

Financial Assistance in the Euro Area: An Early Evaluation

Presentation at Peterson Institute

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This study

- **Two innovations in major financial assistance programme:**
 - Adjustment within EMU
 - Institutional set-up of EU-IMF cooperation (the 'Troika')

- **Our aims:**
 - Assess programme outcomes (irrespective of institutional set-up)
 - Assess institutional set-up
 - Draw lessons for future programmes, if any
 - Draw lessons for IMF cooperation with regional entities

- **Basis for assessment:**
 - Comparison with other programmes
 - Comparison between initial programmes and outcomes
 - Interviews with policymakers

Outline

What is special?

- Economic constraints
- Programme design
- Initial conditions

Programme assessment

Institutional dimensions

Conclusions

1. Crises in the euro area: what is special?

▪ **Economic constraints**

- Irrevocably fixed exchange rates, single monetary policy
- Large cross-border exposure, unrestricted capital mobility (in principle)
- Prohibition of monetary financing

▪ **Policy constraints**

- No EU institutions in place that could provide assistance
- No experience of assistance, therefore IMF participation indispensable

▪ **Legal constraints**

- Financial assistance to sovereigns regarded by some as illegal.
- European Commission bound by the Treaty in giving policy recommendations to member states

Consequences

■ Financing

- Programme size tailored to cover gross budgetary financing needs
- Access to liquidity (standard repos + ELA) determines credit volume
- Balance-of-payment financed by programme + Eurosystem

■ Assignment

- Focus on budgetary retrenchment to:
 - Limit programme size and restore sustainability
 - Foster price-wage adjustment
- Structural reforms to:
 - Help target real exchange rate (shift/steepen the Phillips curve)
 - Help reallocate resources to traded-goods sector
 - Enhance growth potential
- Delicate sustainability / competitiveness trade-off

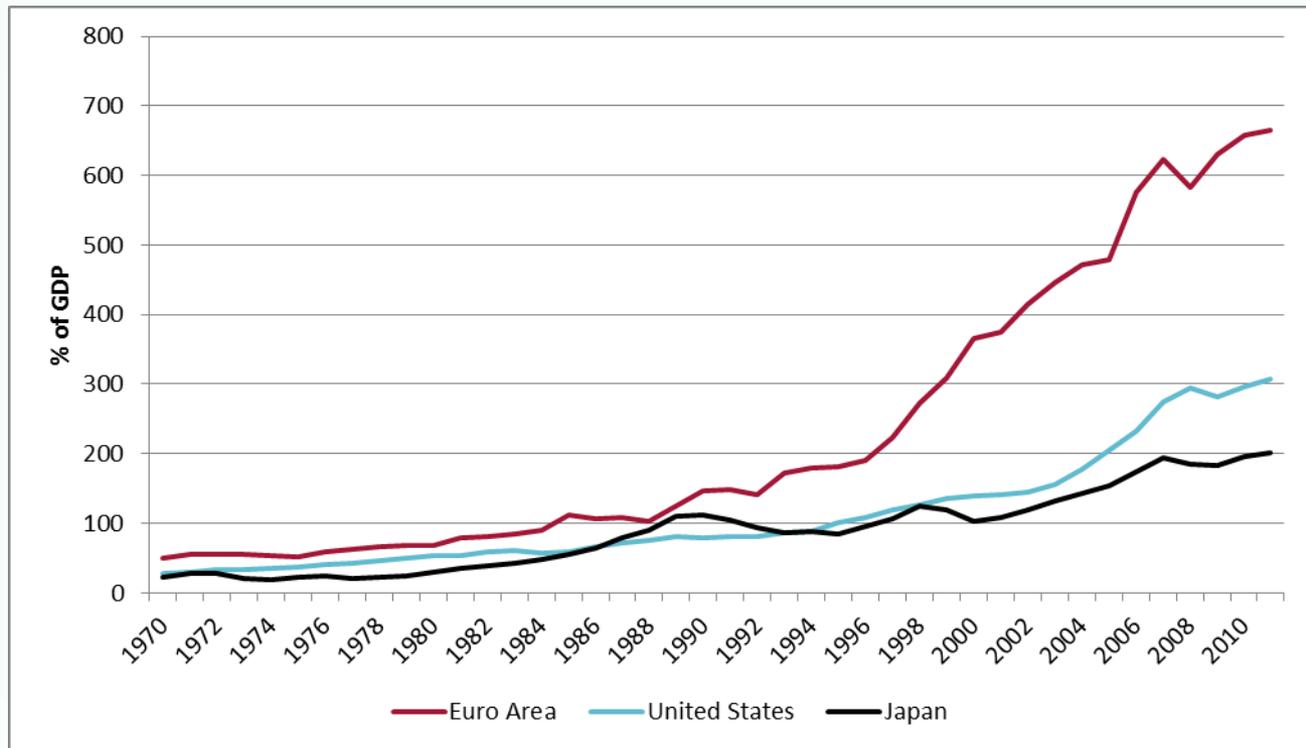
How financing needs were determined

	Greece 1	Ireland	Portugal
	10Q2-13Q2	2010-2013	2011-2014
A) General Government deficit	53.0		22.0
B) Debt amortization	138.3		80.9
C) Adjustment	1.5		2.1
D) Gross financing need (A+B+C)	192.8	98.9	105.0
E) Debt issuance/Roll-over	93.5	48.9	47.0
F) Privatization	0.0	0.0	5.0
G) Net Financing need (D-E-F)	99.2	50.0	53.0
H) Bank support	10.0	35.0	25.0
I) Total Financing need (G+H)	109.2	85.0	78.0
J) Contribution IMF	30.0	22.5	26.0
K) Contribution EFSM, EFSF, ESM, EU countries	80.0	45.0	52.0
<i>Memo: Use of country's financial buffers</i>		17.5	

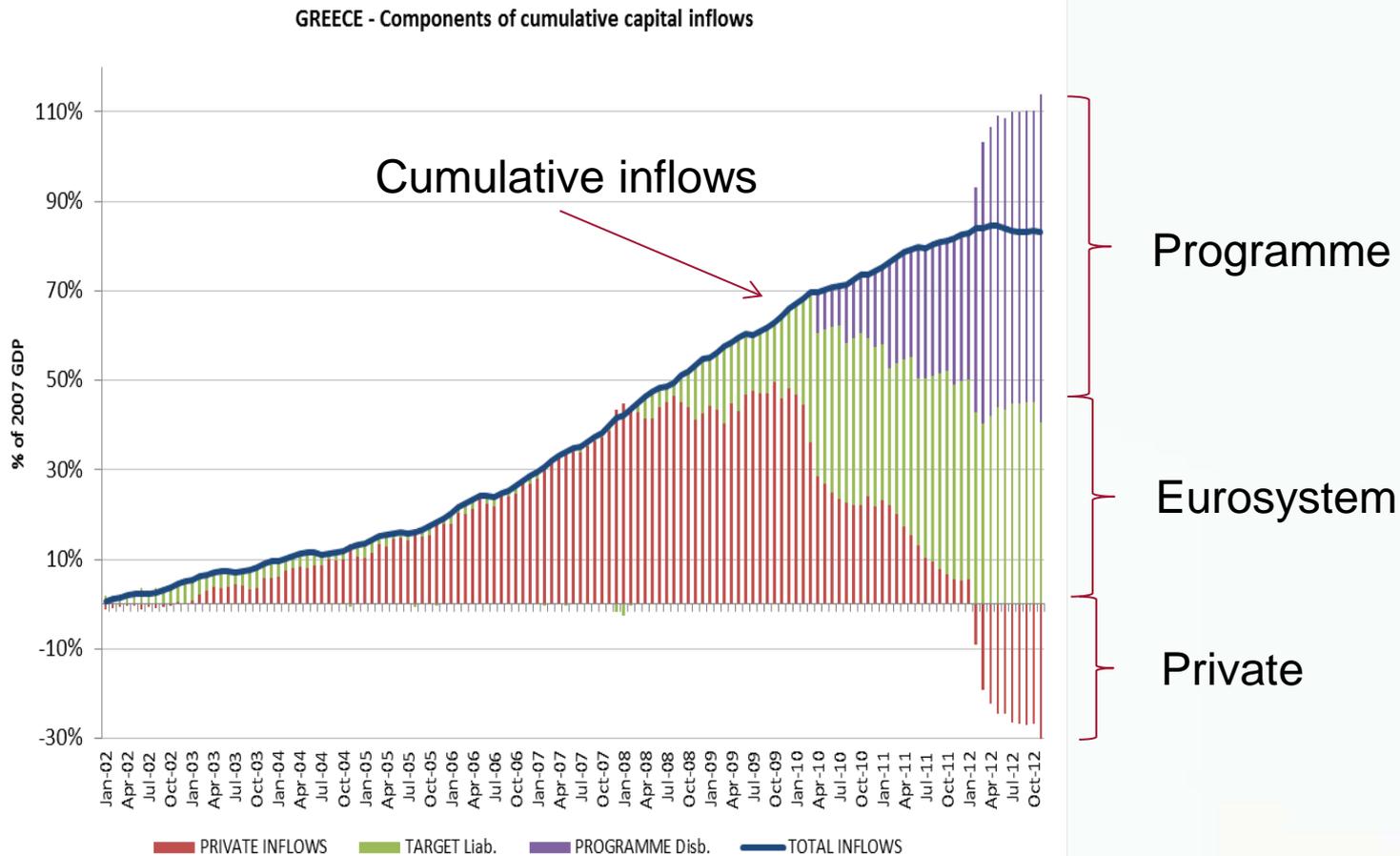
Source: European Commission Programme documents.

Financial integratui pre-crisis

Cross-border assets and liabilities, 1970-2010



Balance-of payments financing by Eurosystem (ex post)

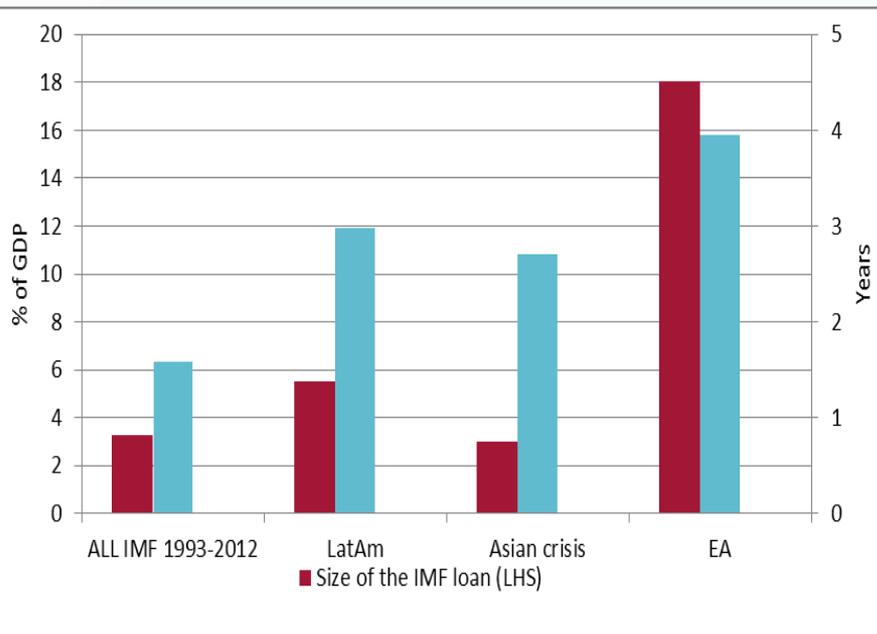


Source: Merler and Pisani-Ferry (2013), Bruegel updates.

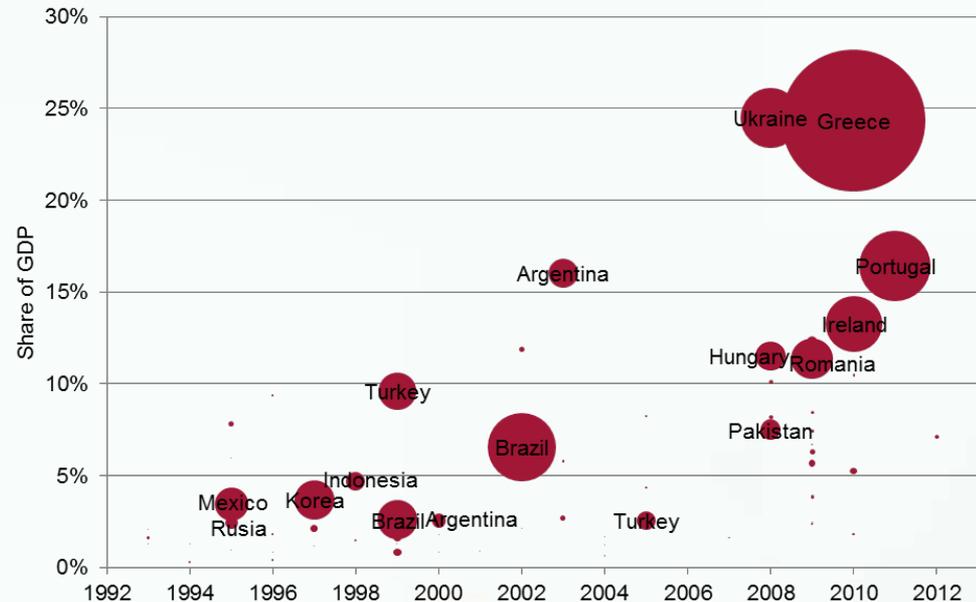
Very big programmes (note: IMF only)

- Size and length of IMF programmes by region (note: IMF only!)

Size and length



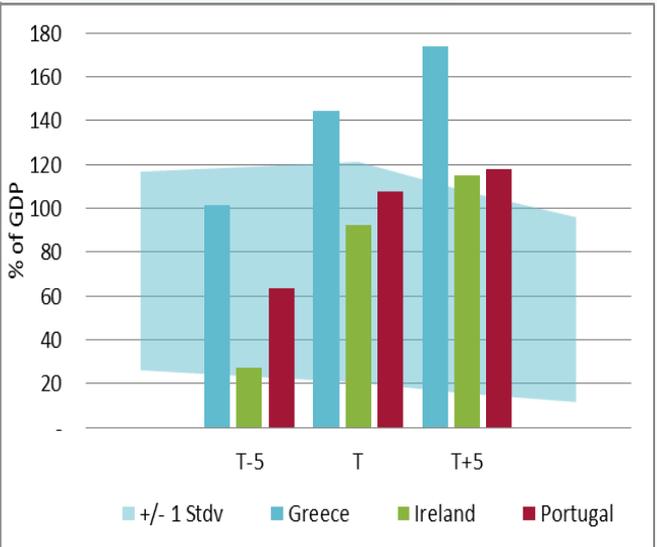
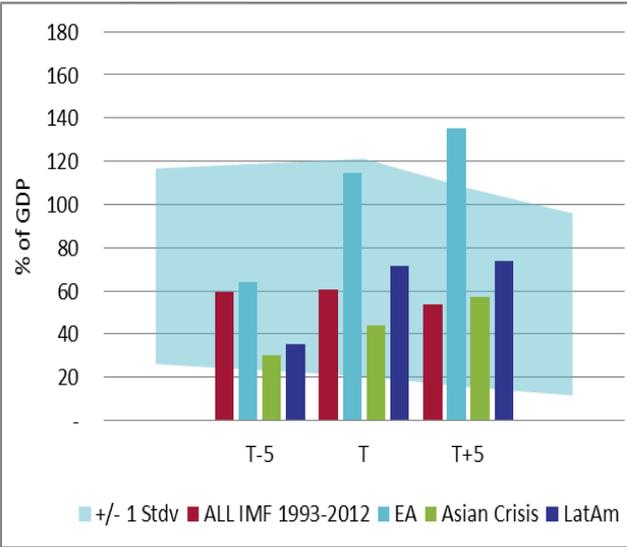
Relative and absolute size



Note: in the case of the EA countries the length is taken as currently scheduled. On RHS graph diameter of bubbles indicates absolute size of the loans in US dollars.

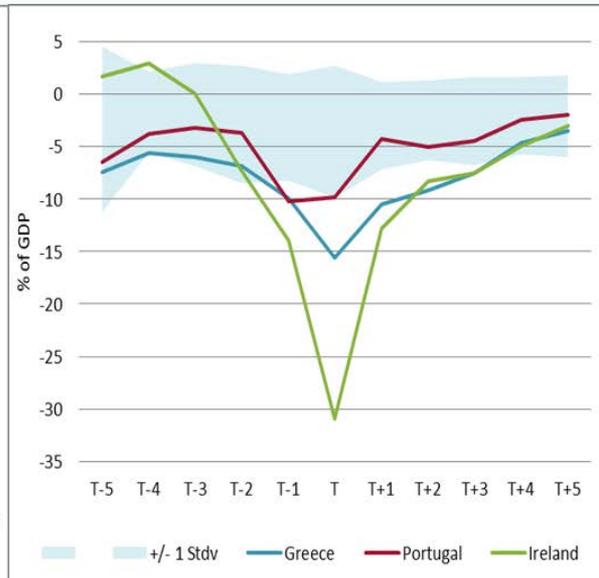
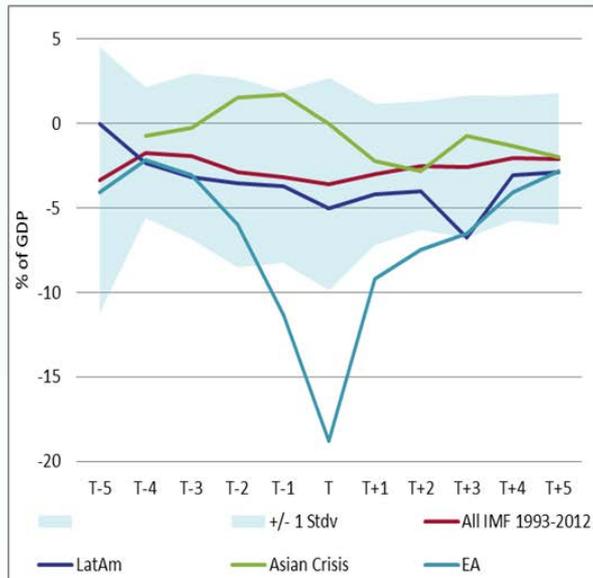
Source: IMF MONA database and IMF WEO (October 2012).

Initial conditions: large debts and deficits



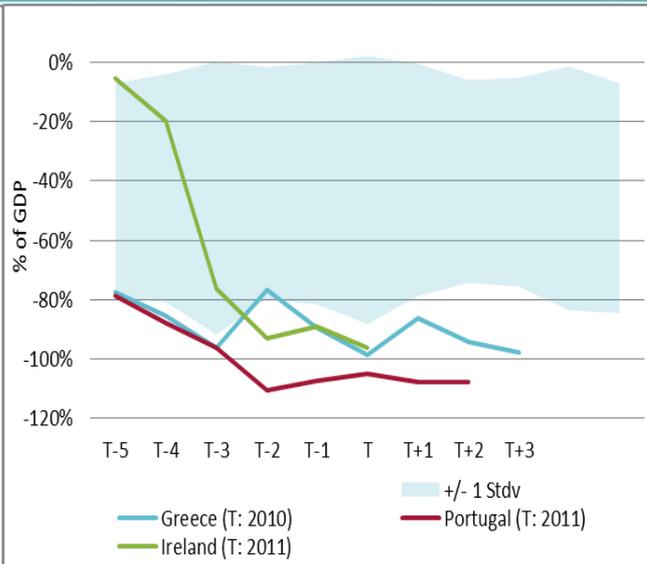
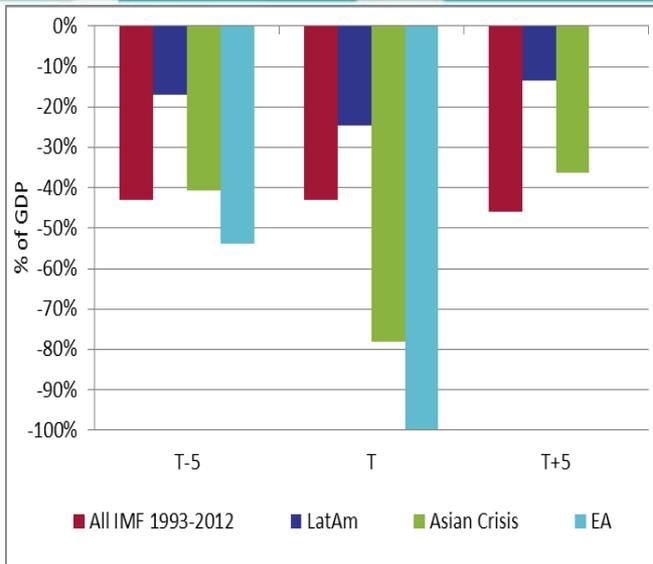
Debt

Deficits



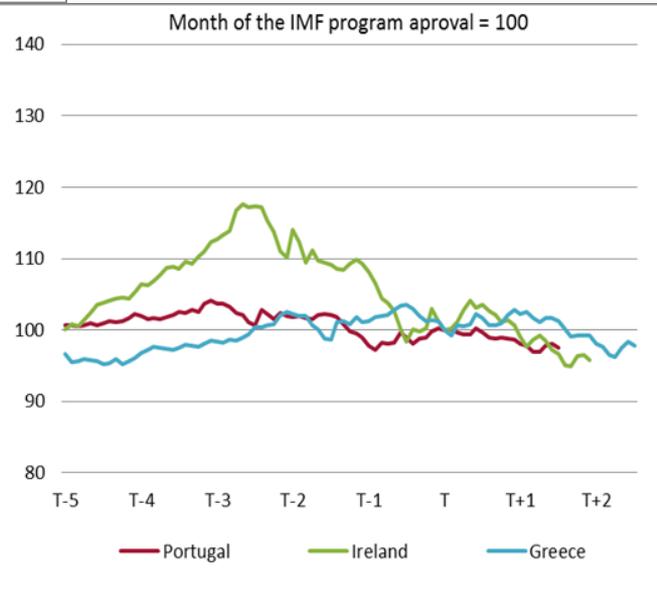
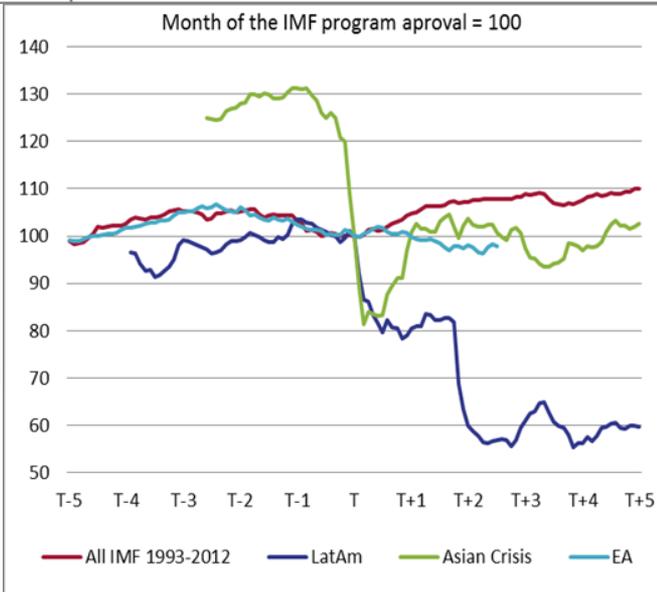
Initial conditions (2): large negative NIIP and REER

rigidity



NIIP

REER



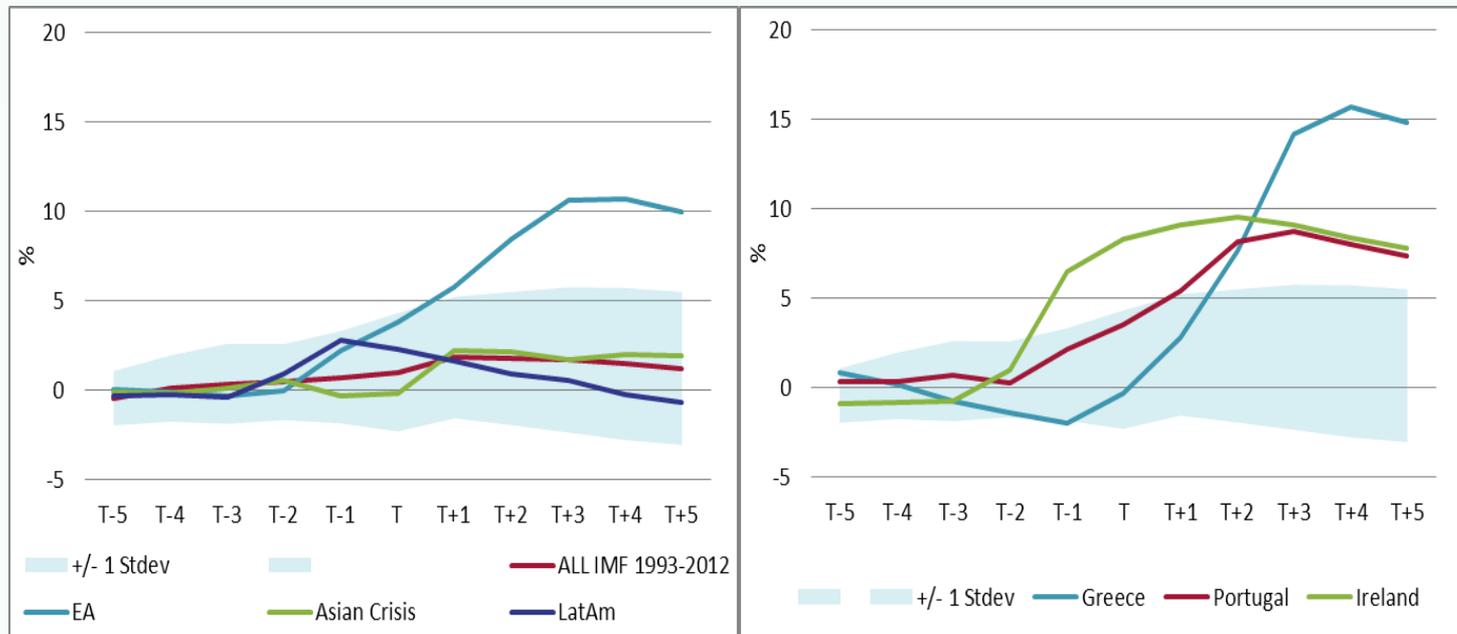
2. Assessing the 3 Troika programmes

Projections and reality for 2013

	Greece		Ireland		Portugal	
	Programme May-10	Feb-13	Programme Dec-10	Feb-13	Programme May-11	Feb-13
Projection	2013	2013	2013	2013	2013	2013
Real GDP (% change)	2.1	-4.4	2.5	1.1	1.2	-1.9
HICP (% change)	0.7	-0.7	1.6	1.3	1.5	0.5
Unemployment (%)	14.8	27	11.6	14.6	12.4	17.3
General government deficit	4.8	4.6	7.5	7.3	3.0	4.9
General government debt	149.7	175.6	120.5	122.2	108.6	123.9
Current external balance	-5.6	-4.3	2.6	3.4	-3.9	-1.4
Domestic demand (% change in volume)	0.7	-7.6	0.4	-0.4	-0.3	-2.8

Unemployment

- Unemployment rate relative to previous 10-year average



Source: IMF WEO (October 2012)

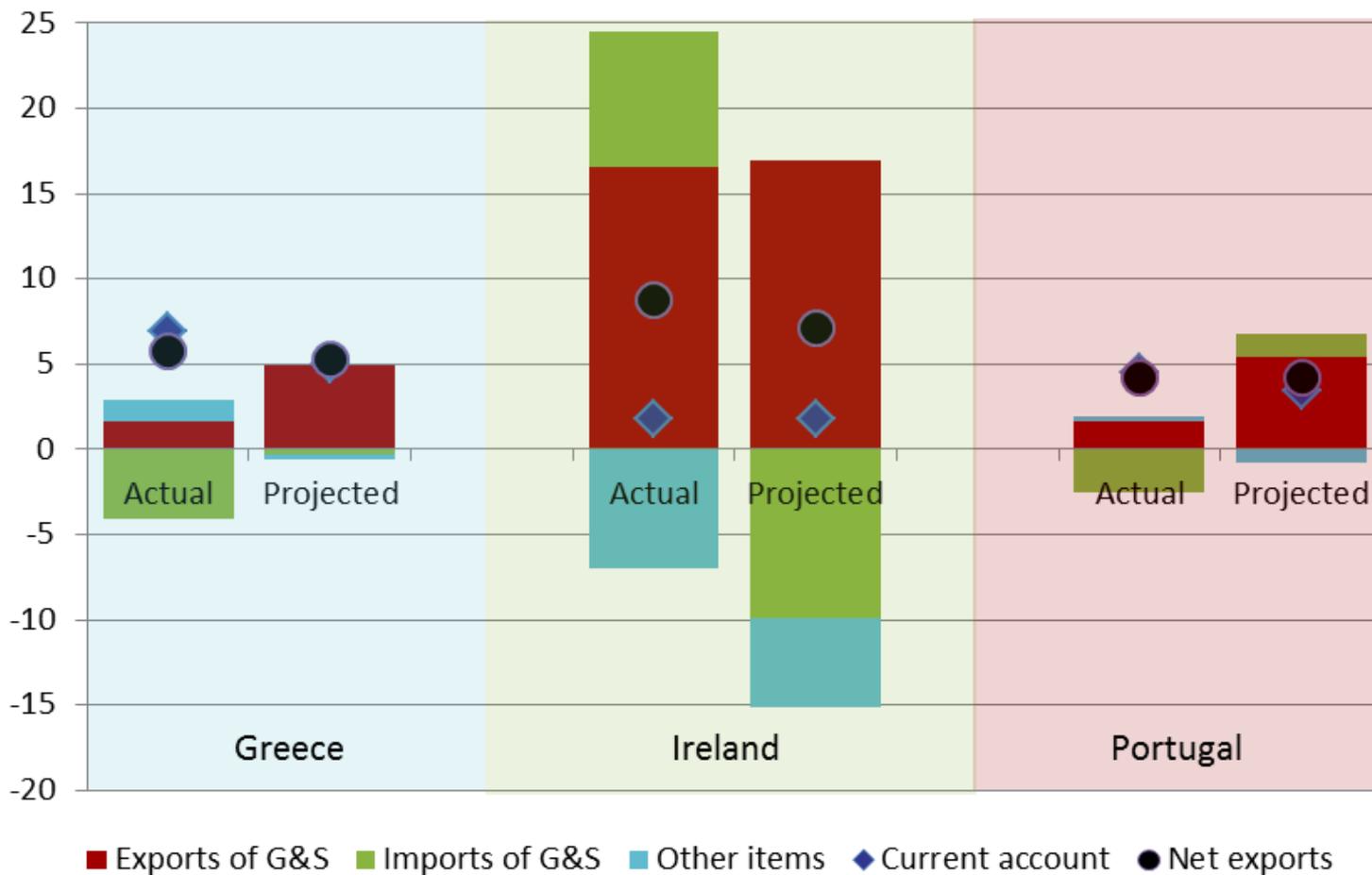
Debt: the Greek case

Table 6: Greece - Breakdown of the gap between May 2010 and Jan 2013 fiscal targets for 2013
(All variables expressed as % of GDP)

	Primary balance	Overall balance	Gross debt
2013 target as set in the May 2010 SBA programme	3.1	-4.8	149.0
- Worse 2009 initial conditions	-1.8	-2.0	14.3
- Revenue shortfall due to adverse GDP developments	-3.2	-3.2	
- Effect of lower nominal GDP		-1.0	38.4
- Interest rate on public debt		4.5	
- Larger than expected overall deficits			1.7
- Fiscal consolidation effort (residual)	1.9	2.0	
- Debt accumulation residual			1.7
- Debt restructuring			-26.6
2013 outturn as forecasted in the January 2013 review	0.0	-4.5	178.5

Current account components: projected and actual

Change in current account during the programme years
(as % of 2013 GDP)



Expectations vs. reality

▪ Overall

- Larger fall in domestic demand and output
- Much worse unemployment
- Worse debt ratio despite larger fiscal efforts (denominator effect)
- Better current account position

▪ Differences

- Greece much worse on all accounts
- Ireland stands out for REER improvement, export performance
- Portugal much better than Greece on implementation, but remaining structural weaknesses

Success or failure?

▪ **Success**

- No exit
- Prospects for market access: Ireland, Portugal

▪ **Failures**

- Slower-than expected adjustment (Greece, Portugal)
- Higher-than expected economic and social cost
- Political sustainability

▪ **What could have done differently?**

- Time-consistent EU stance
- Better economic environment in rest of EU
- Early restructuring for Greece, Senior creditors' bail-in for Ireland
- Fiscal devaluation
- Less austerity (= more financing)

3. Institutional issues

- **Troika set-up without precedent**
 - IMF cooperation with regional entity (remember AMF!)
 - Commission: broad-mandate entity rather than specialised agency
 - Central bank on the lending side of the table
- **How the Troika works**
 - Neither a decision-making nor a lending institution
 - No Troika conditionality but separate IMF and EU conditionalities
 - Three unequal partners

Table 2: Distribution of roles in IMF and European assistance

	IMF	Euro area
Programme negotiation and monitoring	IMF Staff	Commission services in liaison with ECB
Decision to assist	IMF Board	ESM Board of governors (aka Eurogroup)
Lending	IMF	EFSF/EFSM ²⁰ /ESM

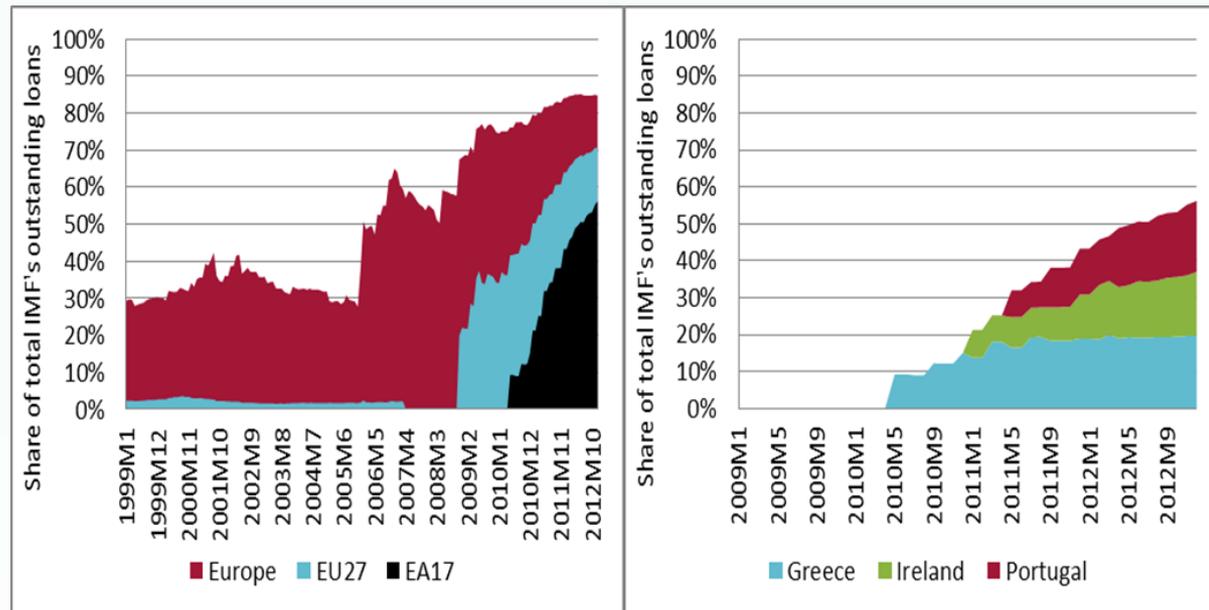
Assessing the Troika

- **Indispensable cooperation**
 - Financing
 - Technology transfer
- **Less problematic than could have been expected**
- **But questions going forward**

EU-IMF cooperation

- **Equality of treatment**
 - Exceptional access policy criterion
 - Weight of euro-area and EU-specific rules
- **Superposition of conditionalities**
- **Decision-making procedures**
- **Resources**
- **Junior role?**

Shares of Europe in IMF lending



Commission role

- **Learning and effectiveness on the ground**
- **Problems:**
 - No vertical integration
 - Commission as 'agent of the EA lender countries
 - Commission as principal: political entity, guardian of the treaty
- **Conflict of interest**
- **Political risk**

ECB role

- **Difficult to assess (no evidence)**
- **ECB acts with its own instruments (collateral, ELA, OMT)**
- **Motive for participation: information, voice**
- **Potential conflicts of interest**

Table 14: Possible conflicts of interest

ECB Role	Ex ante (programme negotiation)	Ex post (programme implementation)
Monetary policy	Too tough on fiscal consolidation	Too soft on inflation
Liquidity policy	Too tough on bank solvency	Too soft on liquidity provision
Creditor (SMP)	Too tough on fiscal consolidation	Too soft on inflation, too timid on restructuring

4. Recommendations

- **Involvement of IMF: as long as EA governance incomplete**
- **Role of IMF**
 1. Provision of technical assistance but no financial assistance
 2. Keep an important lending role
 3. **Function as a 'catalytic lender' with possibility to exit**
- **Role of EC**
 1. Give EC full responsibility for negotiation, financing and monitoring
 2. **Turn ESM into European institution - EMF (European Monetary Fund), with staff seconded from Commission**
- **Role of ECB**
 - **Becomes a (mostly) silent participant in the Troika**
- **Improve accountability**
 - Oversight by European Parliament

Lesson for broader IMF role

- **Cooperation with regional institutions is possible**
- **It is not easy.**

Thank you!

Assessing the Greek programme

Greece in 2013: Expectations vs. Reality

	Initial programme (May 2010)	Current forecast (January 2013)	
Real GDP (2009=100)	96.5	81.0	
Nominal GDP (base estimate for 2009=100)	99.2	77.8	
Real domestic demand (2009=100)	89.7	72.5	
Gross fixed capital formation (2009=100)	82.6	56.6	
Unemployment rate (per cent)	14.3	26.6	
Government deficit (per cent of GDP)	-4.8	-4.5	
Government gross debt (per cent of GDP)	149	178.5	
Exports of goods and services (billions of euros)	60.6	50.6	
Imports of goods and services (billions of euros)	57.5	51.2	
Current-account balance (per cent of GDP)	-4.0	-1.2	

Source: IMF programme documents.