The IMF's Uneasy Excursion into the Euro Zone

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Key Points

- The present article examines the main issues and lessons highlighted by the IMF's involvement in the Eurozone crisis.
- The IMF's experience in the crisis reignites a debate about the appropri ate array of lending facilities and the design of conditionality.
- The very fact that there is a single currency rules out the scope to adjust the real exchange rate by altering the nominal exchange rate.
- Without the ability to alter the nominal exchange rate other ways of influ encing competitiveness are needed.

Introduction

The Eurozone crisis in 2009 and beyond has drawn the International Monetary Fund into unchartered territory. [1] It suddenly became confronted with a range of unfamiliar problems and faced a new set of challenges (Bird and Rowlands, 2010). What are they and how has it dealt with them?

From the mid-1970s (when it had lent to Italy and the United Kingdom) until the end of the 2000s, the Fund lent only to low income countries and emerging economies. While this clientele did not rule out occasions when relatively large economies such as Argentina, Brazil, Mexico, Korea, Russia, Thailand and Turkey resorted to borrowing from it, the Fund appeared no

[1] Acknowledgement: I am grateful to Tom Willett for his comments on an early version of this paper. He is exonerated from all responsibility for what appears here.

longer to lend to 'advanced' economies. The supposition was that such countries had permanently graduated away from it. Indeed, not borrowing from the IMF almost seemed to be a defining feature of being 'advanced'. Low income countries borrowed from the Fund frequently and for prolonged periods of time. Emerging economies were infrequent and temporary users. Advanced economies simply did not use IMF resources at all.

A related supposition was that countries belonging to the Eurozone would never need to seek financial assistance from the IMF. This not only reflected their 'advanced' status but also the fact that they had good access to international capital markets and to European financing should their access to private capital for any reason be temporarily impaired. The Euro crisis changed all this.

By the end of 2014 about 72 per cent of the IMF's outstanding credits and loans under its General Account were to just three Eurozone countries; Ireland, Greece and Portugal. The remaining 28 per cent was spread across thirty three other countries (one of which was Cyprus, another much smaller Eurozone country). Under its concessional Poverty Reduction and Growth Trust Fund fifty seven countries had outstanding credits and loans amounting to a total of 6.2 billion SDRs. Meanwhile the outstanding loan to Greece alone was SDR 21.6 billion.

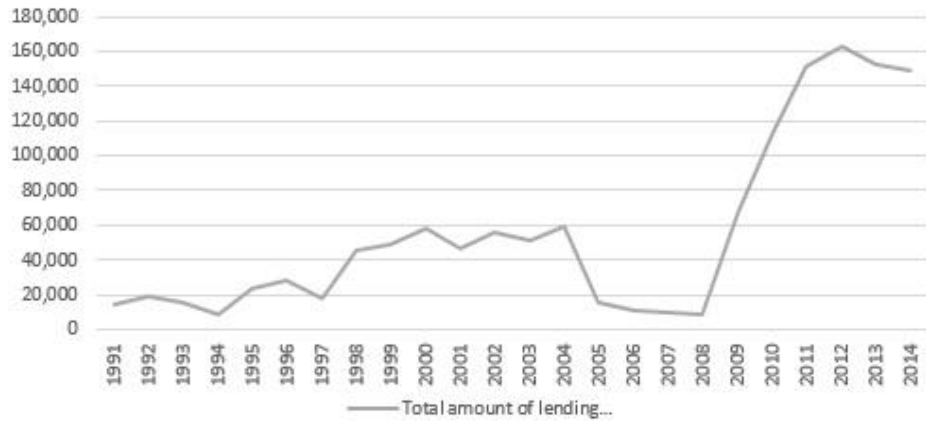
Not only did lending to the Eurozone countries dominate the Fund's portfolio of loans, it also meant that the nature of the IMF's relationship with the main Eurozone institutions, and in particular the European Central Bank and the European Commission, was affected fundamentally. The Fund now shared a creditor role with these institutions and entered into close collaboration with them. Together the three institutions comprised the so-called Troika.

It is interesting to ponder about the issues highlighted by the IMF's involvement in the Eurozone crisis. What lessons can be learnt from the experience? This article briefly examines the main ones.

The lay out of the article is as follows. Section 2 provides a brief factual account of IMF lending to Eurozone countries in the period since 2009. Section 3 is divided into a number of subsections and discusses the traditional functions of the Fund, relating them to its involvement in the

Eurozone. An important sub section investigates the difficulties that the IMF faced in designing appropriate adjustment programs in the Eurozone countries that sought its support. Section 4 examines the institutional and political problems that the IMF's involvement created. By way of conclusion, Section 5 discusses the policy implications of the Fund's experience in the Eurozone.

Figure: 1: Total amount of IMF lending (in millions of SDRs)



Sources: IMF Annual Report, 2000, 2004, 2011, 2014
Note: Figures reflect amount of arrangements in effect at end financial years ending April 30

IMF lending to the Eurozone

Figure 1 provides a picture of IMF lending from 1991 to 2014. Two features of the figure stand out. The first is the decline in IMF lending in the middle of the 2000s. Its low level, and in association with this, the relatively small number of IMF programs, led to questions about the role and relevance of the IMF in the 21st century. The mid-2000s were a relatively tranquil time for the world economy. The burst of IMF activity associated with the East

Asian crisis in 1997/98 and crises in emerging economies including Argentina and Turkey in the early 2000s had faded away. Moreover, many of the poorer countries that had conventionally relied heavily on the IMF were encountering a relatively benign global economic environment and were exhibiting improved macroeconomic management. Inasmuch as the IMF is an international trouble shooter, the absence of international economic troubles appeared to make the IMF less necessary. Of course, as things turned out a storm followed the calm, and the world economy encountered a severe crisis at the end of the 2000s.

The second feature of Figure 1 is the sharp increase in IMF lending in the years following the global economic crisis. Whereas in 2008 there had been a modest thirty four arrangements with the Fund involving total committed resources of only SDR 8.9 billion, by 2011 there were fifty seven arrangements involving resources of SDR 151 billion.

An early precursor of the IMF's changing clientele was the program in Iceland in 2009. Following the privatization of its banking sector in 2003, Iceland had experienced a rapid expansion of the sector which made it vulnerable to a sudden loss of confidence. With just such a loss following the eruption of the global economic crisis, a sharp capital reversal led to a large depreciation in the value of the krona that then caused adverse balance sheet effects. The IMF agreed to a Stand By Arrangement (SBA) designed to restore confidence, stabilize the value of the krona and restructure the banking system. Programs in other European countries were also negotiated: Hungary, Ukraine, Belarus and Latvia. However, in the period immediately following the global economic crisis it was widely assumed that members of the Eurozone would not need to turn to the IMF and that the European Union would provide the necessary financial support for troubled economies.

This assumption turned out to be wrong. In May 2010, and faced with severe fiscal and current account imbalances, debt difficulties and impaired access to international financial markets, Greece signed a Stand By Arrangement (SBA) with the IMF. This was followed later by an extended (Extended Fund Facility) arrangement. The SBA represented part of a package of financing that also involved the EU. The IMF provided about 25 per cent of the finance representing 3,200 per cent of Greece's quota with the Fund. The program involved three key components; consolidating the fiscal situation, strengthening external competitiveness, and safeguarding financial sector stability.

Soon after, in December 2010, Ireland negotiated an EFF loan with the Fund. The program involved resources of SDR 19.5 billion, equivalent to 2,322 per cent of Ireland's IMF quota. Like Greece, the loan was approved under the Fund's exceptional access policy (EAP) and the fast-track Emergency Financing Mechanism. The root cause of Ireland's economic difficulties had been its weakened banking system and the fiscal problems to which this gave rise. The focus of the IMF's involvement was to assist Ireland in restructuring the banking sector and by doing so to underpin the credibility of economic reform.

In May, 2011 Portugal negotiated an EFF arrangement with the IMF. Once again this was organized under the EAP and EFM. It involved IMF lending of SDR 23.7 billion amounting to 2,306 per cent of Portugal's IMF quota. The loan was part of a financial package; the EU provided about twice as much as the IMF. Much as in the case of Greece, the program emphasized fiscal consolidation, structural reform to enhance competitiveness, and reform of the financial sector. An underlying purpose was once again to create confidence and to improve Portugal's access to international financial markets.

In May, 2013, Cyprus borrowed from the IMF under an EFF arrangement. The Fund provided SDR 891 million representing 563 per cent of Cyprus's quota and about 10 per cent of an overall financing package involving the EU and the European Central Bank. Similar to the other Eurozone programs, the one with Cyprus focused on fiscal consolidation and the restructuring the banking sector. Both Cyprus's and Greece's EFFs are scheduled to expire in the first half of 2016. This is therefore an appropriate time to assess the IMF's involvement in the Eurozone countries.

Assessing the IMF's role in the Eurozone

There are various ways in which the functions of the IMF may be conceptualized. It may, for example, be seen as having three potential purposes; crisis averter, crisis lender, and crisis manager. Or it may be seen as performing both a financing and an adjustment role. In this section we use these conceptualizations in order to provide an analytical framework for our discussion of the issues raised by the Fund's involvement in the Eurozone. After this, and in the next main section, we go on to examine some of the institutional issues that have been raised by the IMF's involvement in the Eurozone crisis.

1. Crisis averter

The IMF has regular discussions with member countries about economic performance and policy under Article IV of its Articles of Agreement. The intention is that, as an objective and independent outsider, the Fund may be able to pick up and emphasize potential problems, and discuss ways of overcoming them.

Clearly whatever part it played, the IMF was unsuccessful in averting the crises in Greece, Ireland, Portugal and Cyprus. However, by its very nature this would be true of any situation where a country ends up negotiating a program with the Fund. It is more difficult to determine the circumstances in which a crisis would have occurred had it not been for the IMF's Article IV advice. There is an attention bias in favour of situations where the Fund's crisis-averting function has failed. Might there have been other European countries that were able to avoid or minimize the severity of crises as a direct consequence of the Fund's advice?

A detailed examination of the IMF's surveillance in the euro area in the build up to the crisis by Pisani-Ferry, Sapir and Wolff (2011) tells a mixed story. It claims that while the IMF did identify some of the underlying fiscal and financial problems that were developing in individual countries in advance of the crisis, it did not adequately sustain the pressure on national policy makers to rectify them.

Another observation is that too little attention was paid to shortcomings in terms of labour market flexibility. In the context of a currency union which eliminates the scope to alter the exchange rate, optimum currency area theory shows the importance of having alternative ways of achieving economic adjustment. Their absence will be particularly worrying where there is evidence that the real exchange rate is becoming overvalued, and this was the case in some of the Eurozone countries that subsequently encountered a crisis. A retrospective examination of Article IV consultations suggests that these issues were inadequately acknowledged and addressed. The same goes for the Fund's Financial Sector Assessment Program (FSAP) that failed to adequately emphasize the vulnerability of the financial sector in many European economies, and until 2012 (after the crisis occurred) failed to adopt a pan-European perspective.

More generally, Pisani-Ferry et al. claim that the IMF did not exploit its institutional experience in crisis prone countries and therefore played a less effective role as an independent and critical observer of the Eurozone. They argue that the Fund "fell victim to a 'Europe is different' mindset" (Pisani-Ferry et al. 2011 p.2.). Furthermore, if the IMF was aware of the shortcomings of the Eurozone's institutions, it had little effect on making them good.

2. Crisis lender; how much and under what facilities?

Given the problems in bringing about rapid economic adjustment in the crisis countries, (which are examined in the next sub section), as well as the increasing unwillingness of private markets to lend, it was always going to be the case that the Eurozone crisis countries would need a significant amount of financial support from other sources, including the IMF. Was the Fund able to fulfil this lending function?

Since its establishment in 1946, both the IMF's own resources, (coming from members' subscriptions), and the amount that individual countries can borrow from the Fund, have been based on countries' quotas. These have been presented as the 'building block' of the Fund's operations. However, subscriptions based on quotas have not guaranteed that the Fund's lending capacity has been adequate when large economies have turned to it for financial assistance. In these circumstances, the Fund has had to borrow from selected member countries whose economies are in a relatively strong position; initially from a narrow group of advanced economies under the General Arrangements to Borrow (GAB) negotiated in 1962 and then, following the East Asian crisis, from a wider group of emerging economies under the New Arrangements to Borrow (NAB) negotiated in 1998. In the aftermath of the global economic crisis at the end of the 2000s the NAB was amended and the IMF's lending capacity was tripled.

Similarly notional quota limits on drawings from the Fund have sometimes had to be relaxed in order for it to be able to provide adequate help to countries in economic crisis. As noted in the previous main section, in the cases of the programs in Greece, Ireland and Portugal, 'exceptional' access was deemed necessary. In the Eurozone crisis, therefore, 'exceptional' amounts of IMF lending were unexceptional.

The IMF's experience in the Eurozone crisis highlights the general shortcomings of the quota-based system (examined in detail in Bird and Rowlands, 2006). Having to borrow from member countries in order to augment its resources may involve delays and reduce the Fund's ability to act swiftly and adequately. It may open up the Fund to political manipulation by creditor countries, and it creates an additional element of uncertainty when uncertainty is already an important part of the problem. At the same time, if the Fund is limited in its ability to provide enough direct financial support to countries in crisis, this will mean that the adequacy of overall financing will depend on the extent to which other agencies provide finance, as well as on the effect that IMF programs have on the willingness of private capital markets to lend and on what terms. Without adequate financial support the effectiveness of IMF programs will be diminished.

In the case of the Eurozone crisis, the IMF provided a relatively small amount of the overall financing associated with the programs it supported by comparison with the European agencies. From the media reports at the time, it was open to the accusation from them that it was not prepared to 'put its money where its mouth was'. The Eurozone experience raises the generic question of how to determine which creditor agencies should provide financial support to countries in balance of payments crisis. This is particularly relevant in circumstances where there is a monetary union and regional institutions that can supply financial support. It then leads on to the question of institutional comparative advantage. Might the Fund's comparative advantage lie in designing appropriate economic policy in crisis conditions?

Moreover, in the case of the Eurozone crisis, the Fund's ability to create market confidence was far from universal. Event study analysis suggests that the signing of a program with the IMF had a substantial positive effect on market mood in the case of Greece's original agreement as reflected by a pronounced increase in the price of Greek debt, but a negative one in the cases of Ireland and Portugal.

As already noted, some of the IMF's lending to the Eurozone countries occurred under SBAs and some of it (indeed most of it) under EFFs. However, when one examines the published 'letters of intent' relating to the programs in the affected Eurozone countries it is not easy to pick out significant differences in the nature of the economic reforms that were being supported by the Fund. All of the programs involved similar elements. For illustrative purposes, Greece's SBA involved 6 performance criteria (frequently relating to fiscal correction) and 13 structural benchmarks (frequently relating to fiscal and banking sector reform) whereas Cyprus's EFF involved 7 performance criteria and only 9 structural benchmarks covering similar issues. EFFs incorporate a longer time frame than SBAs but this could have been accommodated by having a series of SBAs or simply by allowing SBAs to be phased over a longer period.

Early in the 2000s the use of extended arrangements had declined to very low levels. Whereas there had been eleven of them in 2000, this number had fallen to just one in 2006 and 2007. Some empirical studies discovered that after an initial period following the introduction of extended arrangements, there were no statistically significant differences in the economic circumstances that led to EFF programs as compared to SBAs (Bird and Rowlands, 2007). There were some suggestions that EFF lending might soon be abandoned altogether.

The Eurozone crisis reactivated extended IMF lending and resulted in EFFs accounting for the largest proportion of the use of IMF resources.

There is, however, a potential inconsistency in using EFFs. In principle, they differ from SBAs because they are intended to put more emphasis on medium term structural adjustment. However, other reforms to IMF conditionality that were made in the wake of the global economic crisis, alongside the introduction of new lending facilities, shifted the Fund away from using structural conditions as performance criteria. Structural conditionality now took the form of 'benchmarks'. Failure to comply with this element of conditionality does not have such serious ramifications for the borrowing country since it is only failure to comply with performance criteria that automatically puts subsequent instalments of an IMF loan under immediate threat. The IMF's involvement in the Eurozone crisis therefore reignites a debate about the appropriate array of IMF lending facilities and the detailed design of conditionality.

3. Crisis manager; the IMF's adjustment role

An important component of managing and resolving an economic crisis is to devise the optimum blend of financing and economic adjustment. In the previous sub section we have examined the Fund's financing role in the Eurozone crisis. In this sub section we turn our attention to its adjustment role.

The IMF becomes involved in a member country under the auspices of a program when the country has a 'balance of payments need'. This occurs when the contemporary balance of payments situation is unsustainable. In most cases there will have been economic mismanagement of some kind in terms of fiscal and monetary excesses. However, the vulnerabilities to which these give rise will probably have been exposed by an economic shock emanating from either the current account (for example an export shortfall) or the capital account (a sudden loss of market confidence and a capital reversal).

In more general terms, an unsustainable balance of payments reflects a situation in which domestic aggregate demand exceeds aggregate supply. Correction therefore requires a combination of policies designed to reduce aggregate demand and to increase aggregate supply. The former policies may be expected to focus on fiscal and monetary policy. The latter will focus on structural adjustment aimed at increasing economic efficiency; although exchange rate policy is also likely to play a key role in improving international competitiveness.

Conventionally IMF programs cover all the components of economic adjustment in some way. They usually involve measures to strengthen the fiscal stance by compressing government expenditure and increasing tax revenue; to correct monetary sector disequilibrium by reducing the rate of monetary expansion and raising interest rates; to bring the exchange rate closer to its fundamental equilibrium rate, often by engineering a depreciation in the nominal rate; and to improve the supply side of the economy by a series of sectoral and microeconomic reforms. The intention is that, by putting in place a program of economic reform that will correct the underlying macroeconomic imbalance and by providing sufficient finance to support the program, there will be a beneficial impact on market confidence.

The problem for the IMF in the context of the Eurozone crisis countries that faced unsustainable balance of payments deficits was that this conventional strategy could not be adopted. The Fund was forced to try and design programs that would achieve the conventional set of targets but in a set of circumstances that did not allow it to use the conventional set of economic policy instruments.

The well-established theory of economic policy tells us how difficult it is to achieve multiple targets when there are fewer instruments to use and when the instruments that are available are inappropriately 'assigned'. In the Eurozone, it is the European Central Bank that sets euro wide monetary policy. Moreover, the very fact that there is a single currency rules out the scope to adjust the real exchange rate by altering the nominal exchange rate; this constrains a country's ability to influence its competeviveness. In any Eurozone crisis country, an IMF program is therefore forced to focus on fiscal policy to reduce excess aggregate demand, and on counter-inflationary policies to depreciate the real exchange rate. Strengthening competitiveness will also have to rely heavily on reducing unit labour costs and on labour market reform.

Herein lays the nub of the difficulty that the IMF faced in the Eurozone economies that turned to it for assistance. The policies upon which it was forced to focus were unavoidably problematic. In a stagnant or shrinking economy it is particularly difficult to increase tax revenue. The automatic stabilizer will be causing tax revenue to fall, and increasing tax rates will be politically unpopular and can lead to greater tax avoidance and evasion and to a fall in revenue. Similar problems exist on the government expenditure side. An economic recession will be associated with an automatic increase in some elements of expenditure such as unemployment benefit and welfare payments. Moreover, cutting other components of government expenditure such as the wages of public sector employees will encounter strong political opposition and will tend to reinforce the recession. In a recessionary economy it also becomes harder to handle sovereign debt since the debt-to-GDP ratio will tend to rise.

On top of this, the focus on fiscal policy was also untimely in the sense that there was a lively contemporary debate about its macroeconomic effects. On the one side there were the traditional quasi Keynesian arguments that presented fiscal deficits as having an expansionary macroeconomic impact depending on the value of fiscal multipliers. These arguments suggested that fiscal 'consolidation' would have an adverse effect on economic activity that might offset any beneficial effect on the fiscal balance. On the other side, there was the view that fiscal policy that was notionally contractionary would actually turn out to be expansionary since it would increase market confidence, thereby facilitating the management of debt. It would also, so the argument ran, increase private sector investment and therefore generate economic growth.

The Fund had to reach a real time view on the legitimacy of these opposing arguments in circumstances where there was little evidence upon which to draw. Experience in East Asia in 1997/98 (prior to the popularity of the expansionary contraction hypothesis) had demonstrated how there was a danger of fiscal overkill in the aftermath of a crisis. This occurred largely as a consequence of underestimating the negative effects of a crisis on private sector investment. In circumstances where investment falls relative to saving to a greater degree than expected, the fiscal correction needed to achieve a targeted strengthening in the current account of the balance of payments diminishes. The Fund's programs in the Eurozone crisis countries raised similar issues. After its initial support for fiscal stimulus in the immediate aftermath of the global economic crisis, the IMF switched towards placing a stronger emphasis on fiscal consolidation. As time progressed, however, it acknowledged that fiscal austerity could be taken too far and could be implemented too rapidly. The coexistence of a relatively insignificant effect on confidence alongside a larger negative effect on economic growth became seen as threatening sustained recovery. The dilemma associated with identifying the optimum speed of fiscal adjustment has underpinned the Fund's programs in Eurozone countries.

As far as exchange rates were concerned, adjustment in the real exchange rates of the Eurozone crisis countries depended on reducing their rates of inflation below the rates in competing economies. The problem here was that inflation was already low right across the Eurozone area and there was therefore little scope for correcting the overvaluation of real exchange rates in this way. In 2009 the inflation rate in the Euro area as a whole was only 0.3 per cent. It was 1.2 per cent, -0.9 per cent and -1.7 per cent in Greece, Portugal and Ireland respectively. The inflation rate in the euro area remained low during 2010-13 and at its highest was only 2.7 per cent in 2011.

Other methods of improving international competitiveness were also problematic. In principle, reducing unit labour costs can be achieved in any combination of three ways; increasing productivity through technological advance, reducing own product real wages, or reducing the demand for labour. In practice, and for economies that were in recession, it was difficult to follow any of these paths; not least, in the case of two of them, because of the political resistance that they were likely to encounter.

By examining the 'letters of intent' signed by Ireland, Greece, Portugal and Cyprus it can be seen that, although the programs advocated structural reform, the main emphasis was placed on near term fiscal consolidation. This approach was rather different from the more diverse one adopted in other crisis countries in which the IMF had been involved, such as Brazil, Argentina and Turkey. It raised the possibility (even the strong possibility) that political opposition would impair the implementation of the programs.

As noted above, fiscal consolidation is likely to have a negative effect on short term economic growth. It is politically unpopular. The political sensitivity then reduces the perceived probability that the agreed program will be fully carried through to completion. The low probability of full implementation in turn reduces the credibility of the program with markets. This means that agreeing to a program will not necessarily enhance the country's access to international capital, and in these circumstances there will be yet further pressure on rapid adjustment. A vicious vortex can materialize.

In Greece's case the vortex was initially avoided. There was a strong perception that it had been fiscal excesses that had largely caused the crisis. The announcement of the IMF program with fiscal correction at its core seemed to calm the markets in spite of the problems that might have been anticipated in actually implementing it. In other Eurozone crisis countries where it may have been private sector imbalances rather than public sector ones that were at the heart of the crisis, the Fund's focus on fiscal correction seemed to be less convincing to the markets. Even in Greece the political difficulties associated with implementing the program turned out to undermine its credibility in the longer term with the election of the Syriza government that was pledged to end austerity.

The design of IMF programs in Eurozone countries was in some respects not helped by the 'major overhaul' of IMF conditionality that was reported earlier in this article. As noted then, part of the reform was to stop using structural conditions as performance criteria but instead to use them only as 'benchmarks'. Although structural reform remained an ingredient of IMF programs the decision to desist from using them as performance criteria appeared to reduce their relative importance. To a degree this change was motivated by a desire to improve the implementation of programs by encouraging greater national ownership of them. Evidence had shown that the track record on implementing structural performance criteria was less good than that on macro conditionality. However, there was a dilemma when this change in approach was applied to the Eurozone countries. For countries belonging to a currency union, flexibility in labour markets as a means of encouraging adjustment becomes particularly important since the exchange rate instrument no longer exists. And yet it was just in such Eurozone crisis countries that less pressure was now being exerted on increasing labour market flexibility by the decision to reclassify structural conditionality.

Three other more general but related issues arose from the IMF's involvement in the crisis countries of the Eurozone. First, up until its programs in the Eurozone, the IMF had undertaken surveillance at two levels; bi-lateral and multilateral. There was now a third level; the regional one. The regional and bi lateral dimensions of surveillance overlapped. Second, there was the potential for a fallacy of composition. European economies are strongly interconnected. Thus, if the IMF was undertaking Article IV consultations with (say) Spain and advocating sharper fiscal consolidation, it also needed to take full account of the fact that such a policy would have implications for (say) Portugal. Similarly, a crisis in Greece could affect supposedly much stronger European economies whose banks held a large amount of Greek debt.

Finally, there was an element of a zero sum regional game in the Eurozone. If the IMF was going to be exerting pressure on deficit countries to reduce their deficits to sustainable levels, it also needed to be exerting pressure on surplus countries in the Eurozone to accommodate such correction. The difficulty for the Fund was that while it was reasonably well equipped to exert influence on the deficit countries that needed its support, it was much less able to influence policy in the surplus countries, particularly when the cooperation of these countries was vital in putting together financing packages for the crisis ones.

Of course the inability of the IMF to exert effective pressure on surplus countries is not unique to Europe. But it took on a sharper and more highly charged political relevance in the context of the Eurozone crisis. The concern was that the Fund would be seen as siding with the creditor countries and as losing some of its objectivity and independence. It might then be no longer perceived as an 'honest broker' in its pursuit of a resolution to the crisis, but as acting as an agent of austerity for the richer and more successful Eurozone countries. Just as some observers have claimed that the Fund's lending operations in general reflect a strong US influence, in the case of the Eurozone crisis there was the additional possibility that it would be accused of being unduly influenced by the economically powerful European countries. This leads us on to examine some of the institutional issues to which the Fund's involvement in the Eurozone crisis has given rise.

Institutional issues

Conventionally when negotiating a program, the Fund is dealing only with a country's government. There is a clear creditor/debtor relationship. In the case of the Eurozone crisis it has been dealing not only with the governments of the countries that were seeking assistance but also with other European institutions. This has made life much more complicated.

One innovation that sought to overcome the complexity was the setting up of the Troika comprising the IMF, the European Central Bank and the European Commission. Being part of a team of creditors had some advantages. For example, joint announcements by the Troika appear to have had more impact on markets than announcements by any of the institutions acting individually. It may also have been the case that the Fund was in a better position as a member of the Troika to influence the total amount of finance made available in support of its programs and achieve a superior mixture of financing and adjustment.

However, the Troika also had a downside. The ECB and EC were representing the Eurozone and, in a sense, IMF programs were with the Eurozone and not just with individual countries within it. This meant that the ECB and the EC were representing two points of view. They were co-creditors with the IMF but they also had a clearer identity with the Eurozone and the European project than did the IMF. Media reports suggest that the three institutions not uncommonly disagreed on the best way of handling the crisis. For example, it would seem that at the outset the IMF was in favour of a more generous type of bailout than was the ECB, and that the ECB was very concerned about having its independence compromised. At the same time, however, there were disagreements about the required severity of conditionality. Both the ECB and the IMF tended to disagree with the EC ; the latter preferring a 'softer' approach in terms of the degree of fiscal correction that it felt would be more politically acceptable in the debtor countries. In addition, the Fund may have had reason to believe that it was being used as a scapegoat by the other members of the Troika and by EU creditors as a whole.

The institutional divisions became most pronounced in the circumstances surrounding Greece's third bailout in July 2015. The IMF's view (which it opted to make public) was that the program of policies negotiated with Greece by the Eurozone institutions would prove unsuccessful without some form of debt relief or restructuring. Even putting to one side the political tensions to which the proposed economic reforms involving value added tax and pension reform would inevitably give rise, the Fund believed that the economic forecasts upon which the bailout was based were overly optimistic. The IMF has considerable experience in assessing the sustainability of external debt that it has garnered from its involvement in the Latin American debt crisis in the 1980s and in establishing and operating the Heavily Indebted Poor Country initiative designed to alleviate debt problems in low income countries. In both cases substantial debt relief of some type was involved. With little doubt the IMF considered that its advice was being ignored by the Eurozone institutions in an area in which it had the comparative advantage. A danger from the Fund's point of view was that its apparent inability to influence the third Greek bailout deal suggested that it would be seen as largely impotent. Not only this however. The Fund had supported previous bailouts in Greece and had made resources available under its EAP. The EAP requires the Fund to reassure itself that "a rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term." This test appears to have been laid to one side in earlier Greek bailouts on the grounds that a Greek melt down would have had severely adverse implications for the international financial system. As things turned out Greece defaulted on its IMF debt. The course of events can have done little other than damage the IMF's credibility and reputation, and as a consequence this may have a negative impact on its ability to exert influence in other member countries outside the Eurozone.

More generally, the IMF may have seen itself as being caught in the middle of a largely political bargaining game between the crisis countries and the European institutions.

The Fund cannot volunteer loans. It can only respond to requests from governments. It is feasible therefore that the countries in crisis believed that they were likely to get a better financing package by seeking to involve the IMF. They may have felt that the IMF would be more effective at persuading creditors to extend credits than they would have been on their own and that the endorsement of the Fund would increase their access to financial support from other sources. In this sense there was one interpretation of events that saw the Fund as being used by the debtor countries rather than the creditor ones. Either way, being caught in the middle of a bargaining game is almost certainly an uncomfortable location. The IMF likes to present itself as an independent and technocratic institution, but instead found itself embroiled in a highly charged political environment with which it was ill equipped to cope.

An enduring challenge facing the IMF relates to its own governance and institutional politics. The challenge has become more pressing as a result of the Fund's excursion into the Eurozone. According to many criteria European countries exercise disproportionate influence within the institution. This is reflected not only by their share of voting rights but also by the convention that the Managing Director is a European. In the case of previous regional crises, such as the one in Asia in 1997/98, this had sometimes been presented as an advantage since it implied that the Fund could adopt a more independent and objective approach. The argument could not be sustained when it was Eurozone countries that were borrowing from the Fund. Now, somewhat perversely, some Europeans at the Fund presented their close knowledge of the Eurozone as an advantage. Whatever the merits of this argument, the convention that favoured a European Managing Director could certainly no longer be supported by claiming that Eurozone countries were never involved in IMF programs and that the Managing Director could therefore remain completely objective. Representatives of other client countries of the IMF coming from emerging economies and low income countries might have reasonably questioned the extent to which the exceptional access to IMF resources enjoyed by the Eurozone countries was at least something to do with the undue power exercised by the EU within the organization.

The crisis also raised other somewhat more arcane questions concerning the role of the euro wide equivalent of Article IV discussions and their relationship with the regular Article IV discussions conducted with individual Eurozone countries. The euro wide assessment seemed to have done little to integrate the analyses that were being conducted at the level of individual countries, or to identify common themes and the relevant economic interdependencies. Thus the issue arises as to what function the euro wide analysis should perform and what relationship it should have with the regular Article IV analyses.

Concluding remarks

In the light of the IMF's involvement in the Eurozone crisis and the programs that it has supported in Greece, Ireland, Portugal and Cyprus a number of issues have been raised and a number of lessons need to be learned.

Perhaps most noticeably the Fund's conventional approach to economic adjustment in client countries is not feasible in countries that belong to monetary unions. Rather than being able to call on monetary policy and exchange rate policy to try and create a sustainable balance of payments, pressure falls much more exclusively on fiscal policy. Two key difficulties arise from this. First, there are important areas of academic disagreement about how fiscal policy works and therefore about how it should be designed. Second, since in a crisis the thrust of fiscal policy will be to dampen aggregate demand, IMF-supported programs will encounter strong domestic political resistance. It will be more difficult for governments to implement programs that rely heavily on fiscal correction. The accusation will be made that the Fund is advocating programs of fiscal 'austerity'. If the emphasis is to be placed on fiscal policy as the central instrument of economic adjustment it becomes imperative to resolve the debates about its effects. The Fund needs to ensure that required fiscal consolidation does not translate into fiscal overkill leading to prolonged recession that in turn weakens the fiscal balance. Otherwise the institution's reputation will be damaged as it was as a result of its involvement in the East Asian crisis. But at the same time the need for fiscal correction will be dictated by debt sustainability.

An emphasis on fiscal policy means that IMF programs in crisis countries will follow an expenditure reducing path. International competitiveness will only be affected if such a path reduces the rate of inflation below that of competing countries and depreciates the real exchange rate. Where inflation is already low this strategy for depreciating the real exchange rate will be ineffective, and in any case will take a long time to bear fruit. Generally speaking nominal devaluation is a much more effective way of adjusting the real exchange rate. Without the ability to alter the nominal exchange rate and with the problems associated with using reduced inflation to affect the real exchange rate, other ways of influencing competitiveness are needed. These will have to focus on the supply side of the economy and seek to reduce unit costs of production. The problem is that such an approach will not tend to be effective in the short run and once again it is likely to encounter strong political resistance if it focuses on reducing labour costs. The implementation of programs will then be adversely affected. With the prospect of poor implementation the credibility of IMF programs will be damaged and their potentially beneficial impact on market confidence will be undermined.

Because of the relatively poor record of implementation with respect to structural conditionality in the past, and in an attempt to increase the national ownership of programs, the IMF decided at the end of the 2000s to set structural conditions only as benchmarks rather than performance criteria. This perceived softening in the importance of structural adjustment may however have been particularly inappropriate in the context of the crisis countries in the Eurozone where improving competitiveness was a vital component for improving the sustainability of their balance of payments and the exchange rate weapon was unavailable.

In circumstances where structural adjustment takes time to achieve, it is important that countries have adequate access to finance in order to cushion the process. As the Eurozone crisis illustrated the IMF's continuing reference to quotas as a basis for calculating a country's access to IMF resources is inappropriate. In all the large Eurozone crisis countries conventional quota limits had to be ignored. 'Exceptional' access was in fact the norm even in circumstances where debt sustainability was a crucial cause of concern. The Eurozone crisis has re-emphasized the need to move more fully away from the quota system as a way of determining the Fund's lending capacity and the access that member countries have to IMF resources.

As a result of the above, one may be forced to conclude that the IMF is simply not well suited to deal with crises in Eurozone countries. This point of view may be reinforced by the difficulties that the IMF has encountered in dealing with the European institutions and by the governance issues associated with the disproportionate influence exerted by European countries within the IMF.

If the IMF finds it difficult to play the roles of crisis lender and crisis manager in a Eurozone context, what part should it be aiming to play as a crisis averter and what lessons can be learnt from the failure to play this role adequately in the build up to the Eurozone crisis? More needs to be done in assessing the vulnerability of Eurozone countries to crisis, particularly in the context of assessing the stability of their financial sectors and the sustainability of their debt. The Fund needs to explore ways of becoming a stauncher advocate of reform in advance of crises. This is of course much easier said than done. But it does imply that Article IV discussions need to become more meaningful and that the euro-wide equivalent of Article IV discussions needs to emphasize common problems and the interdependencies within the European economy more completely than they have in the past. The Fund has to use these discussions more effectively as a way of consistently pushing the need for reforms that will reduce the incidence of crises. Such reforms will also involve strengthening the European institutional framework. After all the best way of handling an economic crisis is not to have one in the first place. If this lesson is learnt then the IMF's excursion into the Eurozone may turn out to have been not only uneasy but also temporary. If not, then the Fund could remain trapped in a regional situation that further undermines its global role. There is even a potential scenario where the reluctance of the IMF to participate in further bailouts increases the chances of Greece having to exit from the Eurozone. The IMF finds itself in a no-win Eurozone situation.

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