question. The Fund had undergone a sort of existential crisis during this period, when it was forced to downsize its staff on the grounds that the need for such an institution had diminished.

On the surface, Strauss-Kahn and other IMF officials avoided any comments indicating that they were pressing for a big role in Greece or yearning for an invitation to provide major assistance. Behind the scenes, however, Strauss-Kahn was doing whatever he could to assuage Europeans’ worries and objections to IMF involvement, because of his anxiety to to avoid exclusion lest doubts arise anew about the Fund’s *raison d’être*. He made it clear that the Fund would accept a junior partner role—an almost unprecedented step, because in past cases when the Fund joined forces with other institutions and donors (such as the World Bank), it has played the dominant role in designing terms and conditions, in recognition of its expertise and status as agent of the international community. Only in one case, the 2008 crisis in Latvia, had the IMF accepted a junior partner position, putting up a minority of the funding and acceding to the view of European officials in a disagreement over Latvia’s exchange rate policy.

This is where the Faustian bargain comes in. In my interviews with

¹ George Papaconstantinou, 2016, *Game Over: The Inside Story of the Greek Crisis*, CreateSpace Independent Publishing Platform, Chapter 8.

Strauss-Kahn, he told me that he felt it would have been “lethal to the IMF if the Europeans would handle the crisis by themselves.” Accordingly, he recalled telling top European Commission officials at a meeting in Brussels: “We [the IMF] have to be in, but you will be the leader.” His reasoning was that the IMF would bring expertise and credibility to the crisis that no European institution could match, and to ensure that its views were taken seriously, the Fund would have to make some financial contribution—something less than 50% of a rescue loan, but well above zero. At the same time, the Fund could not expect to exercise the sort of total control over economic policy that it does in most countries because, in this case, it could not realistically demand policy action by the central bank—the ECB being the central bank for all 300 million people living in the euro zone, only 11 million of whom are Greek.

As is well known, the decision about the IMF ultimately came down to one person—German Chancellor Angela Merkel, who effectively overruled Sarkozy and other European leaders at a summit in late March 2010. She concluded that the German Bundestag, and the German public, would never accept funding an emergency loan for Greece unless it came with severe conditions, enforced by arbiters with recognized neutrality and competence—and the IMF was the only institution that came close to this description. So the IMF was in, albeit on junior partner terms, which eventually were negotiated to mean that the Fund’s contribution to the rescue loan would be roughly one-third of the total requirement.

I should add in this regard that the term “junior partner” has been rejected by some at the IMF, including the Fund’s own Independent Evaluation Office, as an apt description of the role the Fund played.² But I can assure you that Strauss-Kahn himself accepted that term in conversations with me and in emails he sent me. He contended, with some reason, that the IMF had little choice if it was to be involved at all.

THE FIRST GREEK BAILOUT (MAY 2010)

With the Troika having thus been constituted, missions from the three institutions were dispatched to Athens in mid-April 2010, the aim being to negotiate what came to be known as “Plan A”—that

² IMF Independent Evaluation Office, 2016, “The IMF and the Crises in Greece, Ireland and Portugal: An Evaluation by the Independent Evaluation Office,” July.

is, a loan of many billions of euros to restore stability by ensuring that Greece could avert a catastrophic default on its obligations coming due over the next two or three years. A huge deadline was looming only a few weeks away, when €8.5 billion was due on May 19 to Greece's bondholders. So intense negotiations took place over a relatively short period of time, in late April and early May, over the terms of this loan. The result was an international bailout of unprecedented size.

Of course, emergency loans of this type invariably come with conditions, and the toughest demands for Greece to accept austere policies were coming from two power centers, the German government and the ECB. It was perfectly reasonable to expect Greece to undergo substantial belt-tightening, since the country had essentially been living well beyond its means for some years. The question was how much austerity would be sensible, because by taking too much money out of Greek pockets, the country's economy—already in recession—would undergo additional contraction, which would be counterproductive; it would cause a vicious circle in which the debt-to-GDP ratio would rise, exacerbating fears about exploding debt dynamics.

The IMF was commendably “dovish” in arguing within the Troika for a somewhat less harsh approach that would give Greece a couple of extra years to shrink its budget deficit. Even so, the rescue program was going to oblige Athens to undertake one of the biggest changes in budget and tax policy in history. Government outlays would be cut by 7% of GDP—and to put that into more understandable dimensions, it is a greater amount, as a percentage of U.S. GDP, than the our government spends on Social Security, Medicaid, military retirement and unemployment insurance combined. Tax revenues would increase by 4% of GDP—which is equivalent to an increase of \$8,600 in the taxes paid by an average American family of four.

Plainly, Greece would require measures to counter the recessionary impact of a tight fiscal policy, or it would fall into an endless downward spiral of recession and a worsening debt-to-GDP ratio. Because of its membership in the euro zone, the country was precluded from the policies that most governments adopt under such circumstances—that is, pumping up the money supply and devaluing the currency. That left one option, namely structural reforms aimed at enhancing the productivity, efficiency

and flexibility of the economy. The Fund and European Commission had long been exhorting Athens to embrace such reforms, and now they had the leverage to impose them. These reforms included streamlining Greece's notoriously overstaffed state owned enterprises, changing labor laws that favored unions, and opening up professions that had long enjoyed protection from competition. According to Troika projections, if Greece faithfully adopted all of these measures, its economy would begin to recover in 2012, after contracting by 2.6% in 2011.³

For an idea of the skepticism about this plan that pervaded the IMF staff, see the confidential memo dated May 4, 2010 by Olivier Blanchard, then the Fund's chief economist, which I disclose in my book. (A copy of the most relevant portions, with key phrases underlined, is reproduced as Exhibit 1.) The degree of budgetary belt-tightening required of Greece "has never been achieved" by any other country, the memo warned. Furthermore, "even with fully policy compliance...there is nothing that can support growth against the negative contribution of the public sector....the recovery would likely be L-shaped, with a recession deeper and longer than projected." The program is thus likely to go "off track even with perfect policy implementation." Put in plainer English, this meant that even if Greece did everything being asked of it, the economy would sink further, because the structural reforms—no matter how sensible—simply wouldn't generate enough of a stimulatory effect. Structural reforms, after all, almost always take a fair number of years to generate positive effects on GDP.

A graphical depiction (See Exhibit 2) helps make clear the grim implications of Blanchard's concerns. In this graph, originally included in a public IMF document in May 2010, the dark solid line shows the projected path for Greece's debt-to-GDP ratio—first peaking, at about 150% of GDP, then sloping back down to relatively sustainable levels—if all the assumptions in the program proved valid (that is, if Greece did everything demanded of it, and the economy responded as forecast.) The dotted line shows what would happen if *just one* of the major assumptions proved too optimistic—that is, if economic growth turned out to be one percentage point a year worse than projected. Under that less rosy scenario, the debt-to-GDP ratio wouldn't decline; it would stay very

³ IMF, 2010, "Greece: Staff Report on Request for Stand-By Arrangement," Country Report No. 10/111, May.

high, almost certainly above sustainable levels. An even more explosive debt path would result if several of the assumptions went unmet.

One credulity-strainer in the first Greek rescue merits particularly close attention. The table in Exhibit 3 shows the Troika's projections in 2010 for Greece's primary budget surplus (that is, the budget surplus excluding interest payments on government debt). The Troika was assuming that the Greek government would run a surplus of about 6% of GDP each year from 2014 to 2020. Obviously if Greece could achieve such a high degree of fiscal rectitude that would help reduce its debt-to-GDP ratio to sustainable levels. But such a large budget surplus entails taking massive amounts of money in taxes from ordinary citizens while putting much less back into the economy in the form of government spending. The assumption that a country like Greece could achieve such a goal year after year was absurd—and other assumptions were too.

THE INTERNAL DEBATE OVER THE RESCUE

Small wonder, given the shaky prospects for Greece to stabilize its debt-to-GDP ratio, that a debate was raging behind the scenes at the IMF about whether to try a Plan B—namely, a “haircut” for the country's creditors in which they would accept reduced and/or delayed payments of interest and principal. Fund economists were divided on this issue; some, especially in the European Department, contended that the rescue stood a decent chance of working if Athens fulfilled all of its promises. But others were more in the Blanchard camp, and in any event the Fund had a high standard for approving a large loan in such cases. The Subcommittee is well familiar with this standard, I believe—its formal name is the Exceptional Access Policy, but in my book I call it the “No More Argentinas rule,” because it was implemented not long after the disastrous failure in 2001-2 of the Fund's rescue for Argentina, when the country defaulted and fell into total economic chaos a few months after receiving a Fund loan. Under the No More Argentinas rule, the IMF could make a large loan to a country in crisis only if rigorous analysis showed that the country's debt was “sustainable with high probability”; otherwise the country should undergo a debt restructuring. Very few people if anyone at the IMF believed Greece met this criterion.

At Strauss-Kahn's direction, high-level staffers from two departments that favored a Plan B-type approach (the Strategy, Policy and Review Department and the Legal Department) held secret discussions in late April 2010 with officials from the German and French finance ministries, in the hope of starting to lay the ground for a debt restructuring. As I report in my book, these discussions were so sensitive that they were held at a Washington hotel rather than in the IMF headquarters building. One reason for the secrecy was the concern that if word leaked, markets would go even more haywire than they already were.

Equally important, any talk of a debt restructuring was drawing enormously powerful and vehement opposition, the most formidable critic being Jean-Claude Trichet, the president of the European Central Bank. For Trichet, who was one of the founding fathers of European Monetary Union, it was unthinkable that a euro zone country would fail to honor its debt obligations in full and on time. In addition to the moral issue, he feared the contagion that might result; once bondholders saw the debt of one euro zone country restructured, they would dump the bonds of other countries in the zone, potentially leading to a catastrophe redolent of the Lehman Brothers bankruptcy in 2008. Advocates of Plan B tended to agree that such fears were reasonably well-founded, but their rejoinder was that countermeasures could be put into place to limit contagion and keep markets stable. And as we now know, the ECB finally took action in the summer of 2012—the so called “whatever it takes” strategy, technically dubbed “Outright Monetary Transactions”—to quell market turbulence once and for all, an action that pretty much ended the viral stage of the crisis. But in 2010, the ECB was unwilling to use its money-creation powers to nearly such an extent.

So it was back to Plan A—€110 billion in loans for Greece, including €30 billion from the IMF and the rest from European governments and institutions. Even if the secret meetings had fully persuaded the German and French ministry officials (which they didn't), opposition to Plan B from other quarters was too strong. Time was of the essence, given the bond payments coming due on May 19; in a sign of the urgency involved in getting Plan A finalized, the IMF board scheduled a meeting on Mother's Day, May 9, to approve the Fund's part of the bailout.

This board meeting was one of the most consequential in the

IMF's recent memory—the loan the Fund was making to Greece, after all, was the largest in history, both in absolute terms and relative to the size of Greece's quota (contribution to the IMF's pool of resources). It has been known for some time, thanks to the leak of a memo to the *Wall Street Journal*, that although the board approved the loan to Greece based on its tradition of consensus, members were sharply divided and quite a few expressed deep reservations about the wisdom of imposing austerity on Athens without requiring the country's creditors to accept any losses. It is also well known that the board enacted a change in the No More Argentinas rule that was inserted into the staff report for the program the board was approving.

A more recent revelation about this meeting, which is reported in my book and came to light with the release of the official minutes in 2015,⁴ is that the directors didn't know about the rule change until the meeting was almost over, when one of them raised questions about some jargon-laced wording on the 19th and 20th pages of the staff report. So not only was the Fund breaking its rule, it was doing so in a manner that can charitably be described as fast and loose.

THE MISSED OPPORTUNITY

A few days after this board meeting, Strauss-Kahn summoned Panagiotis Rourneliotis, who served as Alternate Executive Director for Greece on the board, to his office, and urged him in confidence to convey to Athens the need for an early debt restructuring. This episode reflects well on Strauss-Kahn's perspicacity. But it also raises one of the most troubling questions about the Greek crisis: why wasn't a strenuous effort forthcoming to reduce the country's debt burden soon after May 2010, in the latter months of that year?

The IMF had good reasons to avoid risking a debt restructuring during the spring of 2010. Substantial time would have been required for all the legal procedures that are involved, and failure by Athens to make the payments due to its creditors on May 19 might well have led to a "Lehman moment," given the lack of an

⁴ IMF, 2010, "Minutes of Executive Board Meeting 10/45-1," May 9 (published in the IMF Archives in July 2015).

adequate “firewall” to prevent contagion and other groundwork that would have been necessary for bondholders to accept losses. But suppose Strauss-Kahn had quietly told the IMF’s Troika partners that very soon thereafter, the Fund would insist on a restructuring. He might have said that the Fund would simply not lend its good name and credibility to a plan with insufficiently high likelihood of leading to debt sustainability.

Such an approach would have required confronting Europe’s high and mighty. It presumably would have also required overcoming resistance from the U.S. government, which was still suffering from post-Lehman trauma. Although American officials were playing a much less dominant role in this crisis than they had in previous ones, the United States is the IMF’s most powerful single shareholder, and its officials were opposed to any debt restructuring in the absence of a strong firewall.

Most daunting of all would have been the face-down with Trichet. The ECB president was prone to umbrage when the subject of restructuring a euro-zone country was broached, and he had declared himself loath to take the kinds of monetary policy steps that would have been needed to limit contagion.

In my book, I call this hypothetical scenario a “poker play that would have been the greatest in the history of the global economy.” If the IMF had forged ahead with a debt restructuring, how might Trichet have reacted? Would he have stood his ground, even at the cost of risking a breakup of the currency union? Or would he have grudgingly used every conceivable monetary policy instrument to pacify market alarm? Could the IMF have called his bluff?

The IMF did not attempt this audacious step because—to carry the poker metaphor further—its managing director believed the Fund would only have gotten itself expelled from the card table. As Strauss Kahn told me when I asked him about this imaginary showdown: “We were just recovering, trying to re-establish our role in the global system. I could play this game a little. But I couldn’t go too far.”

THE SECOND BAILOUT OF GREECE (MARCH 2012)

By the third quarter of 2011, with Christine Lagarde now serving as

IMF managing director, it was clear that Plan A was going terribly awry. GDP was declining much more rapidly than the Troika projected; the Greek economy ended the year contracting by 7.1% (vs. the minus 2.6% forecast), and the debt-to-GDP ratio rose to 170% (vs. the 133% forecast). Greece was falling into exactly the sort of vicious cycle that had been feared in the spring of 2010. Was Greece fully abiding by the conditions to which it had agreed? No, but the main reason for the woes afflicting the Greek program was the counter-productive effect that fiscal austerity was having on an economy that had no real means of stimulating growth in the short term.

A new rescue program was in the works, and within the Troika, the IMF was in the forefront of insisting that this time significant “PSI”—private sector involvement, in which Greece’s bondholders would undergo a haircut—must be included. The final deal, approved in March, provided for Greece to receive the biggest debt relief in history. Approximately €200 billion worth of Greek government bonds were subject to a haircut that amounted to well over 50%—estimates have ranged as high as 75%, depending on the calculation method⁵—in which each €1000 of bonds would be exchanged for a package with €465 in face value (consisting of a modest amount of cash, plus new government bonds.) To effectuate such a deep haircut, an ingenious scheme was used involving collection action clauses (CACs). These clauses oblige all holders of a bond issue to accept the terms of a debt restructuring if a sufficient number agree, and the Greek government was able to approve legislation retroactively inserting the clauses into the vast majority of its bonds, which happened to have been issued under Greek law.

Was this debt restructuring desirable? Absolutely, but the problem was that it was too little, too late. Despite all the relief Greece was receiving on its private debt (that is, its bonds), Athens would still be laboring under a huge, €300 billion-plus debt burden because of all the money it borrowed from the official sector (that is, European governments and institutions, and the IMF itself). This point illustrates why bailouts of unsustainably indebted countries can be so injurious. One major drawback is the moral hazard that

⁵ Jeromin Zettelmeyer, Christoph Trebesch and Mitu Gulati, 2013, “The Greek Debt Restructuring: An Autopsy,” Peterson Institute for International Economics, Working Paper 13-8, August.

occurs when private lenders conclude they will be able to get their money back, courtesy of the public sector, no matter how foolish their loans may have been in the first place. Another problem, of more profound concern to citizens of the country being “rescued,” is that debt to official bodies may be very hard to restructure, harder even than debt to private creditors. That is especially true for money owed to the IMF; the Fund enjoys “preferred creditor status,” which means that when a country has received international bailout loans, the Fund must be repaid ahead of all other creditors. The Fund, after all, is the closest thing the world has to an international lender of last resort, lending to countries in situations where all other sources of credit have dried up—metaphorically, entering burning buildings while others are fleeing. This means IMF claims get top priority and countries that fail to repay their IMF loans can expect to be treated like international financial pariahs.

Concern at the IMF about whether the second bailout would work is fairly evident in documents I reviewed for my book. Perhaps the most colorful illustration is a comment that Lagarde made when the broad outlines of the deal were struck at 5 a.m. on February 21, 2012, after a grueling, all-night meeting in Brussels. As European officials were clapping one another on the back in relief over the agreement, Lagarde said: “Don’t celebrate guys. In a couple of years, you’re going to have to dig in your pockets again for Greece.” Again, to understand such skepticism, consider the size of the primary budget surpluses the Greek government was expected to generate under this program—between 4% and 4.5% of GDP each year all the way until 2030, as shown in the table in Exhibit 4. That was less than the 6% of GDP assumed in the first bailout, but it was still ambitious to a ridiculous extreme.

Internal Executive Board documents cited in my book reflect intense criticism at the meeting the board held on March 15, 2012, to approve this program. The Canadian representative at the meeting hit the nail on the head when he contended that Greece’s debt should be “brought down to well below the level targeted in the program, through a combination of more ambitious PSI/OSI.” By “OSI,” he meant “official sector involvement”—in other words, acceptance by Greece’s official creditors of reduction in their claims. But European officials were unwilling to go far in that direction; although they accepted lower interest payments and postponements in maturities on the debt Greece owed them, they

refused to accede to outright forgiveness of the loans they had extended to Athens—a position they have continued to staunchly maintain.

THE LATTER STAGES OF THE CRISIS AND THE THIRD BAILOUT OF GREECE

It is important to note that, although the IMF deserves criticism for bowing to European pressure, it deserves credit for standing up to Europe on a number of occasions, especially during the period starting in the latter half of 2011 after Lagarde became managing director. In August of that year, Lagarde gave a speech questioning whether European banks were adequately capitalized, which infuriated leading officials in the region. In October 2012, analysis issued by the Fund's Research Department, which Blanchard directed, sharply challenged the prevailing European orthodoxy favoring austerity for dealing with crises. In the spring of 2013, when Cyprus underwent a crisis, the IMF succeeded in overcoming European resistance to an approach that Fund officials favored. Although this victory wasn't quite as impressive as has been portrayed in the news media—an approach the IMF would have preferred even more for dealing with Cyprus was rejected by Europe, as my book reveals—it is fair to say that the Cypriot crisis was one of several examples of the Fund taking a considerably tougher and more independent stance than it had before.

Perhaps the most salient illustration of the IMF's increasing assertiveness was the drama that unfolded in 2015 when a radical leftist government came to power in Athens. During this period, the IMF was often credited, justifiably, with playing the role of "honest broker" between Greece and its European creditors—that is, demanding far-reaching reforms from the Greeks while simultaneously insisting that Europe accept debt relief that would put Athens on a sustainable path. For example, when European finance ministers met in Riga, Latvia in late April 2015—an episode that was widely depicted as a massive ganging-up on Greek finance minister Yanis Varoufakis—Poul Thomsen, the director of the Fund's European Department, said, according to notes of the meeting: "I want to caution you, ministers...very significant debt relief will be necessary...do not be surprised when this will come." Fund documents issued during the tense standoff between Athens and Europe in the summer of 2015 provided laudably candid

assessments about the dimensions of the debt problem. And when Greece's left-wing government capitulated to European pressure in July 2015 by accepting yet another harsh rescue package, the IMF finally refused to go along, stating that it would join only after a plan was agreed that would assure reductions in the debt burden in more realistic accord with the country's ability to pay.

It would be misleading, however, to attribute these developments to the change in IMF leadership in mid-2011. Tempting as it is to conclude that the dauntless Lagarde showed more gumption than the crafty Strauss-Kahn, the crucial factor was the different position the IMF found itself during the months after Lagarde's arrival. In contrast to the situation in 2010, when Strauss-Kahn was struggling to ensure that the Fund would play a role in the crisis, Europe was far more anxious during the period starting in late 2011 to keep the Fund involved. This was the time when Europe's need for Fund involvement—both its money and its credibility—was at its peak, and so was the Fund's leverage.

Commendable as the IMF's frankness was in 2015 regarding Greek debt sustainability, I believe the Fund should have been tougher regarding the country's official debt—and acted sooner. It should have exploited the greater leverage that it had to better advantage.

Consider in this regard the strong public statements that Fund officials have made in the past couple of years concerning Greece's primary budget surplus. In mid-2015, an IMF document derided European expectations that Athens could maintain a 3.5% of GDP surplus over the medium term, noting that "few countries have managed to do so."⁶ In April 2016, Lagarde declared at a press conference: "What we find highly unrealistic... is the assumption that this primary surplus of 3.5% can be maintained over decades. That just will not happen."⁷

Lagarde was absolutely right, and she should be applauded for speaking out. Yet recall that the IMF went along with much bigger long-term primary surplus targets, both in the first *and* second bailouts. Why did it take so long for the Fund to deem these

⁶ IMF, 2015, "Greece: An Update of IMF Staff's Preliminary Public Debt Sustainability Analysis," Country Report 15/186, July 14.

⁷ IMF, 2016, "Press Briefing of the Managing Director," April 14.

targets to be economically and socially unattainable? A charitable answer would go as follows: Only later in the crisis did the Fund gain sufficient insight into the Greek political system to see how misplaced its confidence was in the attainability of those targets, and only then could the Fund act resolutely in the face of European resistance. A less charitable answer—which I believe is more apt—is that the IMF took too long, both for Greece’s stake and its own, to muster sufficient pluck.

CONCLUSIONS

Christine Lagarde has restored the IMF’s luster and enhanced its public profile since taking over after the sordid episode of May 2011 that led to Strauss-Kahn’s resignation. Indeed, she enjoys enormous admiration and popularity; her pronouncements on all manner of issues routinely receive respectful attention worldwide. She mobilized a major boost in the IMF’s financial resources from member countries, and was a shoo-in for a second term in 2016 after serving her first five-year term, with unanimous and enthusiastic support of the Fund’s board. When she appeared on *The Daily Show* in 2015, the studio audience welcomed her with wild applause as she bantered with host Jon Stewart—a public relations tour de force that would have boggled the minds of Fund press officers back in the day of her staid predecessors.

At a time when the managing director is held in such high esteem, concern about the IMF’s place in the world might seem incongruous. But all the *bon mots* in the world cannot erase the more substantive developments involving the Fund’s role in Europe both before and after Strauss-Kahn’s departure, nor the harm that resulted.

One word aptly describes the IMF’s role as junior partner in the Troika: travesty. The arrangement struck in the spring of 2010 was an original sin that led to many others. Even though the Fund was putting up a minority share of the loan package for Greece, it should have participated as senior partner, with the power to determine the terms and conditions of the rescue, based on an understanding that it would consult European policy makers without being obliged to defer to them or reach compromises with them.

This is not to say that compromise between the IMF and major

shareholders is necessarily bad; the Fund is a political institution at the end of the day, with a management and staff accountable to the board that represents the member countries. The Fund has been obliged to reach some sort of accommodation with major industrial countries in virtually every crisis it has confronted—one famous example being the role played by U.S. Treasury and Federal Reserve officials during the Asian crisis of the late 1990s.

But in the euro-zone crisis, the line separating legitimate influence from harmful interference was not only crossed, it was trampled on. From the standpoint of the IMF's integrity, the control that Europeans exerted in the euro-zone crisis posed a different and much more harmful threat than that of U.S. officials during previous crises. Unlike the United States, European nations were borrowing from the Fund. Even the rich European countries that never needed IMF aid were in many respects supplicants, using the Fund—both its seal of approval and its money—to save their terribly flawed system of money union. Not only were policy makers from these rich European countries desperate to protect the euro, they were aiming at the same time to ensure their political survival; they were concerned about placating angry, fed-up electorates. For Europeans to be pushing the Fund around under such circumstances was an affront to robust multilateralism.

When it came to the euro zone, therefore, the Europeans should not have been “the leaders,” as Strauss-Kahn put it in his meeting with them in the spring of 2010; the working assumption all along should have been the opposite. Ideally, the Fund should have gotten even more clout, in the form of what I call “super senior” partnership—that is, the authority to set terms and conditions for the entire euro zone. Under the Troika arrangement, the Fund was sitting on the same side of the negotiating table as the ECB, but it should have sat on the opposite side, and it should have had the power to require action from all of the member countries, not just the ones urgently in need of international assistance. As just noted, the Fund was coming to the rescue of the euro; if the countries using that currency were not willing to take the steps that the Fund believed necessary, they of course had the right to refuse. But the Fund had the right, and arguably the duty, to tell the Europeans they would then be left to their own devices.

This is not to imply that the IMF is endowed with such brilliant insight that it can be assured of diagnosing every international

economic and financial problem accurately and prescribing optimal policies. Quite the contrary, my book provides extensive evidence showing how the Fund often makes faulty assessments—for example, the Fund completely failed to foresee vulnerabilities in Europe prior to the crisis. But the case for the Fund exercising supreme authority in financial crisis situations should be based not on its infallibility (which it clearly does not have), but on its independence, objectivity, and global perspective. In other words, although the Fund cannot credibly claim to have superior wisdom regarding each and every crisis that comes along, it should be in a position to assert that its analysis must take priority by dint of its status as a multilateral institution entrusted by the international community to exercise neutral, objective judgment about the best possible resolution.

The question is what the IMF ought to do now to undo, or at least mitigate, the damage done to its credibility and effectiveness in future crises.

Nobody can foresee with any degree of certainty where the next crisis will arise—perhaps it will be Asia, or Latin America. But when it happens, powerful countries may insist that the IMF play a junior partner role again, based on the precedent set in Europe. They may wish to use the IMF to endorse their view of how matters should be handled, possibly for narrow reasons of national interest (protecting their big banks from taking severe losses, for example). Although the euro zone is *sui generis* to some extent, as the only major region of the world with a currency union, that does not mean the problem that arose there with regard to the IMF's role could not happen elsewhere.

Regional financial institutions and ad hoc arrangements among countries are on the rise, one motive being to create alternatives to the IMF or at least influential adjuncts to it. The most recent of these is the BRICS countries' \$100 billion Contingency Reserve Arrangement (CRA), a pool of currencies intended "to forestall short-term balance of payments pressure, provide mutual support and further strengthen financial stability." Although entities such as the CRA will never supplant the IMF, it is not hard to imagine that, in a crisis, they could be used to help tilt the terms of rescue packages in directions that suited major countries' governments, against the Fund's best judgment. Such an approach would erode the IMF's value as a global public goods provider, which would be

to the long-term detriment of all.

In the final chapter of my book, I list a host of policy recommendations aimed at addressing the problems I have cited. These proposals include changes in IMF governance and the establishment of a new Fund facility for handling countries in need of debt restructuring. This portion of the book is the least valuable; many people with greater expertise than I have on these issues are more qualified to figure out how to fix the system. As a journalist whose competitive advantage lies in reporting and writing a narrative, I like to fancy that I have provided an accurate chronicle of events that will be useful to informing the public debate.

Whatever remedies are adopted, they should fully take on board the extent of the IMF's misadventures in Greece. Only then will the Fund stand a decent chance of providing global public goods of the sort the world needs.

EXHIBIT 1



Office Memorandum

To: Mr. Thomsen

May 4, 2010

From:  Olivier Blanchard

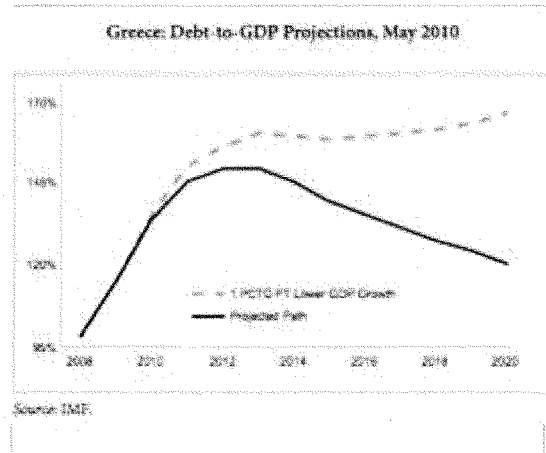
Subject: Greece: Request for Stand-By Arrangement

The report should recognize at the outset that the degree of adjustment envisaged in the program is exceptional and entails severe risks. International experience indicates that a 16 percent cumulative fiscal adjustment over such short period (and with this extent of frontloading) has never been achieved. The absence of other policy levers (interest rates, exchange rates) and far-from-favorable external circumstances (external demand) further complicate the picture.

The program could go fast off track (even with full policy compliance). In the absence of a strong export rebound, there is nothing that can support growth against the negative contribution of the public sector (about 8 percent and 4 percent in 2010 and 2011, respectively). Then, the recovery would likely be L-shaped, with a recession deeper and longer than projected, followed by a period of sluggish growth. This would mean fiscal shortfalls and more severe strain in the financial sector (more fiscal shortfalls).

We are concerned about likely policy slippages and internal inconsistencies in the program that may lead it off track even with perfect policy implementation. We are well aware of the constraints bearing on the design of the program. For that reason, we believe it is critical to reach a clear and confidential understanding with the authorities and the EU on how to proceed forward should such circumstances materialize (this may possibly involve a side letter).

EXHIBIT 2



Source: IMF, 2010, "Greece: Staff Report on Request for Stand-By Arrangement," Country Report No. 10/111, May.

EXHIBIT 3

Table A.1. Greece: Public Sector Debt Sustainability Framework, 2008–2020
(in percent of GDP, unless otherwise indicated)

	Actual		Projections															
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020					
Baseline: Public sector debt 1/	98	115	133	145	149	149	145	139	135	131	127	124	120					
Change in public sector debt	2.1	17.5	18.1	11.9	3.6	0.9	-4.7	-5.5	-3.9	-3.9	-3.5	-3.4	-4.1					
Identified debt-creating flows (2+7+12)	-0.5	16.3	18.2	11.9	3.6	0.6	-6.3	-5.5	-3.8	-3.8	-3.8	-3.7	-4.0					
Primary deficit	0.7	8.6	2.4	0.9	-1.0	-3.1	-5.8	-6.0	-6.0	-6.0	-6.0	-6.0	-6.0					

-5.9	-6.0	-6.0	-6.0	-6.0	-6.0	-6.0	-6.0
2014	2015						2020

Source: IMF, 2010, "Greece: Staff Report on Request for Stand-By Arrangement," Country Report No. 10/111, May.

EXHIBIT 4

Table 9. Greece: Medium-Term Macroeconomic Framework, 2010–20

	2010	2011	2012	2013	2014	2015	2016	2020
	Projections							
Public finances (general government, percent of GDP)								
Total revenues	39.5	41.0	42.2	42.2	42.1	40.1	40.1	40.1
Total expenditures	50.1	50.3	49.5	48.8	44.2	41.7	42.0	41.3
Primary expenditures	44.6	43.4	43.2	40.4	37.6	35.6	35.6	35.8
Overall balance	-10.6	-9.3	-7.3	-6.6	-2.1	-1.6	-1.9	-1.2
Primary balance	-5.0	-2.4	-1.0	1.8	5.5	4.5	4.5	4.5

Modified, as of Nov. 2012

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2020	2025	2030
Baseline: public sector debt 1/	187.3	182.5	179.3	167.9	170.8	177.5	178.3	174.5	170.0	162.7	124.0	101.3	83.6
Of which: foreign currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in public sector debt	-6.2	5.2	16.8	18.6	22.7	-13.1	20.9	-3.9	-4.5	-7.2	-9.9	-3.5	-3.5
Identified debt-creating flows (4+7+12)	-0.2	5.5	16.5	16.5	19.9	-57.8	11.6	1.1	-3.7	-6.8	-9.7	-4.1	-3.8
Primary deficit	2.0	4.8	10.4	4.8	2.3	1.5	0.0	-1.5	-3.0	-4.5	-4.3	-4.0	-4.0

Source: IMF, 2012, "Greece: Request for Extended Arrangement Under the Extended Fund Facility—Staff Report," Country Report No. 12/57, March; and IMF, 2013, "Greece: First and Second Reviews Under the Extended Arrangement Under the Extended Fund Facility," Country Report No. 13/20, January.

Testimony before the
Subcommittee on Monetary Policy and Trade
Committee on Financial Services
U.S. House of Representatives

May 18, 2017

Anna Gelpern
Professor of Law, Georgetown University Law Center
Non-resident Senior Fellow, Peter G. Peterson Institute for International Economics

Introduction

Chairman Barr, Ranking Member Moore, and Members of the Subcommittee, thank you for the opportunity to testify before you on the evolving role of the International Monetary Fund (“IMF” or the “Fund”) in sovereign debt crises, and the implications of its involvement in Greece. In my research on sovereign debt management and financial crises, the IMF has emerged as a central element of the global crisis response and restructuring framework. It is fair to say that the Greek crisis has tested it like no other. The IMF has learned from this experience, and has adapted its policies in response to criticism—just as it had in the 1980s and 1990s—so that it remains an indispensable part of the sovereign debt restructuring regime today. I believe that a strong and independent IMF is very much in the U.S. interest and, on balance, in the interest of the citizens of crisis-stricken countries. Of course, there is scope for reform.

My testimony today will outline the sovereign debt restructuring context, focusing on the role of the IMF, summarize my view of recent restructuring experience, focusing on Greece, and offer reform suggestions.* Sovereign debt restructuring reform should have three objectives, addressing both the perennial flaws in the prevailing regime and new challenges to it. *First*, the reformed regime should achieve sustainable outcomes generally accepted as fair. It should deliver a fresh start for debtors and finality for creditors, and treat similarly situated debtors and creditors alike. *Second*, to that end, the restructuring process should be comprehensive and collective. *Third*, the sovereign debt restructuring regime should be intelligible and accountable to all stakeholders. While overnight transformation is not in the

* Portions of this testimony are based on my article, *Sovereign Debt: Now What?*, which appeared in a special issue of the Yale International Law Journal in 2016.

cards, even partial and incremental changes should be evaluated based on how well they advance the three objectives.

Sovereign debt restructuring reform is not all about the IMF, but it cannot happen without the IMF.

- With respect to the first objective, sustainability, the IMF has already moved to reform its approach to assessing countries' debt burdens, and to open up its methodology to outside scrutiny. In Europe, the IMF has been a force for good—despite its own repeated embarrassments—pushing EU authorities to be more realistic in their projections even in the face of political constraints. Nonetheless, I continue to believe that there is much to be gained from opening the sustainability debate further to competing views.
- As to the second objective, comprehensive and collective process, the IMF is literally the only institution in the world today with capacity to bring together diverse stakeholders in a sovereign debt crisis, including private and other official creditors. The Fund's lending policies are a source of considerable leverage in this area. I am especially gratified by the IMF's engagement with the changing role of official creditors in recent years. The position of the European Central Bank ("ECB") in the 2012 Greek debt restructuring, the still-dominant role of government creditors in Greece today, and a recent bondholder lawsuit against Ukraine, brought on Russia's behalf in London, all illustrate the magnitude of the enduring challenge.
- Finally, the IMF is ideally positioned to promote more transparency, intelligibility, and accountability in sovereign debt restructuring. It has the technical and political tools to secure consistent, comprehensive, and publicly accessible disclosure of debt restructuring results, including both legal and financial terms. There is simply no reason for this information, which is of utmost public importance, to be the exclusive province of academic sleuths (including many of my colleagues and dear friends) on whom we now rely.

The IMF is in a peculiar position today. Unless it receives a massive funding boost, it will stay small relative to the scale of global capital flows. Yet its knowledge, experience, and political clout remain far in excess of its financial might. The IMF's role in Greece today is a case in point. This is precious capital. It is in everyone's interest to protect and fortify it for the crises to come.

I. The Sovereign Debt Context

A. No Fresh Start, Weak Enforcement

When a government cannot pay its bills, it cannot file for bankruptcy. There is no court, no authoritative body to declare that a state is insolvent, to bring all the stakeholders together in a restructuring plan, or to shield its assets from seizure by opportunistic creditors while everyone

works out a compromise to put the country on the road to recovery. To be sure, many governments are leery of bankruptcy: they do not want to submit to a binding process beyond their control.¹ But without bankruptcy, there is also no debt discharge, no fresh start as a matter of right. Sovereign debt is literally forever.

Governments do have the protection of sovereign immunity.² Most of the sovereign debtor's assets are inside its borders; those that are not, such as embassies and military bases, are shielded from seizure. Short of gunboats, there are few ways for creditors to make governments pay.³ However, creditors can make life plenty difficult for sovereigns by trying to cut off their sources of funding and disrupting their international financial transactions.⁴ This requires creditors to stick together, which is no small task without a bankruptcy backstop.

Sovereign borrowing and restructuring are a function of this tension: the debt is hard to enforce, but it never goes away. In practice, debt restructuring has come from bargaining between a government and its creditors. However, it often takes many years, and brings insufficient relief.

Lengthy debt crises bring deadweight losses (they are inefficient), but they also disproportionately hurt the poorest, least sophisticated debtors and creditors.⁵ These ultimate stakeholders of any sovereign debt restructuring regime—citizens, taxpayers, bank depositors and pensioners—lose their livelihoods along with their faith in domestic and international institutions.⁶ Governments lose their capacity to meet the basic human needs of their citizens and to safeguard their human rights.

1. See, e.g., Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 346-47, 352, 391 n. 250 (2005); Jérôme Sgard, *How the IMF Did It—Sovereign Debt Restructuring Between 1970 and 1989*, 11 CAP. MKTS. L.J. 103 (2016).

2. For canonical accounts of the enforcement challenge and its implications, see Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 REV. ECON. STUDIES 289 (1981) (reputation); Jeremy Bulow & Kenneth Rogoff, *Sovereign Debt: Is to Forgive to Forget*, 79 AM. ECON. REV. 43 (1989) and Jeremy Bulow & Kenneth Rogoff, *A Constant Recontracting Model of Sovereign Debt*, 97 J. POLIT. ECON. 155 (1989) (enforcement); MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (2007) (reputation).

3. W. Mark C. Weidemaier, *Sovereign Immunity and Sovereign Debt*, 2014 U. ILL. L. REV. 67 (2014); Pierre-Hugues Verdier & Erik Voeten, *How Does Customary International Law Change? The Case of State Immunity*, 59 INT'L STUD. Q. 209 (2014).

4. See LEE C. BUCHHEIT ET AL., BROOKINGS INST., COMM. ON INT'L ECON. POL'Y & REFORM, *REVISITING SOVEREIGN BANKRUPTCY* (2013) (follow "Download the full report" hyperlink under "Download") [hereinafter *REVISITING SOVEREIGN BANKRUPTCY*].

5. See, e.g., FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, *DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 50-53* (2006) (summarizing economic literature on deadweight losses from sovereign debt default); Peter Fallon & Robert Lucas, *The Impact of Financial Crises on Labor Markets, Household Incomes, and Poverty: A Review of Evidence*, 17 WORLD BANK RES. OBSERVER 21, 21-45 (2002); 2 Jeffrey D. Sachs, *Introduction to DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE: COUNTRY STUDIES—ARGENTINA, BOLIVIA, BRAZIL, MEXICO 19-24* (Jeffrey D. Sachs ed., 1990) (describing the distributional effect of debt crises).

6. Cf. Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of International Public Authority: Towards a Decentralized Sovereign Insolvency Law*, in *SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING* 39 (Carlos Espósito, Yuefen Li & Juan Pablo Bohoslavsky eds., 2013) (arguing that the effects of sovereign debt restructuring

B. *The Sovereign Debt Restructuring Regime and the IMF, a Brief History*

To structure bargaining without bankruptcy, a set of interlocking institutions and norms emerged late in the twentieth century. This informal regime has been anchored in institutions dominated by the Group of Seven (G-7) wealthy nations,⁷ and has continued to evolve. All along, it drew criticism for failing to deliver enough relief or fair distribution; it prevailed nonetheless in good part because “[f]or 30 years sovereign debt restructurings have gotten done.”⁸ New patterns of capital flows and political realignments have challenged the sovereign debt restructuring regime from the moment it came together in the mid-1990s. Recent debt crises, including the crisis in Greece, have exposed more perennial failures and new shortcomings.

Changes in international trade and capital movements, the decline of absolute sovereign immunity, post-colonial and post-Soviet upheavals each periodically called for new debt management and restructuring tools, and forced the old ones to adapt. Growth in bilateral trade finance from the rubble of World War II created demand for coordination among government-to-government creditors. The Paris Club, a regular informal gathering of official bilateral creditors, was born in the 1950s.⁹ The 1970s saw a spike in syndicated loans to poor and middle-income countries, made by banks in major financial centers. The crises and restructurings that followed in the 1980s required a mechanism to coordinate commercial banks. Bank advisory committees, or the London Club process, emerged in response.¹⁰ G-7 finance officials were just backstage with moral suasion, funding and regulatory incentives, because the health of their financial systems depended on the success of the process: banks took nearly a decade to build up enough capital and reserves to absorb losses from debt reduction.¹¹ Meanwhile, sovereign debt kept growing.¹²

fall on the public and should be governed by public law).

7. The Group of Seven (G-7) comprises Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

8. Lee C. Buchheit, *Sovereign Debt Restructurings: The Legal Context*, in SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS? BIS PAPERS NO. 72 107, 110 (July 2013), <http://www.bis.org/publ/bppdf/bispap72.pdf>. For evidence that debt relief comes too late and delivers too little relief, see Rodrigo Mariscal et al., *Sovereign Defaults: Has the Current System Resulted in Lasting (Re)Solutions?* (Escuela de Negocios: Universidad Torcuato Di Tella, Working Paper 03/2015, 2015); REVISITING SOVEREIGN BANKRUPTCY, *supra* note 4, at 5-14; Elena Duggar, *Sovereign Defaults Series: The Aftermath of Sovereign Defaults*, Moody's (Oct. 2013); Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts* (IMF, Working Paper No. WP/12/203, 2012).

9. THOMAS M. CALLAGHY, *THE MISUNDERSTOOD ORIGINS OF THE PARIS CLUB* (2008) (unpublished manuscript) (on file with author).

10. José Antonio Ocampo traces some of the same history, with an emphasis on the booms and busts in different forms of lending to sovereigns, but argues that the accretion of institutions to restructure sovereign debt to different creditors resulted in a “non-system.” José Antonio Ocampo, *A Brief History of Sovereign Debt Resolution and a Proposal for a Multilateral Instrument*, in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 189-195 (MARTIN GUZMAN, JOSE ANTONIO OCAMPO & JOSEPH E. STIGLITZ, EDs., 2016). See also, LEX RIEFFEL, *RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD-HOC MACHINERY* 95-131 (2003) (describing the London Club process).

11. WILLIAM R. CLINE, *INTERNATIONAL DEBT REEXAMINED* 72-73 (1995) (describing changes in the financial position of banks and developing country debt stocks throughout the 1980s); Ocampo, *supra* note 10; RIEFFEL, *supra* note 10. See also, JOSEPH KRAFT, *THE MEXICAN RESCUE* (1984) (a journalistic account of the early days of the Third World Debt Crisis and the bank coordination process). For a description of sovereign debt restructuring as a three-party negotiation including the debtor, the creditor, and creditors' governments, see Jeremy Bulow & Kenneth Rogoff, *Multilateral Negotiations for Rescheduling Developing Country Debt: A Bargaining-Theoretic Framework*, 35 IMF STAFF PAPERS 644 (1988).

12. CLINE, *supra* note 11.

Starting in 1989, banks exchanged unpayable loans for tradable bonds at a discount. Developing countries reduced their debt to foreign banks by a third or more.¹³ Bonds quickly eclipsed loans as the funding instrument of choice for sovereigns, as they had been in the late nineteenth and early twentieth centuries.¹⁴ Defaults returned to the sovereign bond market in the late 1990s, and called for bondholder coordination.¹⁵ Designing the right coordination machinery was a challenge because late twentieth-century bonds traded more widely and actively than their ancestors, and because modern-day bondholders did not normally have enduring ties to governments. Creditor committees, which had led bond restructuring negotiations a century earlier and commercial bank negotiations a decade earlier, have played a limited role in contemporary bond exchanges. For the most part in the late 1990s and early 2000s, debtors and their advisers drove distressed sovereign bond exchanges, which resembled new securities offerings more than the deals brokered by bank advisory committees or bondholder councils of yore.¹⁶

Chronically poor countries cut off from private markets borrowed instead from governments and multilateral institutions such as the IMF, the World Bank, and regional development banks. Many of the economic reform and development programs financed with foreign official credits failed to deliver thanks to some combination of bad design, bad implementation, and bad luck. By the late 1990s, some countries' debts had grown and their economies had deteriorated so much that stretching out repayments (rescheduling) and even substantial debt reduction by Paris Club creditors could not put them on a sustainable path: their debts would keep growing in perpetuity. In response to a global civil society campaign, the G-7 unveiled new dedicated debt relief programs, the Heavily Indebted Poor Countries (HIPC) initiative in 1996 and the Multilateral Debt Relief Initiative (MDRI) in 2005. Throughout the 1990s and into the 2000s, a mix of outside pressure, creditor country politics, new research and policy experience prompted a succession of program changes to deliver more relief in exchange for more reform. Multilateral debt of the world's poorest countries eventually would be cut for the first time alongside bilateral debt, with debt reduction tied to policy and governance conditionality.¹⁷

13. See, e.g., Serkan Arslanalp & Peter Blair Henry, *Is Debt Relief Efficient?*, 60 J. Fin. 1017 (2005).

14. Ross Buckley, *The Facilitation of the Brady Plan: Emerging Markets Debt Trading From 1989 to 1993*, 21 FORDHAM INT'L L.J. 1802, 1804-18, 1820-22 (1997).

15. Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Restructuring Sovereign Debt: Lessons from Recent History*, in FINANCIAL CRISES: CAUSES, CONSEQUENCES, AND POLICY RESPONSES 593 (Stijn Claessens et al. eds., 2014).

16. For accounts of bondholder committees in the nineteenth and early twentieth centuries, see Marc Flandreau, *Sovereign States, Bondholders Committees, and the London Stock Exchange in the Nineteenth Century (1827-68): New Facts and Old Fictions*, 29 OXFORD REV. ECON. POL. 668 (2013); and Rory Macmillan, *Towards a Sovereign Debt Work-out System*, 16 NW. J. INT'L L. & BUS. 57 (1995). On the development of contemporary sovereign bond restructuring practices, see NOURIEL ROUBINI & BRAD SETSER, BAILOUTS OR BAIL-INS? RESPONDING TO FINANCIAL CRISES IN EMERGING ECONOMIES (2004); STURZENEGGER & ZETTELMEYER, *supra* note 3; Ran Bi, Marcos Chamon & Jeromin Zettelmeyer, *The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings* (IMF, Working Paper No. WP/11/265, 2011) Ugo Panizza, Federico Sturzenegger & Jeromin Zettelmeyer, *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LIT. 651 (2009).

17. Technically, the debt was paid off on the debtors' behalf by donor countries. Martin A. Weiss, *The Multilateral Debt Relief Initiative*, CRS Report No. 22534 (Jun. 11, 2012); Martin A. Weiss, *Debt Relief for Heavily Indebted Poor Countries: Issues for Congress*, CRS Report No. RL33073 (Apr. 18, 2006); NANCY BIRDSALL & JOHN WILLIAMSON, DELIVERING ON DEBT RELIEF: FROM IMF GOLD TO A NEW AID ARCHITECTURE (2002); IMF, *Factsheet: The Multilateral Debt Relief Initiative* (updated Sep. 17, 2015); IMF, *Factsheet: Debt Relief Under the Heavily*

Different fora, practices, and techniques—the Paris and London Clubs, bond exchanges, HIPC and MDRI—could be mixed and matched to suit particular debtors, creditors, and debt stocks. By the late 1990s, sovereign debt restructuring was the work of a reasonably integrated regime, even if it was not recognized as such.

The IMF established itself as the foundation of this restructuring regime beginning in the 1980s.¹⁸ It delivered temporary liquidity for the debtor and used its lending instruments and policies to nudge disparate creditor groups to coordinate. By the turn of the century, this role was well-understood by a small core of repeat players: finance officials in debtor and creditor countries, staff and management at multilateral institutions, experts at credit rating agencies, big law and financial firms, and smaller, specialized investors.¹⁹ A country that could not pay its debt first turned to the IMF, which typically offered financial support for up to three years, conditioned on economic reform.²⁰ The IMF indicated what budget savings the country could achieve, which implied a “financing gap” to be filled by new lending and debt relief from other creditors. By default, the IMF also became a gatekeeper: if the gap could not be filled, the program could not go forward. Without IMF funding, the country and its creditors faced the prospect of disorderly default.²¹

For debtors and creditors, there were few good alternatives to negotiation. Throughout the 1980s and 1990s, national courts chipped away at sovereign borrowers’ defenses to paying their debts.²² Yet most government property remained beyond creditors’ reach, either safe inside debtors’ borders or covered by still-potent central bank, military and diplomatic immunities.²³ Governments that could not or would not pay their foreign creditors had to choose between

Indebted Poor Countries (HIPC) Initiative (updated Sept. 17, 2015), <http://www.imf.org/external/np/exr/facts/hipc.htm>; Joshua Busby, *Is There a Constituency for Global Poverty? Jubilee 2000 and the Future of Development Advocacy*, in *GLOBAL DEVELOPMENT 2.0: CAN PHILANTHROPISTS, THE PUBLIC AND THE POOR MAKE POVERTY HISTORY?* 85 (Lael Brainard & Derek Chollet eds., 2008).

18. Sgard puts the start of this role for the IMF in the 1970s; it developed more fully during the Third World Debt Crisis in the 1980s. Sgard, *supra* note 1.

19. See Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627 (2006) (an interview-based study of sovereign bond contract reform, describing different parts of the sovereign debt restructuring community); MITU GULATI & ROBERT E. SCOTT, *THE 3 1/2 MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* (2012) (describing and interviewing lawyers in New York and London); cf. YVES DEZALAY & BRYANT G. GARTH, *DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER* 10 (1996) (describing the tightly-knit international arbitration community).

20. Lee Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 CHIL. J. INT’L L. 333 (2005).

21. *Id.* at 341-42. Buchheit points out that this IMF role was not well understood by the private sector. While this may have been true of the private sector in general or investor groups new to the sovereign debt restructuring scene, it was not true of insiders like him, who numbered in the dozens. *Supra* note 24. Ocampo argues that outright defaults in the interwar periods led to better economic outcomes for the borrowing countries than the managed restructuring process described here. Ocampo, *supra* note 10.

22. For U.S. jurisprudence, see, for example, *Argentina v. Weltover, Inc.*, 504 U.S. 607 (1992) (U.S. courts have jurisdiction over domestic-law bonds payable in New York; debt issuance is commercial activity outside the scope of sovereign immunity); *Allied Bank Int'l v. Banco Credito Agrícola de Cartago*, 757 F.2d 516 (2d Cir. 1985) (eliminating the Act of State Doctrine as a defense to sovereign default); and *Elliott Assocs. v. Banco de la Nación*, 194 F.3d 363 (2d Cir. 1999) (effectively eliminating the champerty defense in sovereign debt).

23. *The “ARA Libertad” Case (Argentina v. Ghana)*, Case No. 20, Order of Dec. 15, 2012, 12 ITLOS Rep. 332.

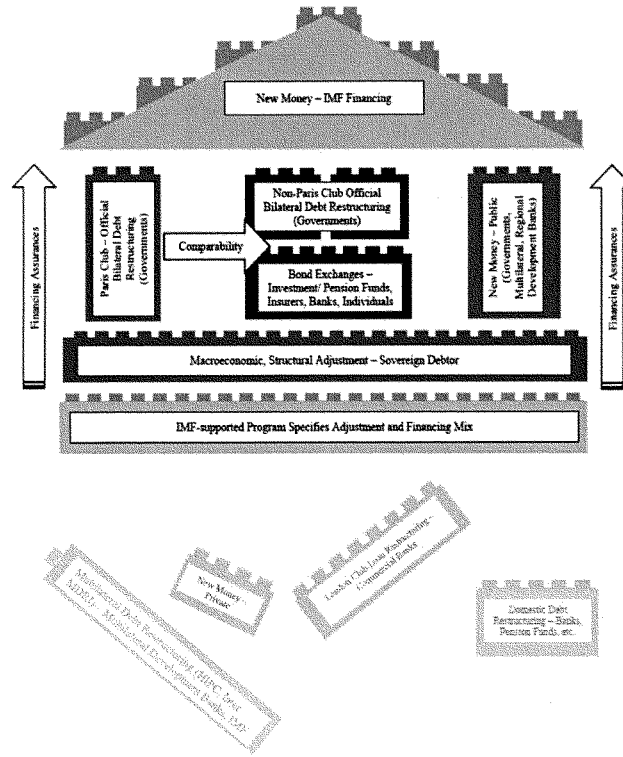
compromise and a lifetime of hiding assets and rerouting payments, which made it hard to pursue international trade and finance.²⁴ Meanwhile, creditors with judgments against sovereigns could spend years scouring the world for morsels of attachable property and hassling debtors into settlement. A scant few could play this game; hardly anyone else found it appealing.²⁵

The sovereign debt restructuring regime at the turn of the century had features that helped it manage sovereign debt distress to survive in a world without statutory, court-supervised bankruptcy, robust contract enforcement, or strong shared norms. *First*, creditors with similar interests, legal entitlements and constraints stuck together; each group followed a distinct restructuring process reflecting its particular attributes and relationship with the debtor. *Second*, groups of creditors—official bilateral lenders, banks, and foreign bondholders—normally linked their own concessions to those of the other groups, and to the IMF program parameters. The Paris Club’s insistence that sovereign debtors obtain “comparability of treatment” from other public and private creditors is perhaps the best-known example of such linkage. *Third*, the entire process was dominated by repeat players, a feature to which I return in more detail below. One might picture the regime in the late 1990s and early 2000s as a building assembled out of Lego blocks (Figure 1). Each block represents a different creditor group that might contribute debt relief or new financing. Different building blocks could be assembled based on an IMF-supported program design. The precise mix would depend on the sovereign’s debt composition, and its political and financial constraints.

24. Compare stylized description of enforcement in Bulow & Rogoff, *Is to Forgive to Forget* and *A Constant Recontracting Model*, *supra* note 2.

25. For game-theoretic analysis of sovereign debt restructuring episodes, see, for example, VINOD K. AGGARWAL, *DEBT GAMES: STRATEGIC INTERACTION IN INTERNATIONAL DEBT RESCHEDULING* (1996).

Figure 1: The Sovereign Debt Restructuring Regime circa 2000



It is important to emphasize that the regime depicted in Figure 1 might have been informal, but it was far from chaotic. It delivered a measure of relief for debtors and impressive returns for creditors with no treaty, no statute, and no court in charge.²⁶ It was flexible enough to adapt to massive shifts in global politics and economics. It was also effective enough, and accepted generally enough—just enough—to preempt far-reaching alternatives that periodically sprouted up.²⁷

26. Carmen M. Reinhart & Christoph Trebesch, *A Distant Mirror of Debt, Default, and Relief* (Univ. of Munich, Dep't of Econ., Discussion Paper No. 2014-49, 2014), https://pub.ub.uni-muenchen.de/21832/1/Distant_Mirror_October_27_2014.pdf; Carmen Reinhart & Christoph Trebesch, *Sovereign Debt Relief and its Aftermath*, 14 J. EUR. ECON. ASS'N 215 (2016) (debt relief figures); Michael Tomz & Mark Wright, *Empirical Research on Sovereign Debt and Default*, 2013 ANN. REV. ECON. 247; Christoph Klingens et al., *How Private Creditors Fared in Emerging Debt Markets, 1970-2000*, at 37 (IMF, Working Paper No. WP/04/13, 2004) (observing "sizable ex post premiums" for creditors of emerging market countries in the 1990s).

27. See, e.g., Sgard, *supra* note 1; RIEFFEL, *supra* note 10, at 132-48 (describing the North-South Dialogue and the defeat of the International Debt Commission proposal in the 1970s); Hagan, *supra* note 1 (describing the rise and

Nonetheless, it is hard to explain the regime's durability by its outcomes alone. Restructurings came late, and often took a long time to complete.²⁸ They delivered short-term liquidity relief, but often did not address the underlying solvency problems.²⁹ Re-defaults followed within a few years of sovereign debt restructurings in nearly forty percent of the cases.³⁰ While causation is open to debate, some mix of ill-conceived and ill-timed relief, and bad policy, likely played a part.

The dominance of repeat players and institutions shaped by long-term political alliances may help make sense of the regime survival puzzle. Late twentieth century sovereign debt restructurings involved a relatively small and tight cohort of officials from a handful of countries and international organizations, a dozen or so big financial firms, and half a dozen law firms.³¹ They had developed restructuring practices through trial and error, reacting to crises. They were also invested in these practices and controlled the institutions charged with their operation. Knowing the composition of and relationships among the creditor groups, the customary sequence of negotiations, the range of terms Paris Club creditors had accepted as "comparable," the habitual exclusion of certain informally "preferred" claims from burden-sharing³² was (and still is) invaluable in a world without public bankruptcy. Such knowledge can confer status, gain a seat at the negotiating table, and even help fashion arguments for reform. Long-term investment in the regime and a measure of social cohesion among those "in the know" helped sustain it.³³

On the other hand, the structure of the regime—let alone the logic behind it—was unintelligible to ordinary people, the ultimate debtors and creditors. Public debt was a matter for private ordering, both in the legal sense (contract) and in the practical sense (behind closed doors). The regime as a whole could hardly claim to be effective, fair, or legitimate in absolute terms, if only because so few saw it as a regime or agreed on a standard by which to judge it.³⁴ It might have delivered serviceable outcomes, but for most stakeholders, it was not worth fighting for.

fall of the IMF's proposal for the Sovereign Debt Restructuring Mechanism (SDRM)).

28. See, e.g., *supra* note 8 (multiple sources citing evidence of the "too little-too late" problem in sovereign debt restructuring).

29. See, e.g., IMF, *The Fund's Lending Framework and Sovereign Debt – Annexes*, (June 2014), [hereinafter IMF Lending Framework Annexes]. IMF Lending Framework Annexes.

30. Duggar, *supra* note 8.

31. GULATI & SCOTT, *supra* note 24, at 59-61; Gelpern & Gulati, *supra* note 24, at 1634-36 (2006).

32. Exclusion from comparability and other burden-sharing mechanisms was tantamount to a grant of seniority ("preferred creditor status") for claims of identical legal rank. Short-term trade credits, interbank loans, and, until recently, multilateral debt, have enjoyed such informal preference—presumably based on other participants' collective judgment that it was in their interest to consent to informal subordination. See RUTSEL SILVESTRE J. MARTHA, *Ranking of Obligations*, in *THE FINANCIAL OBLIGATION IN INTERNATIONAL LAW* 479 (2015).

33. Compare this depiction and Pierre-Hugues Verdier, *The Political Economy of International Financial Regulation*, 88 *Ind. L. Rev.* 1405 (2013) (arguing that soft law and informal network governance in international financial regulation has empowered certain political actors to the detriment of financial stability).

34. Legitimacy here does not look solely or primarily to the authority of the parties or the restructuring forum, but rather to the terms of the debt and the restructuring process that produce it. See Marie Sudreau & Juan Pablo Bohoslavsky, *Sovereign Debt Governance, Legitimacy, and the Sustainable Development Goals: Examining the Principles on Responsible Sovereign Lending and Borrowing*, 24 *WASH. INT'L L.J.* 613 (2015); cf. the discussion of legitimacy above and in the text to ODETTE LIENAU, *RETHINKING SOVEREIGN DEBT: POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE* (2014) (considering the function of sovereignty in sovereign debt).

C. A Changing Landscape, 2000-2010

Several trends, some of which date back to the 1990s, have threatened to undermine the sovereign debt restructuring regime pictured in Figure 1. I will focus on three of these trends. *First*, new creditors grew in importance. Countries such as China and Russia, as well as distressed bond funds and sovereign wealth funds,³⁵ among others, were not necessarily invested in the old restructuring processes and institutions. *Second*, cross-border capital mobility and government creditors' participation in the private capital markets eroded the boundaries of creditor groups, along with internal discipline and linkages among restructuring fora. *Third*, the vast scale of global capital flows made the IMF small by comparison, and put its central coordinating role in crisis management at risk.

The rise of new official bilateral lenders has received relatively little attention in the academic and policy debates, particularly when compared to the attention showered on distressed bond funds. In the 2000s, manufacturing and commodity exporters with large stores of government savings, most notably China and the Gulf states, began investing more of their foreign currency reserves in the emerging markets.³⁶ This trend accelerated after 2009, when interest rates dropped near zero in Europe and the United States post-crisis, and sent investors looking for higher returns elsewhere.³⁷ In parallel, China expanded its official bilateral lending to poor and middle income governments so dramatically that it eclipsed the original Paris Club lenders in some countries within a few years.³⁸

New creditors contributed to the rise in complex forms of government-to-government lending that did not quite fit Paris Club reporting conventions. For example, Venezuela began borrowing from China against future oil sales in 2007; by 2015, oil payment advances from China

35. "Sovereign wealth funds (SWFs) are special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage or administer assets to achieve financial objectives, and ... [invest] in foreign financial assets." International Working Group of Sovereign Wealth Funds (IWG-SWF), *Generally Accepted Principles and Practices—Santiago Principles*, at 3 (Oct. 2008).

36. See IMF, *Market Developments and Issues*, Global Financial Stability Report 99 (April 2006), [hereinafter IMF GFSR April 2006]; see, e.g., *Portfolio Overview*, ABU DHABI INV. AUTHORITY (ADIA), www.adia.ae/En/Investment/Portfolio.aspx (specifies 10-20% for government bonds and 15-25% for emerging markets). ADIA's total assets under management were estimated at \$773 billion. Andrew Torchia, *Abu Dhabi fund ADIA Manages More of its Billions In-House*, REUTERS (June 2, 2015).

37. Serkan Arslanalp & Takahiro Tsuda, *Tracking Global Demand for Emerging Market Sovereign Debt* (IMF, Working Paper No. WP/14/39, 2014).

38. For example, China became Angola's largest creditor by 2014, holding 41% of its debt, followed by the United Kingdom with 27%. IMF, *Angola Staff Report for the 2014 Article IV Consultation*, Country Report No. 14/274, at 9 (Aug. 14, 2014). Some of China's exposure is secured by oil. Yun Sun, *China's Aid to Africa: Monster or Messiah?*, BROOKINGS (Feb. 2014). China's lending to Congo has grown rapidly since 2006, much of it effectively secured by oil proceeds that Congo is required to keep on deposit in China. China became the dominant creditor after Congo secured HIPC and MDRI relief from wealthy countries and multilateral institutions. IMF, *Republic of Congo Staff Report for the 2014 Article IV Consultation*, Country Report No. 14/272, at 9 (July 7, 2014); see also IMF, *Republic of Congo Staff Report for the 2014 Article IV Consultation—Debt Sustainability Analysis*, Country Report No. 14/272, at 2 (July 7, 2014) (China accounted for 63% of Congo's official bilateral debt and 15% of its overall external debt in 2010).

reportedly were among the scant few sources of external financing it had left. In mid-2016, Venezuela approached China for a debt restructuring by another name as more and more of its oil exports effectively functioned as debt repayments.³⁹ Angola was even worse off, with no spare export capacity left after making its debt payments in oil.⁴⁰

Lending that combined features of trade, investment, development aid, and strategic alliance-building was not new, but the scale and the players were.⁴¹ In the past, such complex, mixed-motive arrangements might have been settled quietly on the margins of Paris Club negotiations. Classifying the debt and finding a forum to renegotiate it is more of a challenge today, when both debtors and major creditors view the prevailing regime with suspicion, and are underrepresented in its institutions.⁴²

Further complicating matters, government creditors could take advantage of bigger, deeper, more liquid international capital markets to sell their bilateral loans.⁴³ On the one hand, official creditors such as central banks and government reserve managers have long been important buyers of sovereign debt. Their market participation was viewed primarily through the lens of their monetary and exchange rate policy functions, and their extreme conservatism. However, it became increasingly apparent in the 2000s that central banks, reserve managers, and sovereign wealth funds were not uniformly risk-averse as bond investors; some made bets on the debts of troubled countries and actively managed their sovereign debt portfolios.⁴⁴

Active bond trading benefited sovereign borrowers: it promoted information and price discovery, expanded the range of potential buyers, and saved borrowing costs over time. However, it also meant that the mix of public and private creditors behind a debt stock could change at any

39. Corina Pons, Alexandra Ulmer & Marianna Parraga, *Venezuela in Talks with China for Grace Period in Oil-for-Loans Deal*, REUTERS (Jun. 15, 2016).

40. Libby George, *Growing Chinese Debt Leaves Angola with Little Spare Oil*, REUTERS (Mar. 14, 2016).

41. The phenomenon of deliberately ambiguous financing forms is not new. For example, the United States financed South Vietnam's military with disguised agricultural credits during the Vietnam War. See, e.g., Agreement between the Government of the United States of America and the Government of the Republic of Viet-Nam for Sales of Agricultural Commodities, 22 U.S.T. 1459, Sec. II.A.2 (June 28, 1971); Marian Nash (Leich), *Contemporary Practice of the United States Relating to International Law*, 91 AM. J. INT'L. L. 697, 705-06 (1997). Vietnam refused to repay the credits when it came to the Paris Club to restructure its debt in 1993. The difference is that the new creditors are not fully part of the institutions within which creditors negotiated how to deal with these ambiguities. For example, after the fall of Saddam Hussein, Iraq claimed that much of its "debt" to its Gulf neighbors was supposed to have been a grant, to help support Iraq in its war against Iran. Negotiations with Gulf countries, which were not part of the Paris Club, lasted for years after the Paris Club had agreed on near-total relief. MARTIN A. WEISS, CONG. RESEARCH SERV., RL33376, IRAQ'S DEBT RELIEF: PROCEDURE AND POTENTIAL IMPLICATIONS FOR INTERNATIONAL DEBT RELIEF 6 (2009).

42. See, e.g., MARTIN A. WEISS, CONG. RESEARCH SERV., RS21482, THE PARIS CLUB AND INTERNATIONAL DEBT RELIEF 1 (2013) (China and Gulf states are not part of the Paris Club); NGAIRE WOODS, GOVERNING THE GLOBAL ECONOMY: STRENGTHENING MULTILATERAL INSTITUTIONS 2 (2008) (observing that China and Gulf states are underrepresented in the multilateral organizations, including the IMF and the World Bank).

43. See, e.g., Thomas Laryea, Donegal v. Zambia and the Persistent Debt Problems of Low-Income Countries, 73 L. AND CONTEMP. PROBS. 193-200 (2010) (analyzing a lawsuit brought in English courts by a private offshore fund on contracts that originated with Romania's bilateral agricultural credits to Zambia. Romania sold the loans to a private investor and avoided restructuring them in the Paris Club); see also, Felipe Ossa, *Woolly Outcome for Aries*, ASSET SECURITIZATION REPORT (July 3, 2006) (reporting Germany's securitization of its export credit loans to the Russian government).

44. See, e.g., IMF GFSR April 2006, *supra* note 36; Brad Setser, *Norway was against Iceland before it was for Iceland*, FOLLOW THE MONEY BLOG (May 17, 2008); Andres R. Martinez, *CIC Stops Buying Europe Government Debt on Crisis Concern*, BLOOMBERG (May 10, 2012).

time, so that not even the debtor could ever know for sure who held what debt.⁴⁵ This would present a challenge when trying to organize a restructuring.

While the mid-2000s were a period of rapid growth and relative calm in the sovereign debt markets, the IMF's ability to anchor a hypothetical crisis response⁴⁶ suffered from the growing gap between its resources and the scale of global capital flows. Figure 2 shows IMF lending capacity against the background of capital flows in and out of the euro area and developing countries between 1999 and 2006. At the end of 1999, with much of Asia, Brazil, and Russia still in crisis, the IMF could lend up to \$86 billion of its own resources, and borrow an additional \$47 billion from wealthy member governments.⁴⁷ Even after disbursing nearly \$10 billion to Brazil, \$5.6 billion to Russia, and \$6.3 billion to Indonesia during its 1998-1999 financial year,⁴⁸ the IMF could backstop a respectable 35 percent of gross outflows from the developing world. By 2006, with large emerging market economies issuing bonds and repaying the IMF, it could lend up to \$189 billion of its own resources—but that was only eleven percent of the \$1,723.8 billion in outflows from the developing world.⁴⁹ Including \$1,941.4 billion from the euro area in 2006 would put available IMF resources at five percent of the relevant capital outflows. Then again, no one had imagined in 2006 that the IMF would be disbursing \$20.6 billion to Greece and \$8.1 billion to Ireland in just four years.⁵⁰

45. While their effect in sovereign debt markets is the subject of a heated debate, at least in theory, the rise of credit derivatives can further exacerbate the divergence between creditor incentives and their contractual claims. See Patrick Bolton & Martin Oehmke, *Credit Default Swaps and The Empty Creditor Problem*, 24 REV. FIN. STUD. 8 (2011); David Mengle, *The Empty Creditor Hypothesis*, ISDA RES. NOTES (2009); Skylar Brooks et al., *Identifying and Resolving Inter-Creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring*, CENTRE FOR INT'L GOVERNANCE INNOVATION (Jan. 12, 2015), https://www.cigionline.org/sites/default/files/pb_no53.pdf; Nikki Tait & David Oakley, *Brussels Gives Sovereign CDS Trading All-Clear*, FIN. TIMES (Dec. 6, 2010), <http://www.ft.com/intl/cms/s/0/5be55b2a-016a-11e0-9b29-00144feab49a.html#axzz42Ye94mRb> (reporting the results of a European Union inquiry into credit default swaps as a potential source of speculative pressure on sovereign debt prices).

46. PAUL BLUSTEIN, *OFF BALANCE: THE TRAVAILS OF INSTITUTIONS THAT GOVERN THE GLOBAL FINANCIAL SYSTEM* 1 (2013) (describing the IMF during this period of relative calm, and its efforts to prepare for a potential crisis).

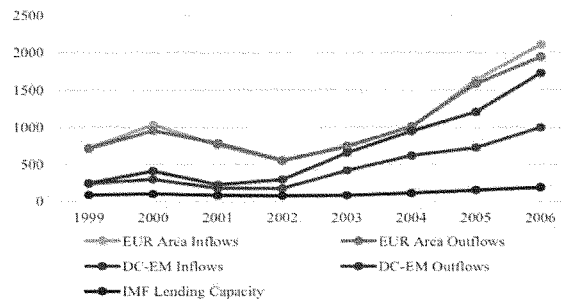
47. *IMF's Financial Resources and Liquidity Position, 1997-December 1999*, <http://www.imf.org/external/np/tre/liquid/1999/1299.htm> (Net Uncommitted Usable Resources).

48. IMF, *Report of the Executive Board for the Financial Year Ended April 30, 1999*, Annual Report 1999, at 100-101 (Apr. 1999). U.S. dollar amounts are based on SDR1=USD1.37.

49. IMF resources fared better compared to portfolio flows. In 2006, it could finance approximately 19 percent of combined euro area and developing country portfolio outflows. It could supplement this lending capacity in 2006 with \$51 billion from borrowing arrangements with members. *IMF's Financial Resources and Liquidity Position, 2004-December 2006* (One-year Forward Commitment Capacity, memorandum items for General Arrangements to Borrow and New Arrangements to Borrow); IMF, *Financial Market Turbulence: Causes, Consequences, and Policies*, Global Financial Stability Report 2007, Stat. App. Table I, 136-37 (Oct. 2007) [hereinafter IMF GFSR October 2007]. Although portfolio flows are typically considered more volatile, the distinction between portfolio and other types of capital flows may be overstated. See, e.g., UN Development Programme, *Towards Human Resilience: Sustaining MDG Progress in an Age of Economic Uncertainty* 86 (2011).

50. IMF, *Financial Operations and Transactions*, Annual Report 2011 App. Table II.4 (2011), U.S. dollar amounts are based on SDR1=USD1.62.

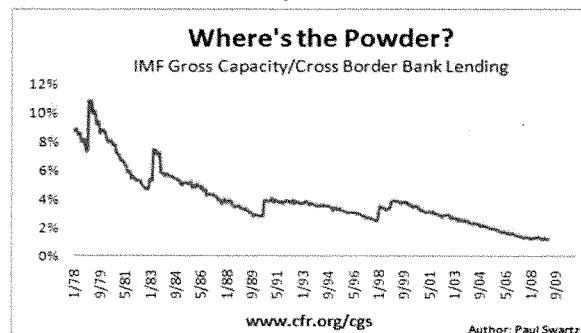
Figure 2:
Total Capital Inflows and Outflows, IMF Lending Capacity
Euro Area, Developing Countries and Emerging Markets
 (USD billions)



Source: IMF ⁵¹

Long-term decline of IMF lending capacity relative to cross-border bank lending, which can be prone to runs, paints a similar picture in Figure 3.

Figure 3:



Source: Council on Foreign Relations ⁹⁴

51. IMF GFSR October 2007, *supra* note 36; IMF's *Financial Resources and Liquidity Position, 1997-December 1999*, *supra* note 89; IMF's *Financial Resources and Liquidity Position, 2004 – December 2006*, *supra* note 91. Figures for IMF lending capacity exclude available borrowing arrangements, which stood at \$47 billion in December 1999, and \$51 billion in December 2006. *Id.* See also, *One-Year Forward Commitment Capacity*, *supra* note 87; MARKUS JAEGER, DEUTSCHE BANK RESEARCH, DOES THE IMF HAVE SUFFICIENT RESOURCES TO BAIL OUT THE EMERGING MARKETS? (2008) (market view of IMF capacity in light of the "explosion" in net private capital flows and potential future exposure).

To the extent the IMF's power to set restructuring parameters and nudge the process along depended on its unique ability to mobilize enough financing quickly to stop a run, stem contagion, and keep the distressed economy afloat during the workout, this power appeared to be at risk.⁵²

The IMF's lopsided governance made matters worse. It reflected twentieth century compromises, with the G-7 and small European countries substantially overrepresented compared to the big emerging markets, whose voice and vote did not reflect the size and international importance of their economies.⁵³ Yet the incumbents showed few signs of either giving up control or investing in the IMF in the early and mid-2000s. As finance got bigger, powerful stakeholders spoke of the need to constrain the IMF as a source of "bailouts" and moral hazard.⁵⁴ Meanwhile, post-crisis countries, particularly in Asia, accumulated vast foreign exchange reserves and put in place regional arrangements that would allow them to bypass the IMF should misfortune strike again.⁵⁵

Despite its outdated vote allocation, shrinking scale, self-insuring clients, and contested track record, the IMF remained indispensable in a debt crisis. It had the unique combination of institutional memory and analytical capacity, a record of past practice, a global membership, and a formal governance structure prescribed by treaty—which made its actions at least somewhat accessible and predictable. The IMF's role as distressed countries' gateway to external financing long made it a valuable lever for other actors; it rose in importance as other elements of the debt restructuring regime weakened. Public and private creditors sought to use IMF lending and arrears policies to gain leverage in restructuring negotiations. Sovereign borrowers cited IMF analysis and policy conditions to bolster their position *vis-à-vis* foreign and domestic constituents.⁵⁶ As it was called upon to fill more coordination gaps, the IMF was becoming both under-funded and overtaxed.

Weaker discipline among creditors was not all bad for the debtors, even if it threatened to prolong the restructuring process. Without tightly-knit creditor groups linked by cross-conditionality, sovereigns could play creditors off against one another. If private foreign investors

52. James M. Boughton, *The IMF as Just One Creditor: Who's in Charge When a Country Can't Pay?* CENTRE FOR INT'L GOVERNANCE INNOVATION 1 (Apr. 27, 2015); James M. Boughton et al., *IMF Lending Practices and Sovereign Debt Restructuring*, CENTRE FOR INT'L GOVERNANCE INNOVATION 4 (June 9, 2014).

53. See, e.g., EDWIN M. TRUMAN, *A STRATEGY FOR IMF REFORM* (2006) (arguing for an overhaul in IMF governance and work program).

54. See, e.g., JOHN B. TAYLOR, *GLOBAL FINANCIAL WARRIORS: THE UNTOLD STORY OF INTERNATIONAL FINANCE IN THE POST-9/11 WORLD*, at 98-110, 130-32 (2007); Hagan, *supra* note 1, at 345.

55. See, e.g., Barry Eichengreen, *Commentary: A Blueprint for IMF Reform: More Than Just a Lender*, 10 INT'L FINANCE 153 (2007). The motives for reserve accumulation are a matter of debate, with authoritative commentary split between attributing it to self-insurance against crises and exchange rate management.

56. See IMF, *Access Policy in Capital Account Crises*, Policy Papers 18-26 (July 29, 2002); IMF, *The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations*, Policy Papers 8-21 (May 22, 2014). See also Lee C. Buchheit & Rosa M. Lastra, *Lending into Arrears—A Policy Adrift*, 41 INT'L LAW. 939 (2007); JAMES M. BOUGHTON, *THE SILENT REVOLUTION: THE INTERNATIONAL MONETARY FUND 1979-1989* (2001); NGAIRE WOODS, *THE GLOBALIZERS: THE IMF, THE WORLD BANK AND THEIR BORROWERS* (2006) (describing emerging markets officials using the IMF as a lever in domestic reform negotiations).

would not lend or restructure, a government might turn to an oil-rich neighbor; if IMF conditions seemed too onerous, it could try borrowing from domestic banks, or from China; if Paris Club relief were slow in coming, foreign bondholders might be persuaded to move first.⁵⁷

The upshot of these developments was a restructuring regime that was losing sway over both debtors and creditors. The London Club had disappeared as bank loans gave way to bond financing; the Paris Club at risk of becoming a side show. The IMF was at risk of becoming “just one creditor” among many—and far from the biggest—anchoring a regime where other creditors could not be counted upon to cooperate.⁵⁸ In the background, national courts presided over isolated claims with no mandate to consider the overall debt picture, and had no way to compel the sovereign to follow their orders. Such a regime might be able to nudge willing parties to compromise, but was hardly fit to host mortal combat to come.

II. Greece in Context

In the article from which I draw in this testimony, I describe a series of crises between 2010 and 2015 that publicly exposed major flaws in the existing sovereign debt restructuring regime. Below I focus on Greece because, in my view, it presented the biggest challenge to the IMF’s role in the regime—but also illustrates its potential. Early in the crisis, the IMF repeatedly failed to shape debt restructuring outcomes, tainting public perceptions of its analysis and lending decisions. Greece also demonstrated the toxic politics of government-to-government debt—reviving ugly stereotypes and stoking historical resentments—which threatened political compromises underpinning Europe’s monetary union.⁵⁹

The IMF, the European Commission, and the European Central Bank (ECB) launched a €110 billion (\$145 billion) financing program for Greece on May 9, 2010. The IMF’s contribution of €30 billion (\$40 billion) to this “troika” package was by far the largest program in its history.⁶⁰ The program went ahead despite IMF staff concerns about public debt sustainability, and based on heroic assumptions about tax collection, privatization, unemployment, economic growth, and a speedy return to the capital markets.⁶¹ Figure 4, drawn from the IMF’s own ex-post evaluation of that program, illustrates.

57. Argentina, Ecuador, Nigeria and Venezuela all successfully deployed such strategies.

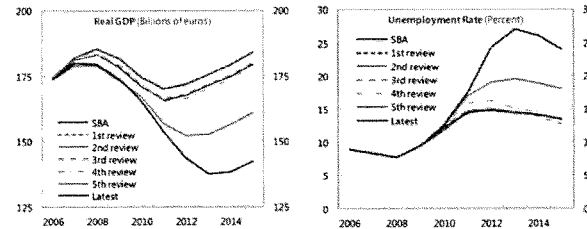
58. Boughton, *supra* note 52.

59. IMF, *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*, Country Report No. 13 (June 2013) [hereinafter IMF Ex-Post Evaluation of SBA (Greece)].

60. Press Release, IMF, *IMF Executive Board Approves €30 Billion Stand-By Arrangement for Greece*, No. 10/187 (May 9, 2010); IMF Ex-Post Evaluation of SBA (Greece) *supra* note 59, at 9.

61. IMF Ex-Post Evaluation of SBA (Greece) *supra* note 59, at 8; see also WILLIAM R. CLINE, MANAGING THE EURO AREA DEBT CRISIS 185 (2014); David Keohane, *Greek Government Acquires More Realistic Crystal Ball*, FT ALPHAVILLE (Nov. 1, 2012) (citing IMF and market analysis of IMF forecasts).

Figure 4:
Evolution of IMF Program Projections for Greek GDP and Unemployment
under the 2010-2012 IMF Stand-By Arrangement for Greece⁶²
 ("SBA" reflects projections in the May 2010 IMF stand-by arrangement)



Early baseline projections had the debt ratio rising from 115 percent of Gross Domestic Product (GDP) in May 2010 above 150 percent in 2013, potentially reaching 220 percent in some stress scenarios.⁶³ The Fund's assumptions and program conditions were more sober than those of the European authorities before the IMF had been brought in. Moreover, IMF staff analysis, however rosy, was sufficiently pessimistic to warrant the conclusion that Greek debt could not be sustainable with "high probability" in the medium term.

This judgment about debt sustainability posed a problem under the IMF's policy barring large-scale lending to over-indebted countries. As the staff saw it, the IMF had two choices: condition its participation in the troika on Greek debt relief, or ask its Executive Board to approve a policy change. Less than two years after the failure of Lehman Brothers had brought global finance to the brink, fear of Greece turning into "another Lehman-type event" took debt restructuring off the table.⁶⁴

The Lehman reference underscores the challenge of managing debt crises in large economies integrated in regional and global financial systems (the euro area is an extreme example). Neither the IMF nor the European Union was prepared to address contagion in 2010 with liquidity support for its likely victims. Although IMF members had agreed in 2009 to lend the Fund up to \$576 billion,⁶⁵ its resources remained visibly inadequate to rescue large euro area

62. IMF Ex-Post Evaluation of SBA (Greece), *supra* note 59, at 13, 17, 25.

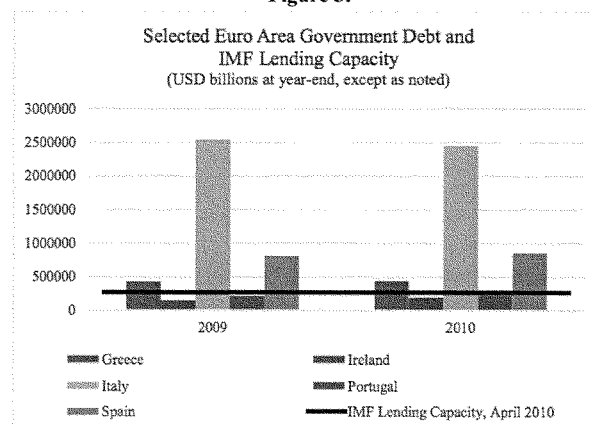
63. Paul Blustein, *Laid Low: The IMF, the Euro Zone and the First Rescue of Greece*, CENTRE FOR INT'L GOVERNANCE INNOVATION 2 (Apr. 7, 2015); IMF, *Greece: Preliminary Debt Sustainability Analysis—Updated Estimates and Further Considerations*, Country Report No. 16/130.1 (May 2016), [hereinafter IMF Preliminary Greek DSA May 2016] (citing public debt ratio of 115 percent of GDP, projected to top 150 percent despite policy adjustment); IMF Ex-Post Evaluation of SBA (Greece), *supra* note 59, at 16, 26-27 (citing initial projections for debt to peak at 154-156 percent of GDP in 2013, but continuing to rise above 220 percent under stress).

64. Blustein, *Laid Low*, *supra* note 63 at 27.

65. IMF ANNUAL REPORT FY2011 at 49 (tenfold expansion and activation of New Arrangements to Borrow (NAB) between November 2009 and April 2010); DOMENICO LOMBARDI & SARAH PURITZ MILSOM, THE BROOKINGS

economies, certainly not two or three at the same time. The IMF's lending capacity in April 2010, on the eve of its first Greek program, was \$255.5 billion, counting supplemental borrowing of \$253 billion.⁶⁶ In the next twelve months, it would approve nearly \$210 billion in new commitments, including large, front-loaded programs for Greece and Ireland.⁶⁷ Spain and Italy, which looked shaky, were in a different category altogether. At the end of 2009, Spain had \$815 billion in sovereign debt and Italy had \$2.5 trillion, compared to Greece's \$431 billion. In less than two years, foreign banks reduced their Italian government debt holdings by over \$125 billion.⁶⁸

Figure 5:



Sources: Eurostat, Board of Governors of the Federal Reserve System, IMF⁶⁹

INSTITUTION, THE EURO-AREA CRISIS: WEIGHING OPTIONS FOR UNCONVENTIONAL IMF INTERVENTIONS 4 (Dec. 2011).

66. IMF's Financial Resources and Liquidity Position, 2008 – April 2010.

67. IMF ANNUAL REPORT FY2011, Appendix Table II.1: Arrangements Approved during Financial Years Ended April 30, 2002-2011, and Appendix Table II.4: Purchases and Loans from the IMF, Financial Year Ended April 30, 2011. SDR=USD1.61967. IMF Financial Activities -- Update April 28, 2011.

68. Approximately half of Italian government debt was held by non-residents, mostly in the euro area. INT'L MONETARY FUND, ITALY: SELECTED ISSUES, IMF Country Report No. 12/168 87-88 (Jul. 2012) (detailing Italian debt composition); IMF, *The Quest for Lasting Stability*, Global Financial Stability Report 19 (Apr. 2012) (Figure 2.6, showing a reduction of foreign bank holdings by €94 billion between Q1 2010 and Q3 2011). EUR=USD1.3449 at the end of Q3 2011. Board of Governors of the Federal Reserve System (US), U.S. / Euro Foreign Exchange Rate [DEXUSEU], (retrieved from FRED, Federal Reserve Bank of St. Louis, May 31, 2016); see also IMF, *Restoring Confidence and Progressing on Reforms*, Global Financial Stability Report 30 (Oct. 2012) (Figure 2.9, showing the exit of foreign private investors in Italian and Spanish government debt).

69. Eurostat, Government Consolidated Gross Debt by Components - Annual Data [tipsgo11], ("Government debt is defined as total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government."); Board of Governors of the Federal Reserve System (US), U.S. / Euro Foreign Exchange Rate [DEXUSEU], (retrieved from FRED, Federal Reserve Bank of St. Louis, May 31, 2016); IMF's Financial Resources and Liquidity Position, 2008 – April 2010 (One-Year Forward Commitment Capacity).

If the crisis in Greece spread to Italy, contagion across the euro area, to the United Kingdom and the United States could bring back the darkest days of September 2008.⁷⁰ The euro area might have addressed the problem on its own—it had a powerful central bank, and strong economies at the core—but it was only beginning to develop the political consensus, legal and institutional tools against contagion.⁷¹ When the risk of contagion topped the policy agenda, it was down to the IMF, which had crisis-fighting experience and resources on standby. In 2010, these resources were not enough to support new and potential IMF clients, which were vastly bigger than the old ones.

With no backstop in sight for large economies vulnerable to contagion from Greece, the IMF changed its lending policy. From May 2010, countries whose debts were not sustainable with high probability could avoid restructuring and still get large-scale IMF support, provided there was a high risk of “systemic international spillovers.”⁷² Greece then proceeded to borrow at least in part for the sake of broader financial stability—although Greece alone would be bound to repay.⁷³

The IMF’s failure to insist on debt relief for Greece in 2010 was not in itself a challenge to the old sovereign debt restructuring regime; it was the IMF’s inability well into 2011 to force a restructuring once it became convinced that one was necessary, and despite the risk to its own resources.⁷⁴ Finance officials had always been wary of debtor moral hazard, hurting banks, spending tax money, and, more recently, undermining the “catalytic” effect of IMF lending on the debtor’s access to the private capital markets.⁷⁵ The Lego house in Figure 1 did not require debt reduction *per se*, only some combination of new money, debt restructuring, and adjustment to fill the financing gap during the program period. Countries avoided restructuring in 21 out of 53 emerging market sovereign debt distress episodes identified by the IMF between 1980 and 2012.⁷⁶ Debt stock sustainability only became a formal condition for very large (“exceptional access”) IMF programs in a policy introduced in 2002, as part of a campaign to limit bailouts and moral hazard.⁷⁷

70. IMF, *Italy: 2012 Article IV Consultation*, Country Report No. 12/167, at 12 (2012), <https://www.imf.org/external/pubs/ft/scr/2012/cr12167.pdf> (Box 2: Italy – Spillovers from a Potential Intensification of the Euro Area Crisis, showing cross-border borrowing by Italian banks exceeding €1.4 trillion, primarily from Germany, France, and Austria, as well as elsewhere in the euro area, Eastern Europe and the United States).

71. IMF, *Euro Area Policies: 2015 Article IV Consultation—Press Release, Staff Report, and Statement by the Executive Director*, Country Report No. 15/204, at 5 (July 2015) [hereinafter, *Euro Area Article IV Report 2015*] (highlighting continuing risk of contagion from Greece despite new ECB tools).

72. *IMF Reforms Policy for Exceptional Access Lending*, IMF Survey, (Jan. 29, 2016).

73. *Supra* note 11–12 and accompanying text; compare lending to Greece to avoid a crisis elsewhere in Europe and lending to developing countries in the 1980s to avoid a banking crisis in New York and London, *supra* note 16 and accompanying text. The argument that Greece borrowed for lack of better tools to avoid contagion broadly is distinct from the argument that troika loans bailed out French and German banks. See, e.g., Dan Davies, *2010 and All That—Relitigating the Greek Bailout (Part I)*, BULL. MKT. (Jul. 21, 2015) (considering accusations that the Greek rescue benefited German and French financial institutions).

74. See Ashoka Mody, *In Bad Faith*, BRUEGEL (July 2, 2015), <http://bruegel.org/2015/07/in-bad-faith/> (arguing that the IMF acted in bad faith by letting debt relief be deferred while insisting, along with euro area governments, on crippling adjustment conditions in Greece).

75. IMF Lending Framework Annexes, *supra* note 29 at 9–20.

76. *Id.* at 28.

77. The new criterion was part of an effort to limit debtor and creditor moral hazard from IMF programs, instituted just as the global financial markets entered a period of relative calm. *Id.*; TAYLOR, *supra* note 54, at 119–21, 130–32 (2007).

There is no evidence that the 2002 policy made large programs any more exceptional, nor that it made debt restructuring more common—there were few crises to test it in the mid-2000s. However, for as long as the IMF remained a source of some and the gatekeeper for most external financing in crisis, the 2002 reform raised the stakes for IMF staff analysis of borrowers' debt sustainability. As the policy came to be interpreted, large-scale IMF programs would require deep debt restructuring unless that analysis showed sovereign debt to be sustainable “with high probability.”⁷⁸ Private creditors became big consumers of the analysis, and tough critics of the methodology.

The IMF's capacity to leverage its analytical and financial resources to shape a country's recovery program had long anchored the sovereign debt restructuring regime. Greece exposed the limits of this role. IMF staff called for debt relief early in 2011; a bond restructuring came a year later, after more than \$150 billion in private capital had fled the country and was replaced by public funds from the euro area and the IMF.⁷⁹

After the bond restructuring in March 2012, discussed in more detail below, a new four-year Fund program brought more lending and projections that Greek debt would fall below 120 percent of GDP by 2020—even as domestic politics deteriorated and support for the program sank.⁸⁰ According to the IMF's own assessment in 2017, this program still suffered from implausibly rosy projections about political support for reform, market confidence and economic performance. However, IMF staff were markedly clearer in expressing their skepticism in the program documents⁸¹ and, after a program overhaul in 2013, program assumptions drifted closer to reality (Figure 6).

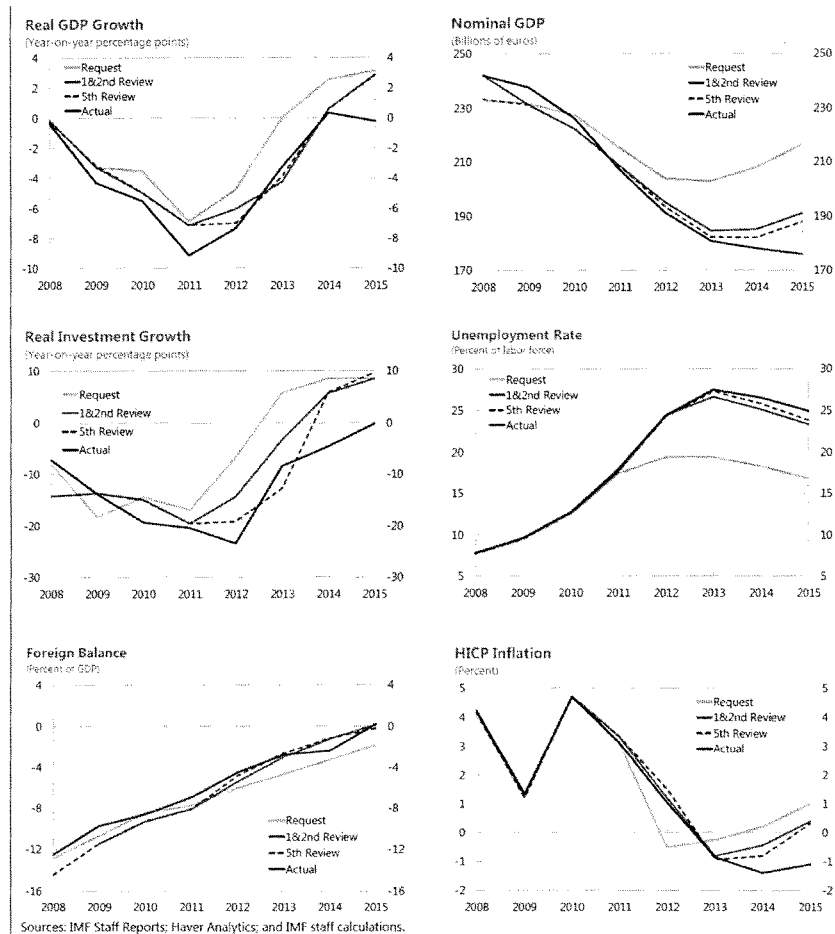
78. IMF Lending Framework Annexes, *supra* note 29.

79. IMF Ex-Post Evaluation of SBA (Greece), *supra* note 59, at 27; see also Matthew Higgins & Thomas Klitgaard, *The Balance of Payments Crisis in the Euro Area Periphery*, 20 CURRENT ISSUES ECON. & FINANCE, no. 2, 2014, at 7.

80. IMF exposure would remain essentially unchanged. Press Release, IMF, *IMF Executive Board Approves €28 Billion Arrangement under Extended Fund Facility for Greece*, No. 12/85 (Mar. 15, 2012).

81. IMF, *Greece: Ex Post Evaluation of Exceptional Access under the 2012 Extended Arrangement* No. 17/44 (Feb. 2017) [hereinafter IMF Ex-Post Evaluation of EFF (Greece)], at 1.

Figure 6:
Evolution of IMF Program Projections
under the 2012-2016 IMF Extended Fund Facility for Greece



Source: IMF⁸²

Nonetheless, the program went off track in 2014. In July 2015, the debt stock neared 180

82. IMF Ex-Post Evaluation of EFF (Greece), *supra* note 81 at 18.

percent of GDP and the Greek banking system was on life support from the ECB, rationing cash withdrawals. A new government was in a standoff with the troika over a third IMF program, and the IMF was at odds with its troika partners over government-to-government debt relief. In the middle of an acute political crisis, Greece threatened to abandon the euro and delayed repayment of €1.55 billion (\$1.73 billion) to the IMF . . . causing new anxiety for being “the first developed country to default” on the multilateral lender.⁸³

The second IMF program never came back on track, and was abandoned in January 2016 in the face of continued political turmoil. After a brief drop in 2012, Greek debt-to-GDP ratio was back at 180 percent in early 2016, and has mangled there since. In May 2016, Euro area governments agreed to disburse €10.3 billion (\$11.5 billion) in new loans, but the IMF held back on a new program: it would wait for “a clear, detailed Greek debt restructuring plan.”⁸⁴ This was finally a principled position that might have produced better results had it come sooner.

IMF staff had a hard enough time negotiating Greek program parameters with euro area institutions when private investors’ money was on the line; with euro area taxpayers as the dominant creditors, the political challenge was nearly insurmountable.⁸⁵ At the outset, program parameters had to be settled with euro area institutions first, leaving little room for Greek agency (or policy “ownership”)⁸⁶ For their part, euro area leaders had left themselves limited scope to maneuver: after telling their citizens that EU treaties categorically barred public debt forgiveness, they had to choose between the prospect of outright default and a mix of transactional engineering, accounting gimmicks and wishful thinking about Greek citizens’ tolerance for more austerity.⁸⁷ More bilateral financing was unpalatable, but default was still unthinkable for fear of financial and political contagion. The search for alternatives had produced six years of crippling economic decline and political upheaval.⁸⁸

It was a foregone conclusion that the Paris Club would have no part in the Greek debt restructuring, even though it had been the preeminent forum for restructuring government-to-government debt, while the Greek debt stock looked more and more like those of the poorest countries in the Paris Club, cut off from private markets.⁸⁹ Nonetheless, Europe insisted on

83. See, e.g., Reuters, *Greece Becomes the First Developed Country to Default on IMF Loan*, NEWSWEEK (July 1, 2015).

84. *Greece Bailout: IMF Queries Eurozone Debt Relief Deal*, BBC (May 25, 2016).

85. IMF Ex-Post Evaluation of SBA (Greece), *supra* note 59, at 21, 30-32.

86. On Greek program “ownership,” see IMF Ex-Post Evaluation of SBA (Greece), *supra* note 59. Compare BLUSTEIN, *supra* note 54, with WOODS, *supra* note 99 (on economic reform and power dynamics between emerging market and multilateral officials).

87. See, e.g., Ashoka Mody, *Wolfgang Schäuble, Debt Relief, and the Future of the Eurozone*, BRUEGEL (August 6, 2015); Paul Carrel, *Legal Gray Areas Give Scope for Greek Debt Relief If Europe Wants It*, REUTERS (July 9, 2015).

88. See Mody, *supra* note 87.

89. Both had triple-digit debt ratios and few private creditors. For example, at the end of 2012, after most of its privately held debt had been repaid or restructured, Greece had a debt-to-GDP ratio north of 150 percent and rising, while private creditors held approximately 20 percent of its debt; the rest was in the hands of other governments and the IMF. IMF Preliminary Greek DSA May 2016, *supra* note 63, at 4; compare debt composition figures cited in Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, 28 ECON. POL’Y

handling Greece as a family affair. To lighten its debt service burden, euro area governments quietly extended repayment term to between fifteen and forty years, and lowered interest rates to 1.2 percent on average for the moment; however, they stood firm against reducing principal claims.⁹⁰ This approach might have relieved near-term liquidity pressures, but was not enough to alter the debt trajectory, nor to stop government-to-government debt from fueling political fights that cast doubt over the viability of the monetary union.⁹¹

In contrast to the tortured path to official debt relief, the 2012 Greek bond restructuring was a brilliantly executed operation—on a technical level. Once it was launched, the deal was done, and done quickly. It covered a record-breaking stock of debt, approximately €200 billion (\$260 billion), and reduced the private debt burden by over fifty percent.⁹² The smooth execution was mostly attributable to the fact that more than ninety percent of the bonds were governed by Greek law and could be amended retroactively by statute.⁹³ The Greek Bondholder Act enabled the government to call a single vote of all its Greek-law bond holders, with quorum and voting thresholds set low at fifty percent and 66 2/3 percent, respectively, to ensure success.⁹⁴ The voting mechanism in Greek retroactive legislation was fundamentally unlike then-standard majority amendment provisions (“Collective Action Clauses,” or “CACs”) in sovereign bonds: the law was designed *ex post* to prevent individual bond series from dropping out and free-riding on the rest. CACs incorporated in contracts *ex ante* had always allowed some bonds to drop out. The single stock-wide vote legislated in Greece meant that either all or none of the bonds polled were bound to restructure.

Greece got much less benefit from the CACs already incorporated in its foreign-law bond contracts, which had been held up as a bulwark against free-riders in G-7 statements and G-10 reports since the mid-1990s.⁹⁵ As was customary at the time, CACs in Greek bond contracts governed by English and Swiss law applied only to individual bond series. Holdouts secured blocking positions in more than half of the series by number. The restructuring vote failed for approximately forty-four percent of foreign-law principal outstanding.⁹⁶ Private creditors holding

513 (2013) [hereinafter *Greece Autopsy*], and Liberia in 2007-2008, with 28 percent of the debt stock in the hands of commercial creditors, and an external debt-to-GDP ratio of 186 percent before debt relief. IMF, *Liberia: Enhanced Initiative for Heavily Indebted Poor Countries – Completion Point Document and Multilateral Debt Relief Initiative*, Country Report No. 10/192, at 32, 41 (July 2010).

90. IMF Preliminary Greek DSA May 2016, *supra* note 142, at 4-5 (arguing that substantial official debt relief to date is not enough to achieve sustainability); see also William R. Cline, *Policy Brief 15-12: From Populist Destabilization to Reform and Possible Debt Relief in Greece*, PETERSON INST. INT’L ECON. (Aug. 2015).

91. See, e.g., Jason Hovet, *Czech President Floats Idea of Greece Paying Debts by Hosting Migrant Centers*, REUTERS (Andrew Bolton ed., Mar. 6, 2016); Yanis Varoufakis, *Germany Won’t Spare Greek Pain—It Has an Interest in Breaking Us*, GUARDIAN (July 10, 2015).

92. *Greece Autopsy*, *supra* note 89, at 2.

93. *Greece Autopsy*, *supra* note 167. Retroactive legislation superimposed a majority voting mechanism on the entire stock of domestic-law bonds. Although it was enacted after consultations with creditors, it was in no way contractual—neither consensual nor market standard. The thresholds were designed to ensure that dissenting creditors would be outvoted by a combination of Greek and other euro area banks.

94. *Id.* at 11-12.

95. *Id.* at 42.

96. *Greece Autopsy*, *supra* note 89.

€6.4 billion (\$8.3 billion) in bonds kept their old bonds and have been paid on schedule since.⁹⁷

The 2012 restructuring also caused controversy for excluding €56.7 billion (\$73.7 billion) in bonds held by euro area institutions, primarily the ECB and national central banks in the euro area.⁹⁸ The ECB was Greece's largest bondholder and the biggest holdout. The exclusion of central bank holdings sent the signal that some official creditors would get paid first even when their contracts were identical to those of private creditors, and threatened to make official support synonymous with subordination in the eyes of such creditors.⁹⁹ To diffuse market fears that could undermine its emergency interventions, the ECB later promised that its new financing would be on equal footing (*pari passu*) with the debt owed to private creditors.¹⁰⁰ This promise has not been tested.

In sum, from the perspective of the evolving sovereign debt restructuring regime, the Greek experience between 2010 and 2016 implied that the IMF was weak, the Paris Club irrelevant, government creditors paralyzed by domestic politics, and issue-by-issue CACs mostly futile. It highlighted a peculiar structure of accountability in crisis management institutions, which allowed Greece to accumulate unpayable debt at least in part thanks to their own inability to stop contagion and manage domestic politics in creditor countries. Echoing the experience of developing countries in the 1980s, Greece took on more and more debt at least in part because the international financial architecture was unequipped to process its default.

Today, Greece has total debt of €326 billion (\$364 billion), of which it owes €226 billion (\$252 billion) to the ECB, the European Financial Stability Facility (EFSF) and its successor the European Stability Mechanism (ESM), and other governments in the euro area.¹⁰¹ In other words, Greece's debt problem is overwhelmingly official, and therefore politically fraught. As noted earlier, much of the official debt has been restructured to lengthen maturities and reduce the interest rate, so that Greece's payments are relatively modest. However, the enormous stock of debt and the likelihood that it would not come down on its own in the foreseeable future can depress investor confidence, and dim recovery prospects further. Perhaps more importantly, given recent history, the large debt stock can severely undermine political support for reform and continue to serve as a source of political discord in the euro area.

97. *Id.*

98. *Id.* at 15, 28.

99. In addition to the Eurosystem holdings, €350 million in bonds held by the European Investment Bank (EIB) were excluded from restructuring. *Id.* On the other hand, Greek bonds held by the Norwegian sovereign wealth fund were treated alongside privately held bonds, and restructured over its objections. Richard Milne, *Norway State Fund Sells Eurozone Debt*, FIN. TIMES (May 4, 2012).

100. Press Release, European Central Bank, Technical Features of Outright Monetary Transactions (Sept. 6, 2012) ("The Eurosystem intends to clarify in the legal act concerning Outright Monetary Transactions that it accepts the same (*pari passu*) treatment as private or other creditors with respect to bonds issued by euro area countries and purchased by the Eurosystem through Outright Monetary Transactions, in accordance with the terms of such bonds.").

101. Jeromin Zettelmeyer, Eike Kreplin, & Ugo Panizza, *Does Greece Need More Official Debt Relief? If So, How Much?*, Peterson Institute for International Economics Working Paper 17-6 (Apr. 2017) at 3.

On the bright side, the IMF's position in the troika arrangement has changed dramatically since the early days of the Greek program. After ending its last disbursing program in early 2016, the Fund has actively engaged in policy formulation and review, but has not resumed a financing program pending credible assurance of adequate debt relief by Greece's European partners. Meanwhile, the ESM has extended an €86 billion (\$96 billion) program for Greece, covering the period from August 2015 to August 2018. As part of the program, euro area governments have insisted on IMF involvement to boost the credibility of policy design and performance review. In other words, for as long as it stands firm on its policy principles, the IMF may well have more policy clout now than it did in 2010, with less of a financial stake. This may be a temporary and idiosyncratic development, a function of recent history with IMF and euro area performance in the Greek crisis. Continued hopes for the IMF's return to a financing role, albeit a modest one, may have played a part. Nonetheless, it is a significant development. It shows that, while money is important, it is ultimately not the sole—or even the biggest—source of the IMF's leverage.

III. Exceptional Access Reform and Contagion

The IMF's involvement in Greece in 2010-2012 faced withering criticism from all quarters. Fund staff responded with a concerted effort to recapture policy initiative in debt restructuring beginning in 2013.¹⁰² Most importantly, in January 2016, the Executive Board did away with the systemic risk exception that had allowed the IMF to lend to Greece and others despite its questionable debt profile.¹⁰³ It also expressly broadened the range of restructuring outcomes IMF staff could seek when a country's debt sustainability was in doubt, introducing a measure of flexibility in the 2002 lending policy as it had been interpreted.¹⁰⁴

Under the new policy, a country whose debt sustainability is in the gray zone might be asked to secure its creditors' commitment to maintain their exposure as a condition of IMF support. Although the debt would not be paid on schedule, creditors would not necessarily suffer losses until and unless the analysis indicated that the debt was, in fact, unsustainable. However, public money would not finance massive payments to private creditors, as happened in Greece in 2010-2012. Similar conditions had been imposed on several occasions before 2002.

Had the revised policy been in place in 2010, it probably would not have changed the outcome in Greece. European authorities at the time resisted the notion of *any* change in the payment terms of EU member state debt, and, in the aftermath of Lehman, other governments agreed. The no-restructuring bridge was crossed with the 2012 Greek bond exchange. On balance, the new exceptional access policy should reduce pressure on IMF staff to produce optimistic debt

102. See *Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF (April 26, 2013) [hereinafter IMF 2013 Sovereign Debt Review].

103. Press Release, IMF, *IMF Executive Board Approves Exceptional Access Lending Framework Reforms*, No. 16/31 (Jan. 29, 2016).

104. *Id.*

projections in order to lend.

Nonetheless, the subject of contagion, which loomed large over the IMF's early lending to Greece and the erstwhile systemic risk exception, remains an important gap in the international policy framework. The IMF's revised access policy effectively tries to remove the Fund from the contagion calculus when the crisis country's debt is unsustainable. The policy approved in January 2016 suggests that, to stem contagion, other governments should finance a country like Greece bilaterally on below-market terms.¹⁰⁵

Disclaiming responsibility for fighting contagion should help reduce political pressure on the IMF to lend to over-indebted countries—a good thing.¹⁰⁶ However, if this disclaimer is to have broad credibility, it is imperative for other parts of the global financial system to take on the task of addressing the risk of contagion.¹⁰⁷ In Europe, a response to contagion without the IMF is more plausible today than it might have been in 2010 or even 2012, since the euro area has developed an expanded toolbox to provide central bank liquidity and multilateral crisis financing, at least to the smaller economies.¹⁰⁸ However, if these tools, in Europe or elsewhere, prove to be inadequate relative to the scale of likely capital outflows, pressure on the IMF would return in the next crisis. As a membership organization with a crisis-fighting mandate, the IMF could find such pressure hard to resist, with further damage to its analysis and reputation.

IV. Lessons and Policy Recommendations

Sovereign debt restructuring has always been a flawed enterprise. It would be wrong to describe the 1980s and the 1990s as the halcyon days of debt relief and burden-sharing. Agreements took years to negotiate and failed to secure a durable exit from debt crises. There were endless iterations of piecemeal relief and painful adjustment. But by the end of the twentieth century, debt crises unfolded in a regime that had its own structure and customs, and exerted a measure of discipline over its constituents within an IMF-centered analytical framework, thanks to cohesion among similarly-situated creditors and linkages among public, private, domestic and external restructuring processes. The regime was surprisingly resilient: creditors could come and go, but the overall framework would change incrementally, in response to discrete problems. It was recognizable from crisis to crisis, and was familiar to a small core of specialists and repeat players. Nonetheless, it was unintelligible as a whole, and felt unaccountable to the lending and

105. Press Release, IMF, IMF Executive Board Approves Exceptional Access Lending Framework Reforms, No. 16/31 (Jan. 29, 2016) (reporting Board approval of the policy); IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper (Apr. 9, 2015) (policy reform proposal). Going forward, this would mean a lot more bilateral rescue packages of the sort the United States had arranged for Mexico as a temporary measure to stem the 1990s Tequila crisis.

106. IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper 10-11 (Apr. 9, 2015).

107. IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper (Apr. 9, 2015).

108. Euro Area Article IV Report 2015, *supra* note 71

borrowing public.

The Greek crisis was one of a series of shocks that threw the regime into disarray. It was particularly damaging to the IMF. Having lost its preeminence as a lender, the Fund appeared to compromise its analysis under political pressure from a powerful subset of its shareholders. Meanwhile, debt fueled street protests and political crises. It was high time for reform.

Initiatives to reform the sovereign debt restructuring regime poured in from different corners of the sovereign debt universe. As noted earlier, the IMF launched a comprehensive review of sovereign debt restructuring in 2013, including proposals to reform its analysis and lending policies.¹⁰⁹ The U.N. General Assembly called for a multilateral sovereign debt restructuring framework in September 2014, and endorsed a set of “Basic Principles” for sovereign debt restructuring a year later.¹¹⁰ The resolutions built on a multi-year work program at the U.N. Conference on Trade and Development (UNCTAD), which also produced a restructuring “roadmap” for sovereign debtors.¹¹¹ The International Capital Market Association (ICMA) proposed new contract reforms in August 2014, including stock-wide aggregated majority voting adapted from the 2012 Greek Bondholder Law. “Super-aggregated” CACs were a product of ICMA’s collaboration with other industry bodies, large emerging market debtors, the IMF and official bilateral creditors. They have been adopted in the majority of new international sovereign bond issues—although outstanding stock without these terms remains high.¹¹²

Perhaps more than any other actor in the sovereign debt restructuring regime, the IMF has learned from the crisis, and has pursued meaningful reforms. I have already mentioned its initiatives with respect to debt sustainability analysis and large-scale lending, as well as its facilitation of bond contract reform. However, more remains to be done to achieve sustainable outcomes, a comprehensive and collective restructuring process, and an intelligible and accountable restructuring regime.

A. Sustainable Outcomes

The existing regime tends to approach debt sustainability as a fact, an ascertainable threshold: an economy’s debt stock or debt service burden is either stable and payable, or doomed to keep growing. As noted earlier, this threshold can be hard to calculate with precision; however,

109. IMF 2013 Sovereign Debt Review, *supra* note 102.

110. Sixty-ninth General Assembly, 102nd Meeting (PM), Discussion of Draft Resolution on “Basic Principles on Sovereign Debt Restructuring Processes” (document A/69/L.84), September 10, 2015.

111. Report of UN Conf. on Trade and Dev., *Sovereign Debt Workouts: Going Forward, Roadmap and Guide* (Apr. 2015).

112. *Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts*, IMF, December 2016. The U.S. Treasury convened a working group for two years, culminating in ICMA’s model clause proposal, *Collective Action Clauses*, INT’L CAP. MKT. ASS’N (August 2014); see also Anna Gelper, Ben Heller & Brad Setser, *Count the Limbs: Designing Robust Aggregation Clauses in Sovereign Debt Contracts* (forthcoming in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman, José Antonio Ocampo & Joseph E. Stiglitz eds., 2016)).

the basic idea is relatively straightforward.

It is generally understood, but less commonly discussed, that sustainability is also a political judgment about distribution of resources between debtors and creditors, and among different creditors with claims on the sovereign. A sovereign debtor allocates political capital, reform efforts and budget resources across a range of priorities that might include veterans' pensions, foreign bond payments, domestic bank bailouts, girls' education, and gold statues of military leaders. A government creditor chooses to lend its crisis-stricken neighbor billions of dollars to pay off its bonds, to wage war on a common enemy, to pursue economic reform, or some combination. In all cases, achieving sustainability requires political support from the government's domestic constituents and foreign creditors, since it implies loss distribution on a substantial scale.

Because they implicate sensitive political calculations, debt sustainability judgments expose IMF staff to political pressure, overt or implied. As the Greek case amply demonstrates, sustainability politics can threaten the IMF's credibility, and cast doubt on its impartiality. Crucially, sustainability judgments are at greater political risk when they are tied rigidly to lending policies. In a battle between emergency financing and analysis, analysis is likely to lose.

To reduce the political burden on the IMF while taking advantage of its staff expertise, it is important to build still-broader consensus around debt sustainability methodology, including the range of assumptions that might go into a model, and to harness independent analytical capacity outside the Fund, which could be mobilized in crisis and be accepted by the relevant constituents.

For example, sustainability determinations could be made by standing or *ad hoc* expert panels, drawn from agreed lists including market, civil society, and public sector representatives. Such panels may consider data and other input from IMF staff, peer governments, market and academic experts. A representative working group under the auspices of the IMF or another multilateral body can develop and periodically review the substantive methodology, and agree on rules for constituting panels. Panel determinations of sustainability need not be binding. However, debtors and creditors may wish to incorporate them by reference in their contracts and policies, to reduce uncertainty in the event of a crisis. In a more modest version of this proposal, the IMF would continue to follow its in-house debt sustainability analysis (DSA), but would account publicly for any material divergence between its own analysis and that of an independent panel.

IMF DSAs can and should continue to play an internal role at the Fund, for example, to assess the risk of a program to the IMF's own resources. This determination is distinct from whether a country should borrow or restructure, and on what terms—and would benefit from being made separately. Put differently, it is plausible for the IMF, the sovereign borrower, and its creditors to reach different conclusions about what is achievable and desirable, taking both politics and economics into account. Each may come to the table with different assessments and different

normative priors. IMF staff may well decide that the sovereign's analysis does not add up. In that case, the IMF should not lend. If no other funding is available, the government may default or restructure; it may also continue to engage with the IMF to arrive at a consensus analysis. However, it is also possible that other financing sources would materialize, especially if the IMF is capacity constrained.¹¹³ A key lesson of Greece is that abstaining from a program that might strain its analytical credibility can bolster the IMF's position in a more diverse field of creditors, and preserve its resources—perhaps even to fight contagion.

B. *A Comprehensive, Collective Restructuring Process*

Among the most sobering lessons from Greece concerns the role of government creditors in sovereign debt restructuring. In late twentieth-century restructurings, debtors came from low- and middle-income countries, while creditors came primarily from G-7 and OECD countries and had a stake in the Paris Club forum. With very rare exceptions, government-to-government debt tended to stay in the hands of the original creditor.

It would be imprudent to assume that the next sovereign debt crisis would continue to follow this pattern. Some of the biggest official bilateral creditors, including China, Russia, and the Gulf states, have no stake or a limited stake in the Paris Club process (although Russia is a member). After the Greek experience, it is safe to say that any debt problems of euro area countries would be entirely outside the club's purview.

On the other hand, more and more governments hold one another's bonds. As noted earlier, the ECB was the biggest holdout in the 2012 Greek restructuring. It has since stated that it considers itself bound to vote against a debt restructuring if CACs were invoked.¹¹⁴ In a very different setting, Russia's sovereign wealth fund, which holds a \$3 billion bond claim against Ukraine, remains the biggest holdout in that country's 2015 bond restructuring. In 2016, the bond trustee sued Ukraine on Russia's behalf in an English court. The court reaffirmed in March of this year that the bonds would be treated as ordinary commercial contracts, notwithstanding the extraordinary circumstances of the Russia-Ukraine conflict.

The rise of new creditors and forms of financing that mix trade, investment, and finance, elevates the importance of consistent accounting and reporting. If the trend continues, it will get harder and harder to categorize a debt contract as official, private, domestic, or external. Private financial industry groups, official creditors, including the IMF and members of the Paris Club, but

¹¹³ Boughton, *supra* note 52.

¹¹⁴ *Opinion of Advocate General Cruz Villalón* delivered on 14 January 2015, in *Peter Gauweiler and Others v Deutscher Bundestag*, Request for a preliminary ruling from the Bundesverfassungsgericht, at §235 ("Moreover, the ECB has stated in its written observations that, in the context of a restructuring subject to CACs, it will always vote against a full or partial waiver of its claims. In other words, the ECB will not actively contribute to bringing about a restructuring but will seek to recover in full the claim securitised on the bond. The fact that the ECB acts with a view to preserving its claim in full confirms that the aim of its conduct is not to grant a financial advantage to the debtor State but to ensure that the latter meets the obligation it has entered into.")

also the International Forum of Sovereign Wealth Funds,¹¹⁵ would benefit from comparing notes on their respective accounting conventions and reporting requirements. Unless such groups cooperate in this apparently mundane task, creditors would be tempted to engage in a form of regulatory arbitrage, characterizing the same debt in multiple ways in order to free-ride on others' concessions.

The IMF recently reformed its policy on lending to countries that have stopped paying their government creditors, to bring it in closer alignment with its policy on sovereign arrears to private creditors.¹¹⁶ This was a sensible change, arguably long overdue. However, more analytical and policy work remains to be done to ensure that all official and all private creditors contribute to resolving a sovereign debt crisis in a fair and meaningful way. In particular, it is important to account for governments and private creditors holding identical tradable bonds while their interests and sources of leverage over the sovereign debtor are very different. The experience in Greece and Ukraine suggest that creditors with fundamentally different incentives should not participate side by side in the same bond restructuring vote; however, there should be a credible way to account for their contribution to the country's recovery program. One way of addressing this problem in a bond restructuring would be to disenfranchise all bonds held by official creditors in a debt restructuring vote—or, at a minimum, to segregate them in a separate voting pool bound to make comparable concessions.¹¹⁷

Finally, much has been said already on the need to elaborate the IMF's approach to working with countries that are members of a monetary union. The fact that a sovereign debtor in a monetary union has limited agency, and that other stakeholders and decision makers may be beyond the purview of conventional IMF tools, is among the more painful and awkward lessons of Greece. The fact that a monetary union can, in effect, take some policy areas and sources of funding off the table is counter to the imperative of making the debt restructuring process collective and comprehensive. It also detracts from transparency and legitimacy.

C. *An Intelligible and Accountable Regime*

Sovereign debt restructuring experience must be accessible and intelligible to the public. Of all the items on my policy wish list, this is the easiest to implement, and likely to have a significant long-term impact.¹¹⁸ It is also unglamorous.

It is simply wrong in this day and age that sovereign debt restructuring experience,

115. The International Forum of Sovereign Wealth Funds is a self-governing for sovereign wealth funds.

116. IMF, *Reforming the Fund's Policy on Non-tolerance of Arrears to Official Creditors* (Dec. 2015)

117. As an alternative to separate classification or disenfranchisement, official creditors could also commit not to trade their debt, and not to enforce it in national courts. However, such a commitment may be politically hard for official creditors to make, and hard to enforce.

118. This proposal is already part of the UNCTAD Roadmap, *supra* note 111

including the most basic facts about legal and financial outcomes, is not easily accessible in the public domain. Instead, we rely on painstaking detective work of academic researchers and commercial databases. Any international organization, trade or civil society group can host a comprehensive, searchable public database of past restructurings, including financial and legal terms, the treatment of public, private, domestic and foreign claims, and any underlying assumptions—made available as soon as practicable after the agreement is finalized. The sovereign borrower should be responsible for supplying required information in standardized form within a prescribed period. At least basic summary terms should be available in English and in the language of the borrowing country. The requirement to disclose restructuring terms can be incorporated in standard form debt contracts, as well as in IMF and other institutional lending policies. Failure to deliver information within a reasonable period without a compelling justification could give rise to sanctions, including claw backs of restructuring concessions in extreme cases, such as fraud.

Of course, the IMF is ideally placed both to require and host such disclosure. However, if it does not, someone else should.

Conclusions

Sovereign debt crises are, by definition, systemic financial and political crises in the borrowing country. They could never be orderly or predictable in the strict sense. Sovereign debt restructurings in the late 20th and early 21st centuries have had a remarkable track record of operational success and substantive failure. Deals got done, but few debtors got timely and durable relief. The informal regime with the IMF at the core, which has dominated sovereign debt restructuring since the 1980s, has been under stress in recent years as a result of changes in international politics and international capital flows. The Greek crisis is a stark example of the continuing challenges to the regime.

Although the IMF's experience in Greece inarguably damaged its credibility, on balance, the Fund has been a force for good in Europe, and has demonstrably learned from its mistakes. It has undertaken welcome reforms in its lending policies and debt sustainability analysis, and, most recently, has shown that its analytical depth and crisis management experience remain indispensable even after it has stopped lending to Greece. The lesson is not that the IMF never needs the money, but that it always needs credibility—and that it has managed to recapture it in this case, despite the early setbacks. The IMF is the only international institution today capable of bringing together diverse stakeholders in a comprehensive debt restructuring framework, adapting quickly in a volatile and fast-changing world. It is in everyone's interest to bolster the IMF's hard-won credibility and independence and encourage continued reform.

* * *

Testimony before the
Subcommittee on Monetary Policy and Trade
Committee on Financial Services
U.S. House of Representatives

May 18, 2017

Meg Lundsager

Public Policy Fellow

Woodrow Wilson International Center for Scholars

Chairman Barr, Ranking Member Moore, and Members of the Subcommittee, thank you for inviting me to testify on the “Lessons from the IMF’s Bailout of Greece.” Many complex issues surrounded IMF lending to Greece during my tenure as U.S. Executive Director on the IMF Executive Board from 2007-2014. I continue to focus on these issues as a Public Policy Fellow at the Woodrow Wilson International Center for Scholars. My testimony today reflects my personal views, not those of the Wilson Center.

Summary:

International Monetary Fund (IMF) lending to countries that are members of the Eurozone has strained key IMF principles and undermined its lead role in designing adjustment programs and financing packages for countries suffering balance of payments crises. IMF lending programs that normally encompass all aspects of macroeconomic and financial sector policy have been shaped more by European needs than by IMF standards.

Conditionality for Eurozone members differs sharply from that for most other IMF members and weakens the IMF’s commitment to treat its members uniformly in terms of the types of policy adjustments demanded in lending programs. The IMF’s principle of uniformity of treatment has been a foundation of the IMF’s ability to treat each member fairly while designing programs to achieve economic and financial stability. Programs are shaped to country circumstances and therefore are not necessarily identical across the membership. In the Eurozone crisis however, key policies were set by European institutions, leaving the IMF little room to design a program that could create conditions for Greece’s recovery.

IMF financing requirements have come second to European practices and procedures, despite the decades long priority treatment all IMF members have accorded to their loans from the IMF. Eurozone governments have created their own €500 billion financial rescue fund, the European Stability Mechanism (ESM), and therefore do not need IMF funding. With little likelihood that Europe will adjust its internal rules and regulations to accommodate the IMF, the preferred

future approach is that Eurozone countries do not seek IMF lending. If Eurozone members do exercise their right to request IMF financing, the IMF should have in place a defined policy establishing its primacy in program design.

The following statement outlines IMF practices and how programs for Eurozone countries, particularly Greece, deviated from those practices, leading to the conclusion that the Eurozone members should address their financing needs with their own internal resources. Finally, recognizing that the IMF Articles of Agreement enshrine each member's right to seek IMF financing, this statement includes recommended policy reforms the IMF should adopt before lending to a Eurozone member.

IMF Role and Challenge of Eurozone Country Programs

The International Monetary Fund serves as a foundation of the international economic order and over the seven decades of its existence, has supported numerous international economic policy objectives of the United States. The IMF has moved quickly to help crisis countries restore financial and economic stability. This has helped put a floor under a country's economic contraction, preventing economic recessions from becoming economic depressions, thereby reducing the loss of jobs and incomes. This also reduces the likelihood of financial crises spilling across borders.

IMF programs condition lending on economic reforms such as tightening monetary policy by raising interest rates, reducing government deficits, taking action to resolve tottering domestic banks, and in some cases, depreciation or devaluation of a country's currency. The program negotiation enables the country and IMF staff to discuss policy alternatives to achieve the desired objectives. Monetary policy expectations are always included in an IMF program and each program aims to achieve debt sustainability.

The IMF considers exchange rate policy to be a key part of its discussions in all programs. If the country is a member of a currency union and cannot on its own change its exchange rate, the IMF will devise policies that likely have the impact of lowering domestic prices and wages, or reducing that country's inflation relative to trading partners. Relatively lower domestic prices then substitute for an exchange rate adjustment. This is what is meant by 'internal devaluation,' which in the end occurred to some extent in all Eurozone program countries as sharp economic contractions put downward pressures on domestic wages and prices.

This traditional approach is often viewed as the IMF imposing austerity on the member. But of course a country only approaches the IMF for assistance once its economic crisis has destroyed investor confidence and currency outflows have depleted foreign currency reserves. Once foreign exchange reserves are dangerously low, the country has little choice but to devalue its currency and/or drastically tighten its monetary and fiscal policies. IMF policy advice/conditionality and financial support can mitigate the economic contraction needed to restore stability.

The IMF also will work closely with key bilateral and multilateral partners, as aid and credit programs provide valuable technical assistance and critical funding. Debt relief from official and private creditors may also be included in the financing package.

Partnering with other institutions providing assistance requires reconciling divergent institutions' mandates. In recent years, managing such relationships has become much more complex and has put the IMF in the middle of trying to navigate the cross currents among the various partners, while negotiating difficult economic policy choices with the member country. This is what occurred in the case of Greece.

The IMF's lending programs with countries that are members of the Eurozone have brought to light new complexities which the IMF has yet to resolve. IMF involvement in early Eurozone country programs was critical to preventing a broader European wide crisis that ultimately could threaten the existence of the Eurozone. But that engagement also revealed the lack of clarity regarding the IMF role vis-a-vis the European entities providing financial support. European priorities limited the ability of the IMF to follow its traditional approach and adhere to its own policy of uniformity of treatment.

The Eurozone Crisis Impact on the IMF

All countries borrowing from the IMF must show a balance of payments need. Each Eurozone country faced balance of payments difficulties as their trade balances and capital flows worsened. Each Eurozone member also faced large fiscal challenges as economic recessions reduced government revenues. Domestic banking systems needed shoring up and unemployed workers received benefits, requiring additional fiscal resources.

In the end, the governments of Greece, Ireland, Portugal and Cyprus ran out of ready access to Euros, their own domestic currency as depositors shifted funds to other Eurozone countries and governments could only roll over very short term debt at high interest rates.

These four countries are members of the European Central Bank (ECB), which creates Euros and manages monetary policy for the Eurozone. As Greece first slid into crisis, European partners, particularly Germany, planned to resolve the problem within the Eurozone. Once the depth of economic mismanagement in Greece and the size of the financing gap became clear, European partners asked Greece to approach the IMF for financing as well.

Negotiating Greece's adjustment program was complex as the European Commission (EC), the European Central Bank (ECB), bilateral partners, and the IMF all were demanding Greek reforms in exchange for financing. This negotiating pattern evolved into the 'troika' consisting of the European Commission (EC), the ECB and the IMF.

The IMF loan for Greece was put together quickly in 2010 in order to prevent Greece defaulting on its debt obligations. In the months leading up to the Greece program approval in May fears grew that Greece's crisis would spread to other Eurozone members, including Spain and even Italy. Europeans needed the IMF's quick action to keep Greece solvent while they arranged European financing. The IMF could act quickly, while European partner financing required

decisions by national governments and Parliamentary votes. Furthermore, the Eurozone did not at that time have an institution tasked with imposing the kind of macroeconomic conditionality Greece needed and the IMF could provide.

Since that time, Europe has established the European Stability Mechanism (ESM), which has the ability to lend €500 billion and is now the primary source of new Euro funding to Eurozone members. European leaders themselves are now expecting to finance future crisis programs from this mechanism, and claim they are less likely to turn to the International Monetary Fund for financial participation in a lending program. This is a welcome development.

Where does this leave Greece?

In the meantime Greece has yet to restore economic growth or generate new jobs, as investment has stalled amid the uncertainty over external financial support, including how European partners will honor their commitment to restore Greece's debt sustainability. Greece's outstanding debt is very high, at 180 percent of its GDP, and likely to remain high for a number of years.

Greece's European partners have insisted Greece pursue a new program with the IMF to coincide with the final year of Greece's ESM program. Germany seeks a parallel IMF agreement in order to secure domestic German support for the ESM loan disbursement.

The IMF asserts that it will not join a new lending program without European creditors clarifying how they will reduce Greece's indebtedness over the longer term. European officials have ruled out any outright reduction of principal, or 'haircuts', but have signaled that sustained low interest rates and very long maturities could be considered, if necessary, assuming Greece completes its current ESM program successfully next year. The IMF has signaled that it would accept further maturity extensions and longer term commitments of very low interest rates, instead of outright haircuts on outstanding debt.

European officials have repeated previous commitments but as of last week, have not yet specified the extent of debt relief that will be provided to Greece after 2018, assuming Greece meets its ESM program targets. An IMF official stated that the European partners "need to have numbers on what are the potential (debt) measures, to show these potential measures really entail a game changer as far as debt is concerned." The IMF Managing Director, Christine Lagarde, stated "European partners need to be more specific in terms of debt relief." (Reuters May 12, 2017)

The IMF has rightly focused on reducing the level of outstanding debt, to signal to Greek and potential foreign investors that future debt servicing requirements will not impede profitability and investment, which are needed for job creation.

The IMF is also concerned that the Europeans are expecting Greece to run a very tight fiscal policy for a prolonged period of time, something very few countries have succeeded in doing. The IMF would prefer that additional fiscal resources provided by further debt relief be applied to investment and some basic social services in Greece.

Given that the largest share of the debt is owed to Greece's European partners, this is the opportune time for the IMF to disengage from financing Greece's adjustment program. At this time, Greece's outstanding debt to the IMF has dropped to less than \$14 billion, while its debt to European partners remains over \$200 billion.

Contradictions revealed in IMF Eurozone programs

Lending to Eurozone members has been an unusual situation for the IMF. The ECB placed itself as a member of the troika, along with the IMF and the European Commission (EC), when normally a country's central bank is part of the country team negotiating with the IMF. The central bank is typically expected to make commitments as to its path for monetary policy, or its intentions regarding bank supervision, if the central bank has the responsibility for bank regulation.

The Greece program revealed the conflicting priorities among the involved partners:

- European countries were not meeting their self imposed fiscal deficit targets and were not effectively enforcing their own internal fiscal rules, undercutting their ability to impose conditionality on Eurozone crisis countries.
- Europe looked to the IMF to impose that conditionality, but the IMF is a crisis resolution institution focused on restoring basic macroeconomic stability using traditional monetary, fiscal, financial sector and exchange rate policies. This crisis resolution approach should stabilize domestic finances and limit economic contraction while restoring debt sustainability.
- In the past, the IMF left longer term 'structural' measures, such as labor market, pension, or judicial reform for the country to tackle over time, perhaps with the assistance of other multilateral institutions or bilateral partners. As Greece in particular made little progress in these areas needed for fiscal sustainability, the IMF included such structural reforms in its programs. Without sufficient funding or debt relief to cushion the economic downturn, political support for reform dissipated and Greece's program performance fell short.
- As these internal inconsistencies became more obvious, EU and Eurozone institutions nonetheless insisted that their own institutions be repaid, putting pressure on the IMF to join in financing packages.
- Greece delayed repayment to the IMF briefly in 2015 and fell into arrears. The ESM ultimately found a way to enable temporary financing for Greece, which allowed Greece to repay the IMF. But European partners' seeming disregard for the IMF's preferred creditor status, or top ranking among all creditors, raised concerns regarding Europe's willingness to recognize the IMF's paramount role.

The Eurozone as a monetary union creates unique challenges for the IMF. Under the IMF Articles of Agreement, each member country is entitled to seek financial assistance, recognizing that the IMF imposes conditions on that lending in order to achieve economic viability and secure high probability of repayment. Countries come to the IMF to borrow foreign exchange, the global reserve currencies that the country needs to pay for imports or service its external obligations.

The ‘foreign exchange’ the European crisis countries needed was their own domestic currency, the Euro, created by their own central bank, the European Central Bank. In that respect, it was unprecedented for Eurozone members to borrow Euros, a global reserve currency, from IMF members which are not part of the Eurozone and which hold Euros as part of their foreign exchange reserves. Eurozone members should be able to secure Euros directly from their own central bank, the ECB, which creates Euros for its members.

IMF Staff View of Lending to Greece

The IMF staff have undertaken several reviews of their European programs, the most recent being the Ex-Post Evaluation of the 2012 IMF Greece Extended Fund Facility which was published this past winter. Included below are some of the key concerns raised by IMF staff in this recent review:

- IMF staff are not certain that they have the information needed to evaluate the health of Greece’s banks, due to fears that European regulators are not sharing all the relevant information. They are also concerned that European policies regarding bank regulation may not coincide with measures that IMF staff feel are needed to address banking sector weakness.
- IMF staff note that few countries have maintained very tight fiscal policies for many years, as the European partners are assuming Greece will do to achieve debt sustainability. Staff also worry that insufficient attention is being given to broadening the tax base and instead EU partners push higher rates on a small base, further reducing producer incentives to invest or hire new workers.
- IMF staff point to Greece choosing to repay other creditors while briefly falling into arrears to the IMF in summer 2015, contrary to the Fund’s internationally respected preferred creditor status. The European Stability Mechanism (ESM) includes in its treaty recognition of the IMF’s priority status among creditors, but this does not cover the bulk of the European partners’ financing for Greece, which predates ESM lending to Greece. Europeans condition future support on Greece continuing its agreed economic reforms. That provides little assurance if Greece falls short and European partners cease providing new financing, as happened when Greece fell into arrears to the IMF in 2015.
- Finally, staff note that the IMF still has not established a policy for lending to countries that are in a monetary or currency union.

Next steps for the IMF

The IMF is planning to discuss these concerns this summer, according to its work program, which includes conditionality in currency unions among policy items for Executive Board consideration. Development of a Fund wide policy is past due.

In sum, just as the IMF has formalized its approach on exceptional access (or large programs) the IMF should formalize its approach to program countries in reserve currency monetary unions. This could help restore the IMF’s principle of uniformity of treatment among all its members.

The approach should include a process for the IMF to participate in formulating the country's economic reform program and monitoring its performance, without necessarily providing financial support.

If the country requests IMF financing (a right established in the IMF's Articles of Agreement), the monetary union should respect the IMF's lead role in program design and debt sustainability assessments.

An IMF policy on conditionality in currency unions should include the following elements:

- The role of the central bank – the monetary union central bank should include the borrowing country in its normal monetary policy operations;
- The role of currency union fiscal institutions – these institutions should specify the resources and timing of flows that will be provided to the borrowing country, ranging from loans to public investment commitments;
- The role of the currency union's banking regulator – regulators should specify the nature of their supervisory requirements and range of their support to a borrowing country's banking sector and importantly, share data with the IMF and defer to the IMF's policy conditionality requirements;
- The IMF financing role – the IMF contribution to a financing package should be relatively small. A return to shorter term standby arrangements, instead of extended fund facilities with 10 year maturities, should be expected and the levels of IMF financing should be kept within normal limits.
- Program conditionality should adhere to IMF norms and currency union institutions should defer to all IMF requirements.
- The currency union's members and lending institutions should explicitly recognize the preferred creditor status of the IMF, including with regard to their earlier disbursements.

Conclusion

The IMF, European creditors, and Greece have agreed on Greece's policy package for the next year, now before Greece's Parliament. Discussions are ongoing as to the extent of the commitments the European creditors will make at this time for future debt relief for Greece. As noted above, the IMF is insisting on more specificity in order to assess whether Greece will achieve debt sustainability.

The Europeans remain reluctant to provide concrete promises, stating that Greece could achieve debt sustainability by adhering to tight fiscal positions for many years, which the IMF does not believe is feasible or desirable. These divergent positions reinforce the conclusion that the European partners should finish the last year of the Greece program without the IMF, as they have managed to do for the past two years. European institutions can facilitate financing to enable Greece to meet debt payments this summer, as they did in 2015.

A European decision to assume full responsibility for restoring Greece's economic vitality could be a first step in recognizing that the long term viability of the currency union rests on the

members becoming a union and not a collection of widely divergent economies. The new President of France has made some suggestions to move towards centralized fiscal activities, although Germany and other stronger economies remain reluctant to centralize more government activities in European Union institutions.

Taking initial steps towards a fiscal union could lead to a strong *European* economy instead of a group of a few exceptionally strong economies carrying several economically weaker partners. German recognition that a successful union will entail more internal sharing along with France's commitments to its own needed structural reforms could form the basis for a stronger future Europe, which would contribute to higher global growth and financial stability benefiting all countries.

The IMF cannot deliver that, only European citizens and their governments can.



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TESTIMONY

Statement of

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Before

Committee on Financial Services
Subcommittee on Monetary Policy and Trade
U.S. House of Representatives

Hearing on

“Lessons from the IMF’s Bailout of Greece”

May 18, 2017

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Chairman Barr, Ranking Member Moore, and Members of the Subcommittee, thank you for the opportunity to appear before you today on behalf of the Congressional Research Service to discuss "Lessons from the IMF's Bailout of Greece." As requested, my testimony focuses on the implications of the International Monetary Fund (IMF) programs in Greece, particularly their impact on the IMF's capacity to deploy its resources responsibly and effectively.

IMF Involvement in the Greek Crisis

The International Monetary Fund (IMF) is an international organization whose primary purpose is to ensure stability of the international monetary system.¹ The United States is the IMF's largest shareholder and plays a key role in shaping IMF policies and programs. IMF membership has grown from 30 countries in 1945 to 189 countries today.²

The IMF's role in the global economy has evolved over the past 70 years. The IMF was originally created to oversee a system of pegged exchange rates and provide financing to countries facing temporary balance-of-payments crises associated with currency misalignments. In the 1970s, the system of pegged exchange rates broke down, and the United States and several other major economies adopted floating exchange rates. New challenges in the global economy emerged, and the IMF began extending emergency loans to countries facing a broader range of banking, debt, and currency crises. The IMF played a key role in responding to major international financial crises, including the 1980s debt crisis, the Mexican crisis in 1994-1995, the Asian financial crisis in 1997-1998, the Argentine crisis in 2000-2001, and the global financial crisis of 2008-2010. The IMF's track record in crises has been scrutinized, and at times has been characterized by some critics as bailing out profligate governments and imposing austerity policies that have harsh social consequences.³

In recent years, the most challenging economic crisis facing the IMF has been Greece.⁴ The Greek crisis is rooted in concerns about its public debt and finances, although the crisis exposed broader issues with Greece's banking sector, structural policies, and membership in the Eurozone.⁵ The IMF approved two financial assistance programs for Greece, co-financed with European creditors, in 2010 and 2012. For the IMF as an institution, the stakes were high: the programs were among the largest in IMF history, Greece was the first advanced economy to borrow from the IMF in several decades, and failing to contain the crisis could have undermined recovery from the global financial crisis.

Seven years into the crisis, the IMF's record in Greece is mixed. The IMF programs—in conjunction with measures taken by the Eurozone countries and the European Central Bank (ECB)—succeeded in ring-fencing the crisis and preventing spillover from Greece to larger economies in the Eurozone and the broader global economy. However, Greece's economy has not yet recovered. Greece's debt is higher than

¹ For more on the IMF, see CRS Report R42019, *International Monetary Fund: Background and Issues for Congress*, by Martin A. Weiss.

² International Monetary Fund (IMF), *List of Members*, March 7, 2017.

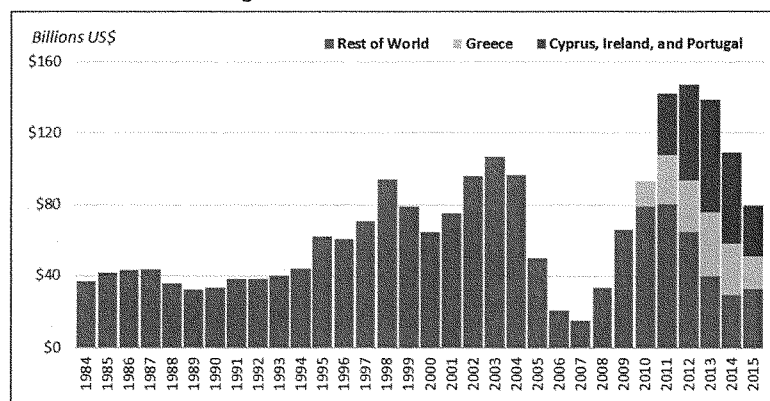
³ For example, see Allen H. Meltzer, "The Report of the International Financial Institution Advisory Commission: Comments on the Critics," in *The IMF and its Critics: Reform of the Global Financial Architecture*, ed. David Vines and Christopher L. Gilbert (Cambridge University Press, 2004), pp. 106-124; Alexander E. Kentikelenis, Thomas H. Stubbs, and Lawrence P. King, "IMF Conditionality and Development Space, 1985-2014," *Review of International Political Economy*, vol. 23, no. 4 (2016), pp. 543-582.

⁴ For more on the Greek crisis, see CRS Report R44155, *The Greek Debt Crisis: Overview and Implications for the United States*, coordinated by Rebecca M. Nelson.

⁵ The Eurozone is a group of 19 of the 28 European Union (EU) member states which have adopted a common currency, the euro.

before the crisis, its economy has contracted by 25%, and one in five Greeks is unemployed.⁶ In the summer of 2015, the Greek government did not make its scheduled repayments to the IMF. It is unusual for any country to miss a payment to the IMF, and Greece became the first advanced economy in the institution's history to do so. Although Greece later made these payments, it raised questions about the Fund's exposure to Greece, one of its largest borrowers at the time (**Figure 1**). Greece remains cut off from international capital markets and relies on a third rescue program financed by European creditors, without IMF participation.

Figure 1. Use of IMF Credit and Loans



Source: IMF, *International Financial Statistics*.

Throughout the Greek crisis, analysts have pointed to missteps taken by a number of actors, including the Greek government, private banks that lent money to Greece, Eurozone leaders and institutions, and the IMF. Given the broader role of the IMF in the global economy, however, the IMF's handling of the crisis in Greece has been widely examined, including by independent analysts and the IMF's Independent Evaluation Office (IEO).⁷

The IMF has defended its policy response in Greece and has taken steps to address some of the issues raised by the Greek crisis.⁸ The IMF changed its policy advice on debt restructuring and austerity during the crisis, declined to participate in a third program for Greece due to concerns about debt sustainability and economic reforms, and revised its lending policies largely based on its experience in Greece. The

⁶ IMF, *World Economic Outlook Database*, April 2017.

⁷ For example, Desmond Lachman, "Greek Lessons for the IMF," *The Hill*, February 20, 2015; Ashoka Mody, "The IMF's Big Greek Mistake," *Bloomberg View*, April 21, 2015; Carmen M. Reinhart and Christoph Trebesch, "The International Monetary Fund: 70 Years of Reinvention," *Journal of Economic Perspectives*, vol. 30, no. 1 (Winter 2016), pp. 3-28; Arvind Subramanian, "How the IMF Failed Greece," Project Syndicate, August 13, 2015; Edwin M. Truman, *The IMF and Euro Area Crises: Review of a Report from the Independent Evaluation Office*, Peterson Institute for International Economics, Policy Brief 16-13, September 2016; Independent Evaluation Office of the IMF, *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*, 2013; Independent Evaluation Office of the IMF, *The IMF and the Crises in Greece, Ireland, and Portugal*, 2016.

⁸ For example, see Olivier Blanchard, "Greece: Past Critiques and the Path Forward," IMF Blog, July 9, 2015.

IMF also financed programs in three other Eurozone countries—Ireland (2010), Portugal (2011), and Cyprus (2013)—which are broadly viewed as successful.

However, the IMF programs in Greece raise a number of broader policy challenges for the IMF that remain outstanding and are likely to be relevant in future crises. These include questions, discussed in greater detail below, about the size and duration of IMF financing, co-financing arrangements between the IMF and other creditors, IMF policy flexibility and accountability, IMF policy towards currency unions, and the seniority of IMF financing.

Should there be limits on IMF financing?

The size of Greece's IMF programs was unprecedented. The amount a country can borrow from the IMF is tied to its financial commitment to the IMF, or its "quota" at the IMF.⁹ Generally, the more a country contributes to the IMF, the more it can borrow from the IMF during crises. During the Eurozone crisis, normal access to IMF financing was capped at 600% of the borrowing country's quota, with procedures for approving larger programs under exceptional circumstances.¹⁰ The IMF programs in Greece, Ireland, and Portugal were three to five times the normal limit, and the largest programs relative to quota in IMF history (**Figure 2**). Although the Eurozone programs were extreme examples, they reflect a broader trend. IMF programs increased relative to the borrower's quota starting in 2008, with large programs in Iceland, Latvia, Hungary, Romania, and Ukraine, among others. Median IMF program size jumped from 75% of the borrowing country's quota in the 1980s to 400% in 2008-2017.¹¹

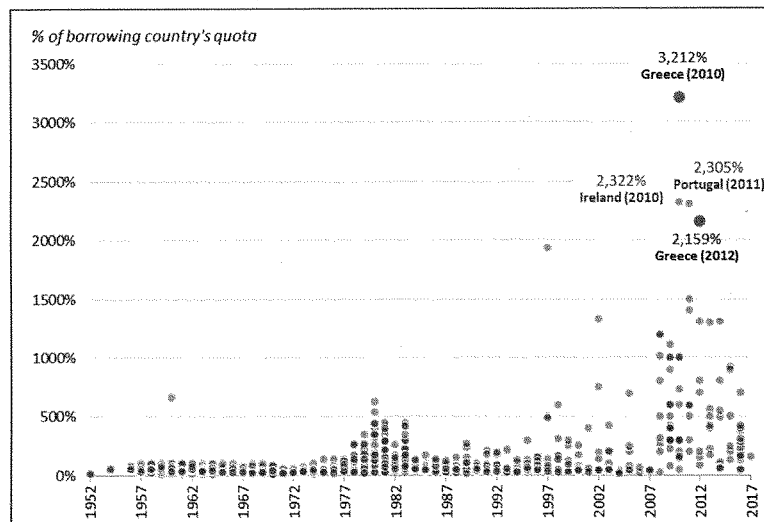
Greece's programs also highlight a pattern for some countries to become repeat or "serial" borrowers from the IMF, even though IMF financing was originally designed to provide short-term balance-of-payments support. With Greece's back-to-back programs, the government received IMF support for a total of 5.5 years (between May 2010 and January 2016). Seven years after its first program, Greece continues to rely on official sector financing, although not currently from the IMF. While the other Eurozone countries (Ireland, Portugal, and Cyprus) successfully stabilized their economies during a single IMF program, some countries are frequent borrowers from the IMF. A quarter of IMF members (48 countries) have been on IMF programs for more than half of the years they have belonged to the IMF; more than a third (70 countries) have been on IMF programs more than 40% of time since joining the IMF.¹² These serial borrowers include a mix of low-income and emerging-market economies.

⁹ A country's quota at the IMF is broadly tied to its size in the global economy, but other factors, including openness to trade, economic variability, and the size of international reserves, also play a role.

¹⁰ Normal access to IMF resources during this time period also included a limit of 200% of quota for any 12-month period during the program, in addition to the 600% of quota limit cumulatively over the lifetime of the program.

¹¹ IMF, *Financial Data Query Tool*. Based on amounts when agreements were approved; some programs were "augmented" during the course of the program (for example, Russia in 1998). Median IMF program 75% of the borrowing country's quota in the 1980s, 50% in the 1990s, and 65% in the 2000s. Excluding precautionary IMF programs, the median program size since 2008 is 300%.

¹² Carmen M. Reinhart and Christoph Trebesch, "The International Monetary Fund: 70 Years of Reinvention," *Journal of Economic Perspectives*, vol. 30, no. 1 (Winter 2016), p. 14.

Figure 2. IMF Programs, 1952-2017

Source: IMF, *Financial Data Query Tool*.

Notes: Program amounts when agreement was approved. Programs included those funded from the IMF's General Resources Account; figure does not include programs funded by the IMF's concessional lending facility.

The trend towards larger and repeated IMF programs raises questions about whether there are limits to what IMF financing can and should be doing. On one hand, lack of clear limits on IMF financing risks moral hazard: that governments will not adopt prudent economic policies if there is an understanding that the IMF will “bail them out,” even at a high cost or over a long time period. Larger and repeated programs can pose risks to donor government contributions to the IMF. More generally, IMF financing was originally designed to help countries address short-term liquidity issues relating to currency misalignments. IMF financing was not originally intended to address the types of crises the IMF has increasingly confronted in recent decades: countries grappling with serious banking or debt crises, where there are questions about the country’s solvency and the country’s financing needs are large and long-term. This raises questions about whether IMF financing has strayed from its original mandate, and how large, longer-term IMF programs fit into the broader international financial architecture, particularly with the World Bank and other multilateral development banks also focused on large, long-term development financing.

On the other hand, there are risks to limiting the resources the IMF can deploy during crises. Large IMF programs post-2008 reflect the severity of the global financial crisis, and it is not clear that the global economy would have been better off if the IMF had taken a less aggressive response. Large programs post-2008 also reflect the fact that IMF resources had not increased at the same rate of global GDP and international economic activity.¹³ Additionally, serial IMF programs reflect the changing nature of

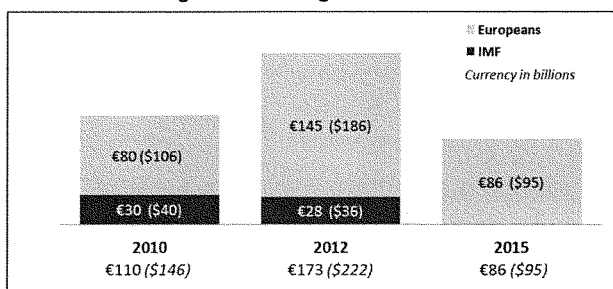
¹³ This was a key argument for doubling IMF quota resources, which was implemented in 2016. For more on the IMF reform package, see CRS Report R42844, *IMF Reforms: Issues for Congress*, by Rebecca M. Nelson and Martin A. Weiss.

economic crises, as the types of crises facing countries in recent decades are associated with deeper and longer drops in economic output.¹⁴ If there is a compelling case for large and repeated IMF programs, which is itself a hotly debated question, there may still be questions about whether IMF policies should be reformed to reflect the shift in types of crises to which the IMF is responding, and how programs can be designed to minimize moral hazard.

Should the IMF co-finance programs with other official creditors and if so, under what circumstances?

At the outset of the Greek crisis, the IMF entered an unprecedented co-financing arrangement with official European creditors. While the IMF provided a minority share of the total resources in the Greek packages (**Figure 3**), co-financing was not by itself unusual in an IMF program. For example, bilateral commitments supplemented IMF resources during Mexico's crisis in 1994-1995 and the Asian financial crisis in 1997-1998.¹⁵ However, it was unprecedented for other official creditors to play a formal role with the IMF in designing and overseeing the program, potentially limiting the independence of the Fund.

Figure 3. IMF Programs in Greece



Source: Independent Evaluation Office of the IMF, *The IMF and the Crises in Greece, Ireland, and Portugal*, 2016, p. 4; European Commission, Greece: *The Third Economic Adjustment Programme*.

Notes: Euros converted to U.S. dollars using exchange rate from the year the program was approved.

Co-financing limited the IMF's financial commitment to Greece, but the IEO found that the so-called "troika" arrangement of the IMF, European Commission, and ECB constrained IMF policy decisions and potentially subjected IMF staff's technical judgements to political pressure.¹⁶ For example, in 2010, some European creditors insisted debt restructuring should not be on the table for Greece. The concerns of the Europeans reportedly overrode IMF staff concerns about the sustainability of Greek debt and the use of debt restructuring as a regular part of the IMF crisis response toolkit. Although the official positions on debt restructuring for Greece evolved and Greece's private debt was restructured in 2012, the delay meant that a large portion of the 2010 program was used to repay Greece's private creditors, and private sector

¹⁴ Carmen M. Reinhart and Christoph Trebesch, "The International Monetary Fund: 70 Years of Reinvention," *Journal of Economic Perspectives*, vol. 30, no. 1 (Winter 2016), pp. 12-13.

¹⁵ For more information on IMF and bilateral commitments during key programs in 1990s and early 2000s, see Nouriel Roubini and Brad Setser, *Bailouts or Bail-ins? Responding to Financial Crises in Emerging Economies* (Institute for International Economics, 2004), Table 4.1.

¹⁶ Independent Evaluation Office of the IMF, *The IMF and the Crises in Greece, Ireland, and Portugal*, 2016.

debt was largely replaced by official sector debt. When Greece did restructure its private debt in 2012, it had limited impact on Greece's overall debt level.

The IMF's experience with the troika arrangement raises questions about whether the IMF should co-finance programs with other creditors. Based on the experience in Greece, co-financing can be helpful in reducing the IMF's financial commitment in a crisis, but problems can arise when the IMF and co-financing partners are not aligned in terms of goals or beliefs about the correct policy response. If co-financing is desirable, there are questions about how to structure co-financing arrangements to maximize effectiveness. This includes the optimal size of IMF financing relative to financing from other creditors and the process by which the IMF designs and oversees programs with co-financing partners.

The IMF does not have a clear policy on co-financing arrangements, although the issue is likely to remain salient in coming years.¹⁷ The financing needs of countries in crisis have increased over the past several decades,¹⁸ and regional financing arrangements, which provide financial support to member countries experiencing financial difficulties, have proliferated. In addition to the new Eurozone rescue fund (the European Stability Mechanism), examples of such funds include the Arab Monetary Fund, the BRICS (Brazil, Russia, India, China, and South Africa) Contingent Reserve Arrangement, the Chiang-Mai Initiative, the Eurasian Fund for Stabilization and Development, and the Latin American Reserve Fund.

How much policy flexibility should the IMF have?

In an unusual step, the IMF revised its lending safeguards in 2010 to allow the first Greek program to go forward despite misgivings about the sustainability of Greece's debt. Greece's financing needs were large, but Greece did not meet the criteria required for accessing loans above the normal IMF lending limits (referred to as "exceptional access" to IMF financing). Specifically, IMF staff could not certify that Greece met one of the exceptional access criteria—that Greece's debt would be sustainable under the program over the medium-term with high probability. However, the IMF believed that the risks from Greece to the global economy were more significant than the risks of extending a large loan to a country with a potentially unsustainable level of debt. The Fund changed the exceptional access criteria to make an exemption for countries that posed a systemic threat to the global economy, allowing the Greek program to go forward.

The rollout of the policy change was opaque and controversial, because the merits and drawbacks of the policy for the IMF were not discussed separately from the exigencies of the Greek crisis.¹⁹ The "systemic exemption" was also criticized for increasing the likelihood that the IMF program in Greece would fail, posing a risk to IMF resources.²⁰ Greece's missed payments to the IMF in the summer of 2015 are cited as evidence that these concerns were founded. However, the "systemic exemption" was also invoked for successful programs in Ireland and Portugal.²¹ IMF staff debated repealing the systemic exemption in

¹⁷ IMF, *Stocktaking the Fund's Engagement with Regional Financing Arrangements*, April 11, 2013; IMF, *Crisis Program Review*, November 9, 2015.

¹⁸ Carmen M. Reinhart and Christoph Trebesch, "The International Monetary Fund: 70 Years of Reinvention," *Journal of Economic Perspectives*, vol. 30, no. 1 (Winter 2016), pp. 3-28.

¹⁹ Paul Blustein, *Laid Low: The IMF, The Euro Zone, and the First Rescue of Greece*, Centre for International Governance Innovation, CIGI Papers No. 61, April 2105; Susan Schadler, *Living with Rules: The IMF's Exceptional Access Framework and the 2010 Stand-By Arrangement with Greece*, IEO Background Paper, 2016.

²⁰ John B. Taylor, "Obama and the IMF Are Unhappy with Congress? Good," *Wall Street Journal*, February 13, 2014; John B. Taylor, "The Lesson Greece's Lenders Forgot," *Wall Street Journal*, July 9, 2015.

²¹ Portugal and Ireland's economies were stabilized at the conclusion of the programs. The governments were able to re-enter capital markets and repay the IMF early. Edward M. Truman, "IMF Exceptional Access and Reform Legislation: Do Not Link the Two Issues," Peterson Institute of International Economics, July 23, 2015.

2014 and 2015.²² The IMF repealed it in 2016, following congressional legislation that conditioned U.S. participation in a broader IMF reform package on its repeal (P.L. 114-113).²³

The 2010 decision to change a key IMF lending safeguard raises questions about the appropriate balance between IMF flexibility during crises and adherence to IMF safeguards that protect IMF resources. Providing the IMF discretion to make policy changes allows the IMF to tap its expertise in unforeseen and time-sensitive crises. The risk is that the IMF may make policy changes that donor governments do not support and make the IMF less predictable as an institution. Additionally, the procedure by which the IMF made the policy change in 2010 raises governance questions relating to transparency and accountability.

How should the IMF engage with members of currency unions?

Greece's membership in the Eurozone is another unusual feature of the IMF programs in Greece. Eurozone members share a common currency and monetary policy, while largely retaining national control over fiscal and banking policies. The unusual split in economic policy responsibilities between national and Eurozone-level authorities complicates IMF surveillance and programs.²⁴ While there is some precedent for IMF support of countries that are members of currency unions (recent examples include St. Kitts, Benin, and Burkina Faso), Greece was unusual due to the size of its economy and the euro's status as a major reserve currency.²⁵

The IMF programs in Greece, as well as in Ireland, Portugal, and Cyprus, treated the crises as crises in individual members of the Eurozone, rather than a crisis of the Eurozone as a whole.²⁶ The conditionality focused on policies directly under the purview of the individual member governments, such as fiscal policies and regulations. Even though the IMF coordinated closely with the ECB, IMF programs did not include conditionality on policies that applied to the currency union as a whole, particularly monetary and exchange rate policies. In most IMF programs, such policies would normally be subject to conditionality.

Additionally, IMF programs in the Eurozone also did not specifically address structural imbalances within the currency union that may have contributed to the crisis, particularly persistent current account imbalances within the Eurozone, or policy reforms in stronger Eurozone members that could have supported the crisis response, including policies to boost domestic demand.

The IMF's experience in Greece raises questions about how the IMF should engage effectively with currency unions and specific members of a currency union. By focusing on the individual member states in the Eurozone rather than the Eurozone as a whole, the IMF programs focused on a narrower set of policy tools than was needed to address the fundamentals of the crisis and imposed more costs of the crisis adjustment on specific currency union members. However, it is not clear what authority the IMF has over currency unions as a whole, or members of currency unions that are not in crisis.

²² IMF, *The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations*, June 2014. IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, April 9, 2015.

²³ IMF, "IMF Survey: IMF Reforms Policy for Exceptional Access Lending," January 29, 2016. For more on the IMF reform package, see CRS Report R42844, *IMF Reforms: Issues for Congress*, by Rebecca M. Nelson and Martin A. Weiss.

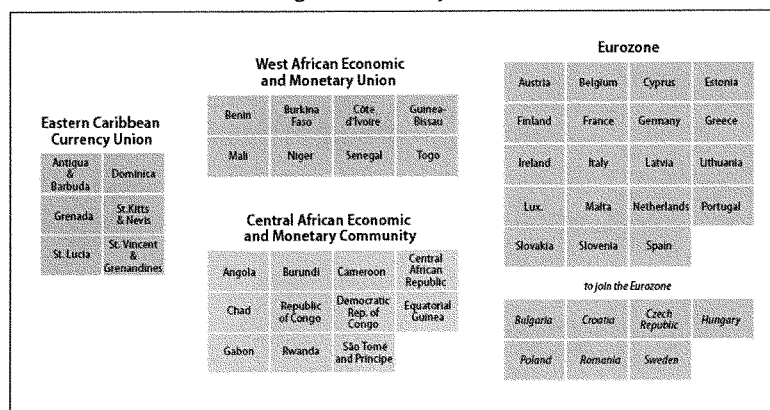
²⁴ For example, see Adam Feibelman, "Europe and the Future of International Monetary Law," vol. 22, no. 1 (2013).

²⁵ Independent Evaluation Office of the IMF, *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*, 2013.

²⁶ Edwin M. Truman, *The IMF and Euro Area Crises: Review of a Report from the Independent Evaluation Office*, Peterson Institute for International Economics, Policy Brief 16-13, September 2016.

The IMF does not have clear guidelines for designing programs in currency unions or currency union members.²⁷ Questions about IMF programs in currency unions may arise in the future. In addition to the Eurozone (19 members), other currency unions in the global economy include the Eastern Caribbean Currency Union (6 members), the Central African Economic and Monetary Community (11 members),²⁸ and the West African Economic and Monetary Union (8 members) (Figure 4). Together, about a quarter of the IMF's total membership currently belongs to a currency union. An additional 7 EU members are expected to join the Eurozone after meeting specific entry criteria.

Figure 4. Currency Unions



Source: Created by the Congressional Research Service.

How secure is the IMF's preferred creditor status?

When the Greek government fell behind on payments to the IMF in the summer of 2015, it continued to meet its debt payments to private bondholders.²⁹ This broke with the long-held convention that IMF has "preferred creditor status:" distressed countries borrowing from the IMF are expected to give priority to payments to the IMF over payments to all other creditors.³⁰ The Greek government faced strong incentives to repay private creditors: the payments to private creditors falling due were small, and there was a market perception that a default on private debt would be "calamitous."³¹ The period in which Greece was in arrears to the IMF was relatively short (less than one month). The Greek government repaid the missed payments to the IMF after reaching a deal with European creditors that unlocked fresh disbursements of funds. However, the period in which Greece was in arrears created substantial uncertainty about the stability of IMF finances, since Greece was one of its largest borrowers.

²⁷ IMF, *Crisis Program Review*, November 9, 2015; Independent Evaluation Office of the IMF, *The IMF and the Crises in Greece, Ireland, and Portugal*, 2016.

²⁸ Anguilla and Montserrat are also members of the ECCU, but are not independent IMF members.

²⁹ Leo Lewis, "Greece Makes Samurai Bond Repayment," *Financial Times*, July 13, 2015.

³⁰ Susan Schadler, *The IMF's Preferred Creditor Status: Does it Still Make Sense After the Euro Crisis?*, Policy Brief No. 37, March 2014.

³¹ Leo Lewis, "Greece Makes Samurai Bond Repayment," *Financial Times*, July 13, 2015.

The IMF's preferred creditor status is viewed as critical to allowing the IMF to work effectively as a lender of last resort, safeguarding IMF resources, and enabling the IMF to charge relatively low interest rates.³² The "seniority" of IMF financing is not written in law, but is agreed in principle by IMF member countries and broadly understood by market participants. Until the Greek crisis, there was a strong historical record of distressed governments defaulting on other creditors (private creditors, bilateral creditors, and other multilateral organizations) prior to missing any payments to the IMF.³³ It is unclear whether Greece's temporary arrears to the IMF are a one-off deviation from a strong historical record, or whether Greece's policy choices set a new precedent for future crises. There are questions about how the IMF could respond if governments and private investors start questioning seniority of IMF financing, including whether the IMF could continue to function in effect as the lender of last resort in the global economy.

Conclusion

In the Greek crisis, the IMF is in many ways in uncharted territory: committing significant financing in back-to-back programs, entering an unusual co-financing arrangement, changing its lending policies, designing conditionality for a crisis in a major currency union, and facing temporary missed payments from one of its largest borrowers. However, the Greek crisis unfolded on the heels of the global financial crisis of 2008-2010, and there was broad agreement that the international economy was too fragile to sustain another systemic shock. Additionally, the IMF was not the only actor taking extraordinary measures to protect the global economy. Central banks were pursuing unconventional quantitative easing programs, many governments were pursuing substantial fiscal stimulus measures, and world leaders overhauled the international framework for economic cooperation, with the elevation of the G-20 as the prominent forum for international economic coordination. The IMF was widely viewed as a critical part of the response to the global financial crisis; in April 2009, G-20 leaders committed to tripling the IMF's resources to ensure it could respond effectively to the global financial crisis.³⁴ There is broad consensus that the IMF contributed to stemming contagion from Greece, consistent with its mandate of promoting international monetary stability.

However, seven years after the first IMF program for Greece was approved, the economic crisis there remains acute and there is no clear long-term plan for stabilizing the Greek economy. Although a number of factors beyond the control of the IMF may have contributed to the current situation in Greece, many observers have noted policy missteps by the Fund and argued that the Greek crisis has tarnished the IMF's reputation.³⁵

The IMF is an international organization that has evolved over time. After a number of major crises, outside analysts and the IMF itself have evaluated the crisis response, leading to changes in IMF policies going forward. The IMF's experience in Greece may be another pivotal crisis that leads to a broader discussion of IMF policies and its role in the global economy. This could include examination of the extent to which the size and scope of recent IMF programs have veered from its original mandate to provide financial support for temporary balance-of-payments crises. In addition, issues could include the IMF's interactions with other financing organizations, IMF safeguards that ensure the Fund's accountability, and the IMF's role as a lender of last resort in the global economy.

³² Susan Schadler, *The IMF's Preferred Creditor Status: Does it Still Make Sense After the Euro Crisis?*, Policy Brief No. 37, March 2014.

³³ Matthias Schlegl, Christoph Trebesch, and Mark Wright, "Sovereign Debt Repayments: Evidence on Seniority," *Vox*, August 11, 2015.

³⁴ G-20, London Summit, Leaders' Statement, April 2, 2009.

³⁵ For example, Shawn Donnan, "IMF under Pressure in Washington over Greek Bailout," *Financial Times*, March 17, 2017.

German Conservative Euro-MP Breaks Ranks Over IMF Role in Greek Bailout

By: Gernot Heller, Michael Nienaber, and edited by John Stonestreet

Reuters

February 16, 2017

IMF participation is no longer crucial for Greece's bailout programme, a German euro-lawmaker close to Chancellor Angela Merkel said on Thursday, breaking ranks with Berlin's official line that the programme would end if the Fund pulled out.

The International Monetary Fund has yet to decide if it will fund the bailout, Greece's third, and says Athens can only hit mandated fiscal targets if it is granted significant debt relief.

The German government - gearing up for what are forecast to be close-run national elections in September - opposes debt relief, and also says the current programme could only continue if the Fund joined in.

But Manfred Weber, who leads the conservative bloc in the European Parliament, said that the IMF's role was no longer crucial.

"If the IMF insists on a debt cut, then one should let it go," he told the Sueddeutsche Zeitung newspaper. "Europe can stand on its own feet now."

The impasse between Greece's international lenders over the country's fiscal targets has slowed progress on a bailout review and rekindled fears of a new financial crisis in Europe.

German Finance Minister Wolfgang Schaeuble said last week that Greece would have to leave the euro zone if it failed to meet its bailout commitments, while the IMF needed to stay on board.

"(IMF involvement) is indispensable for us. That's what the Bundestag agreed on," Hans Michelbach, a senior member of Merkel's conservative bloc in the lower house of parliament, told Reuters on Thursday.

The conservatives' parliamentary floor leader, Volker Kauder, told Focus magazine: "We insist on the commitments. And the International Monetary Fund must remain on board. Otherwise, we can't approve any further aid."

Both Michelbach and Weber are senior members of the CSU, the Bavarian sister party of Merkel's CDU.

The IMF argues that Greece will not achieve a targeted fiscal surplus before debt servicing costs of 3.5 percent of GDP unless it adopts more austerity measures and gets debt relief.

The issue is crucial because the higher the surplus and the longer it is maintained, the less the need for further debt relief.

Berlin, which agrees Greece needs more reforms to improve its competitiveness, believes the Fund can add credibility to the Greek bailout.

EU officials have called IMF projections "pessimistic".

On Wednesday, European Commissioner for Economic and Financial Affairs Pierre Moscovici said the bailout review talks had made progress, but more action was needed to wrap them up.

(Reporting by Gernot Heller and Michael Nienaber, editing by John Stonestreet)

<http://uk.reuters.com/article/uk-eurozone-greece-germany-imf-idUKKBN15V10S>

German SPD Says Europe Can Back Athens Without the IMF

By: Sarantis Michalopoulos

EUROACTIV.gr

January 19, 2017

In an interview with *Süddeutsche Zeitung*, Social Democratic Party of Germany (SPD) deputy chairman Carsten Schneider insisted that the International Monetary Fund's (IMF) participation in the Greek bailout was not necessary. [EURACTIV Greece reports](#).

"We need the IMF for its estimates and independence [...] but not as a lender," Schneider noted.

"As Europeans, we have the European Stability Mechanism (ESM), we are able to find funds in the capital markets," he added, stressing that the current bailout program can be funded without the IMF.

The Syriza-led government has always opposed the IMF's participation in the bailout, criticising its firm stance in the negotiations.

A few days before the controversial Greek referendum in July 2015, then Minister of State Nikos Pappas stated that Europe could continue "without the IMF".

"Europe has the institutional dynamic to find solutions for the crisis without the IMF," he noted.

On the other hand, Berlin has insisted since the very beginning of the Greek crisis that the IMF should remain part of the Greek programme.

The German centre-left politician also said that IMF's involvement was an explicit desire of the conservatives, an idea which was not shared by his party.

In a recent interview also with *Süddeutsche Zeitung*, German finance minister Wolfgang Schäuble floated the idea that if the IMF decides to pull out, Europe could figure out its "own solution" within the eurozone.

He added that such a solution should guarantee a strict implementation of the bailout's terms and be approved by the German parliament.

"If we continue solely then we will have to better guarantee the agreements [...] this role could be assigned to the ESM," he emphasised.

Commission sources cited the ESM Treaty when asked to comment on the matter.

"The European Commission – in liaison with the European Central Bank (ECB) and, wherever possible, together with the IMF – shall be entrusted with monitoring compliance with the conditionality attached to the financial assistance facility," a Commission official told [euractiv.gr](#).

What Athens says

Meanwhile, the Greek government seeks to conclude the second review of the country's bailout will at a Eurogroup on 26 January.

Speaking yesterday (18 January) at the parliament, Greek Prime Minister Alexis Tsipras said that the IMF could remain in the programme but just as a technical adviser.

Commenting on the future relations between Athens and the Fund, Greek Finance Minister Euclid Tsakalotos ironically said: "If we continue to exceed our objectives and the IMF continues to make wrong predictions [on the Greek economy performance], all we can do then is to provide them with technical assistance".

<https://www.euractiv.com/section/euro-finance/news/german-spd-says-europe-can-back-athens-without-the-imf/>

Germany denies devising Greek rescue plan without IMF

By: Gernot Heller

Reuters

January 18, 2017

Germany expects the International Monetary Fund to participate in Greece's bailout program, a finance ministry spokeswoman said on Wednesday, rejecting a newspaper report that Berlin was preparing for a deal without the global lender.

Divisions over labor reforms, fiscal targets and debt relief have prevented Greece and its foreign lenders from concluding a compliance review of its current bailout program, the third since 2010.

The IMF says it will only join in if this rescue is the country's last and it includes significant debt relief.

Bild reported on Wednesday that Finance Minister Wolfgang Schaeuble was preparing for a continuation of aid without the IMF - an option Greek officials said last week that the government in Athens would welcome.

The German mass-market daily gave no source for the information.

A spokeswoman for Schaeuble's ministry rejected the report. "We still expect an IMF participation," she said. "For us, this participation is promised and necessary."

Schaeuble last week already raised the possibility of a new program for Greece without the IMF should the Fund decide to bow out.

Bild said Schaeuble thinks the European Stability Mechanism (ESM), the euro zone's bailout fund, would be tapped to plug the hole left by an IMF departure.

"Plan B"

Schaeuble, who argues that debt relief would take pressure off Greece to reform its economy, has said he favors shifting some of the European Commission's task of enforcing euro zone budget rules to the ESM, which as a non-political body would be better positioned to impose compliance.

An ESM spokesman told Reuters: "We continue to work hard so that the IMF remains engaged in Greece and pursues the work there with the European institutions."

Bild also said Germany's Bundestag lower house of parliament would vote on a modified program before a general election in September.

Lawmaker Eckhardt Rehberg, parliamentary spokesman on finance and budget issues for Chancellor Angela Merkel's CDU, said the Bundestag would have to vote on a new program if the IMF pulled out, "but I don't see such a scenario at the moment."

ESM Managing Director Klaus Regling said in an interview with Bloomberg TV this week that a bailout without the IMF was a "plan B."

Greece's EU lenders want the country to achieve and maintain a primary surplus - after interest payments - of 3.5 percent of GDP beyond 2018, when its program ends. The IMF says that, unless Athens adopts more austerity measures and legislates them upfront, the surplus will only reach 1.5 percent.

Greek government officials said last week that Prime Minister Alexis Tsipras - who is sagging in polls - would welcome an IMF exit, hoping it might help conclude the review without legislating more austerity now.

To help break the impasse, Greece would be willing to discuss fiscal measures that would only be implemented if it missed budgetary targets after 2018. Tsipras said on Wednesday that Greece would conclude the second review of compliance with the program without legislating new measures beyond then.

(Additional reporting by Michelle Martin and Andreas Rinke in Berlin and Renee Maltezou in Athens, and Tom Koerkemeier in Brussels; writing by Joseph Nasr.; editing by John Stonestreet and Richard Lough)

<http://www.reuters.com/article/us-eurozone-greece-schaeuble-idUSKBN1520TX?il=0>

Commentary: The IMF must walk away from Greece**By: Meg Lundsager****Reuters****May 17, 2016**

The depth of distrust between Greece and its creditors grows increasingly clear as both sides resume negotiations for a new bailout program.

The International Monetary Fund is demanding more European debt relief for Greece -- at a minimum, a longer payback period on its European Union loans. But Germany insists that the fund lend to Greece even if Athens receives no immediate additional debt relief. More relief would not be needed for "the coming years," German Finance Minister Wolfgang Schaeuble said.

Yet, additional IMF loans would only paper over Greece's economic problems and postpone the reforms Athens needs to make to remain in the euro zone. Instead of more loans, the IMF should force Greece and its creditors to come up with long-term compromise solutions.

Given Greece's poor record in meeting previous loan conditions, the Europeans seek Greek parliamentary approval of additional budget measures, imposed if Athens fails to meet its targets. This course would leave Greece still uncertain if, or how, its creditors might ease its debt burden. Such economic brinksmanship would also offer Greece little hope of real solution -- which would include restoring private-sector confidence, attracting foreign investment and restarting growth.

The most likely outcome, however, is that all parties blink, some kind of agreement is reached before Greece defaults -- and the cycle starts again.

This papering over of widely divergent positions reflects the euro zone's collective failure to agree on an economic policy -- which the IMF cannot do for them. Given the 500-billion euros in Europe's substantial bailout fund, the European Stability Mechanism, the more than 150 non-European members of the International Monetary Fund should tell Europe: "There will be no more IMF lending to Greece."

Greece's crisis is a stark reflection of Europe's own internal problems. One way the euro zone could begin to solve them would be to create the conditions to generate economic growth across the continent. That means encouraging more investment spending, particularly in the economically weaker countries, and more consumption by cutting taxes in the stronger countries.

By refusing to hand out new loans, the IMF would pressure euro-zone countries to face up to the shared costs -- as well as the benefits -- of preserving their monetary union.

Because all euro-zone countries have reaped significant benefits from membership in the union. Germany, for example, has gained from partnering with weaker economies. The value of the euro reflects the overall region -- not just Germany. Berlin's exports have boomed because the

euro is more depreciated than the deutschmark would be had there been no monetary union. The result is Germany has one of the world's largest trade and current account surpluses.

The euro zone's weaker members, such as Greece and Portugal, have also benefited. Markets have demanded a far lower interest rate on their government debt than if they had not joined the euro zone -- though they did not share in the same export boom.

As for sharing costs, Europe's European Stability Mechanism can now cover the costs of bailing out member governments in crisis. Europe has more than enough resources to manage a Greek adjustment program.

Beyond that, Europe has lagged in agreeing on how to share costs beyond monetary union. It needs, for example, to institute common bank-resolution funds and pan-European deposit insurance. Both steps are critical to prevent one country's bank crisis from spreading to others.

In addition, because Europe is not a United States of Europe, there is no effective overall commitment to support economic growth across the continent. As a result, there is also no enforcement mechanism for changing national economies to make them more competitive while remaining in the euro zone.

The burden of adjustment typically falls only on nations in economic crisis. That should not be. Strong countries like Germany should increase spending to support the union's weaker economies, which would raise overall growth in the euro zone. But there is no mechanism to push Germany to pursue such a policy. Instead, the full burden of supporting euro zone growth falls on the European Central Bank, which is charged with meeting the euro zone inflation goal.

The International Monetary Fund has urged Europe to form a true fiscal union -- with centralized revenue collection and spending decisions -- to ease the strains felt across the region. One start could be a basic social safety net covering all Europe. A new central entity would collect revenues and distribute funds to member states in need. Additional steps toward fiscal union could follow.

This would help build public support for the tough economic changes that could, over time, generate stronger job creation across Europe.

The IMF could continue to provide advice and counsel. But by remaining in negotiations with Greece, its officials are in an awkward -- if not untenable -- position. With Berlin signaling opposition to extending further debt relief, and Athens facing major debt repayments, the IMF will feel pressured to go along with another round of lending.

All the parties are now struggling towards a compromise, somewhere between the IMF seeking immediate additional debt relief and Germany insisting debt relief be decided on later. Greece's Parliament, meanwhile, still needs to deliver more tax hikes, on top of pension cuts approved last week.

The most likely outcome to the latest negotiations will be an economic reform package that fails to deliver either sufficient financing and debt relief or substantial structural reform. It would

likely leave Greece's economy mired in recession. Deep European vulnerabilities would remain exposed, signaling the likely high costs of sustaining Europe's economic viability.

To avoid this, the International Monetary Fund might help far more if it let the euro zone countries face up to their responsibilities. They must finally work out their internal sharing of mutual financial support and common economic growth.

The views expressed in this article are not those of Reuters News.

<http://www.reuters.com/article/us-eurozone-imf-greece-commentary-idUSKCN0Y80G1>

The IMF Should Get Out of Greece

By Ashoka Mody

Bloomberg View

February 3, 2017

The International Monetary Fund's involvement in Greece has been an unmitigated disaster: Time and again, its failure to heed crucial lessons has visited suffering upon the Greek people. When the fund's directors meet on Monday, they should agree to forgive the country's debts and get out.

The IMF should never have gotten into Greece in the first place. As late as March 2010, with concerns about the Greek government's ability to pay its debts roiling markets, Europe's leaders wanted the IMF to stay away. Europeans feared that the fund's financial assistance to one of their own would signal broader weakness in the currency union. As Jean-Claude Juncker famously put it: "If California had a refinancing problem, the United States wouldn't go to the IMF."

Nonetheless, German Chancellor Angela Merkel decided that the IMF's presence was the signal needed to persuade German citizens that Greece needed urgent financial support and that strict discipline in the use of those funds would be enforced. Merkel's political priorities coincided with the interests of Managing Director Dominique Strauss Kahn, who was desperate to pull the IMF out of irrelevance. From that moment on, the IMF became Europe's -- mainly Germany's -- instrument in Greece.

Then came the cardinal error: At the IMF's Board, over the fierce opposition of several executive directors, the Europeans and Americans pushed through a bailout program that, contrary to the fund's rules, did not impose losses on Greece's private creditors. The decision was based on a spurious claim that "restructuring" private debt would trigger a global financial meltdown.

Thus, European governments and the IMF lent Greece a vast sum to repay its existing creditors. Greece's debt burden remained unchanged and onerous, and the most vulnerable Greeks were forced to accept crippling austerity to repay the country's new official creditors. The economy quickly and predictably went into a tailspin.

Even when the IMF recognized the error of its ways, it didn't change course. An internal "strictly confidential" report, later made public, acknowledged that the program was riddled with "notable failures," including the lack of private debt restructuring and excessive austerity.

But the IMF never took responsibility. Instead, it demanded even more austerity throughout 2014. In December, the public rebelled and brought the opposition Syriza party to power, which only made the IMF's demands more insistent. At this point, the evidence that the strategy was pushing Greece to economic and financial collapse was overwhelming. It was like requiring a trauma patient to run around the block before being admitted to intensive care. Yet as usual, the inevitable suffering was blamed on Greece's unwillingness to cooperate.

The absurdity reached an apex in mid-2015, when the IMF released a report stating plainly that under Europe's latest set of austerity proposals, Greece would need a miracle to repay its debts. At the time, the IMF's own research showed that the best course would be to forgive the debt and abandon any further fiscal austerity. This would allow the country some freedom to grow again and possibly even attract new investment. And once that process was underway, Greece could be free of its official creditors and rely once again on private investors under notice that they were fully responsible for the risks they took.

The IMF has since sought to move in the right direction, repeatedly calling on the Europeans to write down substantial amounts of debt. The Germans, however, have refused any meaningful forgiveness. Instead, they have followed a strategy of debt forgiveness in dribbles because they astonishingly believe that German citizens will not be able to do the sums and recognize that ever larger relief is being granted.

And so the austerity has continued, suppressing growth and causing Greece's debt burden -- measured as a percentage of gross domestic product -- to increase. The IMF's latest analysis, in preparation for Monday's meeting, says that Greece's public debt levels could see an "explosive surge."

This strategy is utterly mindless. Greeks have been subjected to gratuitous pain. Those who can leave are doing so, threatening the prospect of a graying and desolate country. With every passing day, the chances that Europe's official creditors will see their money are dwindling. Investors have again pushed up yields on Greek bonds, fearing correctly that we are at yet another impasse.

The agony won't end unless the IMF forces the issue. The IMF and its principal shareholders -- the Europeans and Americans -- made the original mistake and perpetuated the errors. A mere mea culpa is not enough: Real accountability requires the IMF's shareholders to honorably accept real losses. That means forgiving the country's debts to the fund and leaving the Greeks and Europeans to work out their own solution to this mess. If the IMF stays involved, it will succeed only in further shredding its credibility.

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<https://www.bloomberg.com/view/articles/2017-02-03/the-imf-should-get-out-of-greece>

Alexis Tsipras pushes for IMF to stay out of next Greek bailout

By: Kerin Hope and Martin Wolf

The Financial Times

December 20, 2015

Greek prime minister Alexis Tsipras is pushing for the International Monetary Fund to stay out of the country's €86bn third bailout, leaving the eurozone to take full responsibility for overseeing economic reforms.

Mr Tsipras said in an interview with the Financial Times he was "puzzled by the unconstructive attitude of the fund on fiscal and financial issues". He indicated that the IMF should leave his country's third bailout to the eurozone when it decides whether to stay involved early next year.

"We think that after six years of managing in extraordinary crisis, Europe now has the institutional capacity to deal successfully with intra-European issues."

Mr Tsipras's assertion is likely to anger the German government, which has always insisted the IMF stay on board. Berlin values the fund's technical expertise as much as it doubts the European Commission's resolve.

Mr Tsipras also risks alienating the IMF, which is a strong advocate of debt relief for Athens while Germany and other eurozone members are strongly against debt writedowns, although he praised the fund's support on this issue.

Mr Tsipras said his government wanted to implement bailout measures as swiftly as possible with the aim of recovering sovereignty and getting rid of the so-called "troika" of bailout monitors from the commission, IMF and European Central Bank.

"We believe the sooner we get away from the [bailout] programme the better for our country," he said. "If Greece completes the first [progress] review in January, we'll be covering more than 70 per cent of fiscal and financial measures in the agreement."

Mr Tsipras also sounded confident that Greece would lift all remaining capital controls by March and resume borrowing on international capital markets "before the end of 2016".

The Syriza-led government struck a third rescue deal with creditors in July in an abrupt policy reversal aimed at averting a banking collapse and an involuntary "Grexit" from the euro.

"We've been five years in a programme. It's hard for an EU country to have lost its sovereignty for such a long time. To regain it and to get out from the control of the troika, we have to implement the [bailout] agreement. It's hard but it's better than any other choice," Mr Tsipras said

A successful recapitalisation last month of Greece's four biggest banks with participation by private investors has boosted hopes of a return to economic growth in the second half of 2016.

The coalition earned praise from the creditors for winning parliamentary approval for a tough 2016 budget and two separate packages of fiscal and structural reforms. Mr Tsipras acknowledged that a third package due to be approved in January included “one step that is difficult because it contains pension reform”.

Greece is resisting IMF demands for pension cuts, arguing that next year’s target for reducing state pension funds’ deficits can be achieved by restricting early retirement and finding alternative spending cuts.

IMF officials are also sceptical of Greek revenue-raising forecasts for 2016. They are also concerned that this year’s budget projection of zero growth may prove too optimistic given a bigger than expected fall in output in the third quarter.

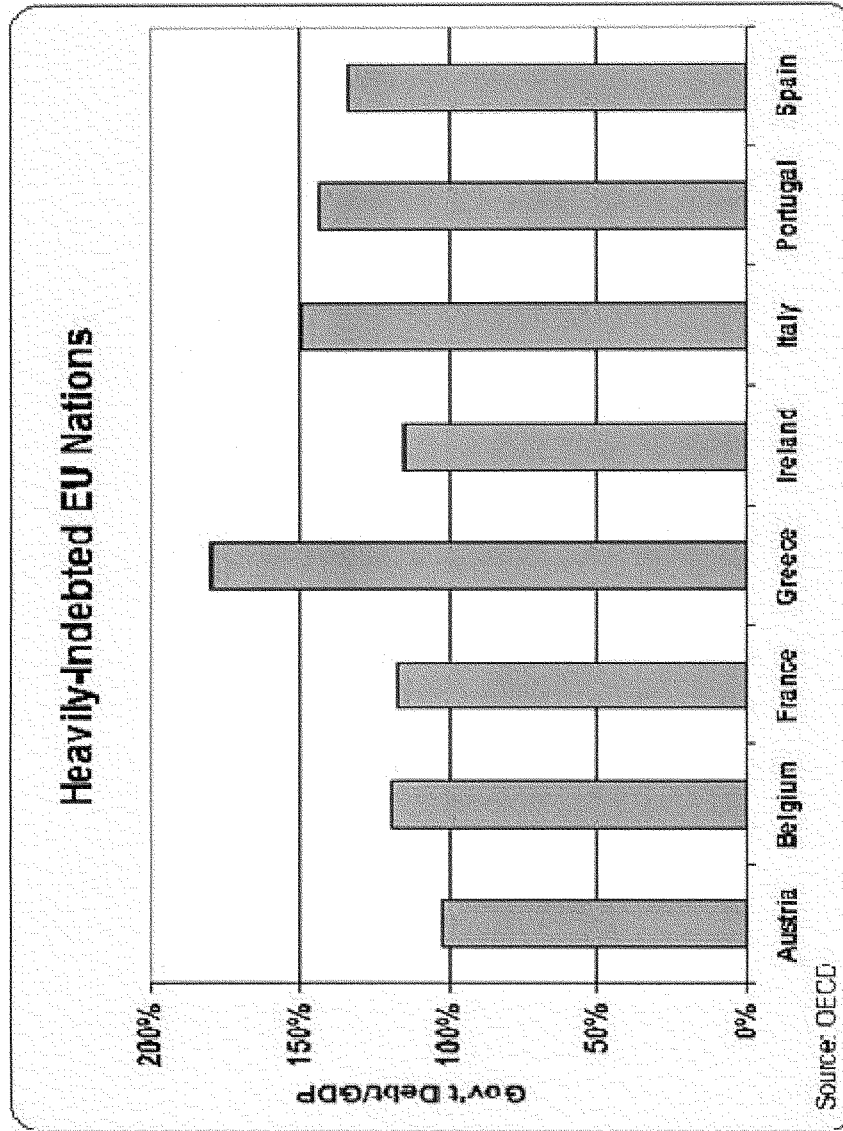
The IMF has suspended further lending to Greece because of concerns about the sustainability of the country’s huge public debt, which is projected to reach more than 190 per cent of national output in 2016.

With most eurozone members ruling out reductions in the nominal face value of the debt owed to them by Greece, the solution will have to be found in other ways, such as a guarantee of continued low interest rates, delayed repayments, or some combination of the two.

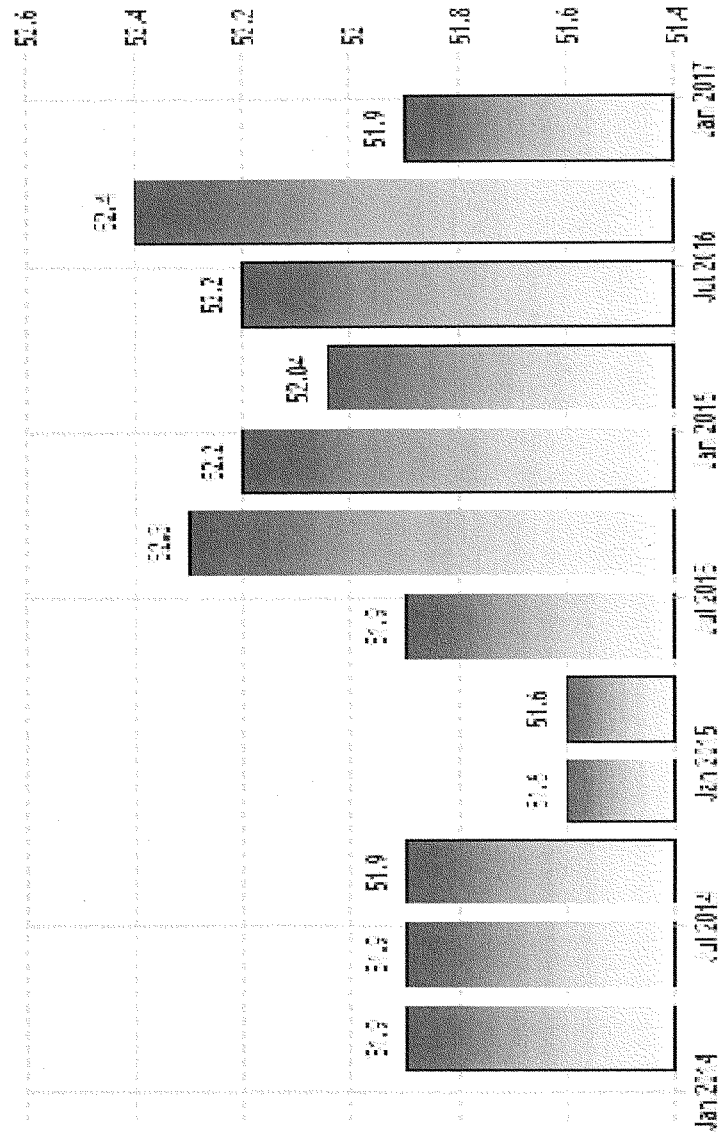
This prospective debt-service burden might, it is thought, discourage potential foreign and domestic investors, because they will be fearful of renewed fiscal difficulties once the debt service burden rises once again.

“Our road map is to complete the first review as soon as possible and then to have a positive decision on necessary debt relief,” the premier said.

<https://www.ft.com/content/05edcba6-a73e-11e5-955c-1e1d6de94879?mhq5j=e2>



GREECE LABOR FORCE PARTICIPATION RATE



SOURCE: EUROSTAT, LABOR FORCE PARTICIPATION RATE IN GREECE

SPIEGEL ONLINE

05/18/2010 03:54 PM

Former Central Bank Head Karl Otto Pöhl**Bailout Plan Is All About 'Rescuing Banks and Rich Greeks'**

The 750 billion euro package the European Union passed last week to prop up the common currency has been heavily criticized in Germany. Former Bundesbank head Karl Otto Pöhl told SPIEGEL that Greece may ultimately have to opt out, and that the foundation of the euro has been fundamentally weakened.

SPIEGEL: Mr Pöhl, are you still investing in the euro -- or has the European common currency become too unstable of late?

Pöhl: I still have money in euros, but the question is justified. There is still danger that the euro will become a weak currency.

SPIEGEL: The exchange rate with the dollar is still close to \$1.25. What's the problem?

Pöhl: The foundation of the euro has fundamentally changed as a result of the decision by euro-zone governments to transform themselves into a transfer union. That is a violation of every rule. In the treaties governing the functioning of the European Union, it explicitly states that no country is liable for the debts of any other. But what we are doing right now, is exactly that. Added to this is the fact that, against all its vows, and against an explicit ban within its own constitution, the European Central Bank (ECB) has become involved in financing states. Obviously, all of that will have an impact.

SPIEGEL: What do you think will happen?

Pöhl: The euro has already sunk in value against a whole list of other currencies. This trend could continue, because what we have basically done is guarantee a long line of weaker currencies that never should have been allowed to become part of the euro.

SPIEGEL: The German government has said that there was no alternative to the rescue package for Greece, nor to that for other debt-laden countries.

Pöhl: I don't believe that. Of course there were alternatives. For instance, never having allowed Greece to become part of the euro zone in the first place.

SPIEGEL: That may be true. But that was a mistake made years ago.

Pöhl: All the same, it was a mistake. That much is completely clear. I would also have expected the (European) Commission and the ECB to intervene far earlier. They must have realized that a small, indeed a tiny, country like Greece, one with no industrial base, would never be in a position to pay back €300 billion worth of debt.

SPIEGEL: According to the rescue plan, it's actually €350 billion ...

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Pöhl: ... which that country has even less chance of paying back. Without a "haircut," a partial debt waiver, it cannot and will not ever happen. So why not immediately? That would have been one alternative. The European Union should have declared half a year ago -- or even earlier -- that Greek debt needed restructuring.

SPIEGEL: But according to Chancellor Angela Merkel, that would have led to a domino effect, with repercussions for other European states facing debt crises of their own.

Pöhl: I do not believe that. I think it was about something altogether different.

SPIEGEL: Such as?

Pöhl: It was about protecting German banks, but especially the French banks, from debt write offs. On the day that the rescue package was agreed on, shares of French banks rose by up to 24 percent. Looking at that, you can see what this was really about -- namely, rescuing the banks and the rich Greeks.

SPIEGEL: In the current crisis situation, and with all the turbulence in the markets, has there really been any opportunity to share the costs of the rescue plan with creditors?

Pöhl: I believe so. They could have slashed the debts by one-third. The banks would then have had to write off a third of their securities.

SPIEGEL: There was fear that investors would not have touched Greek government bonds for years, nor would they have touched the bonds of any other southern European countries.

Pöhl: I believe the opposite would have happened. Investors would quickly have seen that Greece could get a handle on its debt problems. And for that reason, trust would quickly have been restored. But that moment has passed. Now we have this mess.

SPIEGEL: How is it possible that the foundation of the euro was abandoned, essentially overnight?

Pöhl: It did indeed happen with the stroke of a pen -- in the German parliament as well. Everyone was busy complaining about speculators and all of a sudden, anything seems possible.

SPIEGEL: You don't believe in the oft-mentioned attacks allegedly perpetrated by currency gamblers, fortune hunters and speculators?

Pöhl: No. A lot of those involved are completely honorable institutes -- such as banks, but also insurance companies and investment- and pension funds -- which are simply taking advantage of the situation. That's totally obvious. That's what the market is there for.

SPIEGEL: You really think that pension funds should be gambling with high-risk debt securities?

'Totally Normal Market Behavior'

Pöhl: No. They should be investing their investors' money as securely as possible. Should the credit rating of a debtor worsen because that debtor has been living beyond his means for years, then it is completely rational for these institutions to get rid of these bonds -- because they have become

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insecure. Then other investors buy them at a lower price. They receive a higher return, but also have greater risk. That is totally normal market behavior.

SPIEGEL: With the exception that speculators are now carrying no risk at all because euro-zone members have agreed to guarantee Greek debt.

Pöhl: Yes, and that is harmful. It means that the basic balancing mechanism in the market economy is out of sync.

SPIEGEL: Is it possible that politicians invented the specter of rampant speculation to legitimize a break with the Lisbon Treaty and with the ECB's rules?

Pöhl: Of course that's possible. In fact, it's even plausible.

SPIEGEL: What will be the political consequences of this crisis?

Pöhl: The whole mechanism of the European community will change. The EU is a federation of nations, not a federal republic. But now the European Commission will have a lot more power and more authority as well as the potential to interfere in national budget law. That, however, is constitutionally problematic in Germany.

SPIEGEL: But this could also be construed as a positive development. For a long time, critics have been saying that before we can have a genuine currency union we need common fiscal and economic policy. Surely this crisis has brought the EU closer to that goal.

Pöhl: Yes, that is the logical next step of our union, but we must bear the burden. You only have to look at what it is going to cost us Germans. I would have preferred that things hadn't gone quite this far.

SPIEGEL: In the past, the bankers at the Bundesbank, Germany's central bank, were vehemently opposed to any political interference -- for example, when the government wanted to take control of gold stocks. At the moment even larger taboos are being broken -- yet there has been little outcry. Why is that?

Pöhl: The president of the Bundesbank, Axel Weber, is in a bind. He has been issuing warnings about these kinds of developments for some time and he continues to do so. But of course it is difficult to keep this up in the face of a political majority.

SPIEGEL: Especially when he aspires to the presidency of the ECB and is therefore dependent on political goodwill.

Pöhl: That may also play a role.

SPIEGEL: In the run up to the currency union that was formed when Germany was reunified in 1990, it was said that, if something is economically ill-advised, it is also a political mistake. Does the rescue package for teetering euro-zone countries make sense?

Pöhl: It depends on what one wants to achieve. If the point was merely to calm the markets temporarily, then yes. But that can't be the only reason.

SPIEGEL: Because the side effects will be too large, you mean?

Pöhl: Absolutely. Just imagine if claims were made. Germany would have to pay countless billions, which is dreadful. And, it could lead to the euro becoming a weak currency.

SPIEGEL: If you were president of the Bundesbank today, would you be ordering the printing of German marks just in case they became necessary?

Pöhl: No, no, we have not gone that far quite yet. In my opinion, the euro is in no danger. Perhaps one of the smaller countries will have to leave the currency union.

SPIEGEL: How should that work?

Pöhl: It would involve Greece, if we stick with the case we were discussing, reintroducing the drachma.

SPIEGEL: But Greece doesn't seem to have any interest in doing that -- and it would be against European agreements to force Athens to leave the currency union.

Pöhl: That is correct. As long as a country receives such massive support, it would, of course, have no interest in turning its back on the euro.

SPIEGEL: You think that could change?

Pöhl: On the mid and long term, I wouldn't rule it out.

Interview conducted by Wolfgang Reuter

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