# Behind the scenes at the IMF on a fateful day in the Greek crisis

Paul Blustein, July 7, 2015

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John Lipsky answers questions during his press conference October 7, 2010 at the IMF Headquarters in Washington, DC. (IMF Photograph/Stephen Jaffe)

Ever since Greece received its first giant package of emergency loans in May 2010, the International Monetary Fund has come under criticism for joining a rescue effort that flopped at saving the Greek economy from disaster. Most controversially, the IMF changed one of its own rules designed to keep it from piling more loans atop countries with potentially unpayable debts.

A newly declassified IMF document puts the Fund’s role in an even harsher light. Official minutes of the IMF’s executive board meeting that approved the rescue on May 9, 2010 reveal the depth of misgivings among the Fund’s directors about whether Greece would end up saddled with a hopelessly massive debt burden. The minutes also show that confusion reigned about the rule change among the board’s two dozen members, who represent the Fund's 188 member nations. Several expressed surprise when they realized they were changing the rule, and some of the most dismayed indicated that they suspected the move was being snuck past them.

This document has drawn no public attention for two very good reasons. First, it’s buried in the IMF’s online archives, having just been posted under a procedure giving the public access to board minutes after five years. Second, all eyes are on the extraordinarily fraught situation in Greece following Sunday’s referendum in which Greek voters decisively rejected the terms of a compromise offered by international creditors. The “No” vote has inflamed the already-tense relationship between Athens and other major European capitals, raising the likelihood that Greece will soon be forced to abandon the euro, which would plunge its economy into unimaginable chaos for at least a few months if not more.

But the minutes of the May 2010 meeting illuminate current events in Greece by providing revelatory information about one of the most crucial episodes in that fateful first rescue. As in 2010, one of the biggest bones of contention right now is Greece’s debt burden — specifically, whether the country has any reasonable chance of getting its economy on stable footing without a substantial degree of relief from its obligations. The IMF is taking a much tougher position on this issue in 2015 than it did five years earlier. Just a few days ago, the Fund issued a headline-generating report concluding that although Greece’s left-wing government must embrace a painful new round of sweeping economic reforms, its European creditors must also provide massive debt relief, perhaps

by forgiving a significant portion of the principal amount of their loans to Athens, which the Europeans are extremely loath to do. IMF officials have even suggested that they cannot participate in a new rescue in the absence of such a compromise, because doing so could violate Fund rules.

The new disclosures about the May 2010 meeting help explain part of the motivation for the IMF's current hard line — namely, its desire to redeem its institutional credibility. In 2010, the Fund engaged in legal acrobatics to facilitate the Greek rescue, circumventing its "exceptional access policy" — or, as I prefer to call it for simplicity's sake, the "No More Argentinas rule." These terms refer to restrictions the Fund imposed on itself in the aftermath of one of its worst debacles, an effort in 2001 to rescue Argentina that ended a few months later in an economy-crushing default and currency collapse. Under the No More Argentinas rule, the IMF could make large loans only to countries whose debt was deemed sustainable with "high probability." Instead of abiding by the rule in Greece's case, the Fund created a loophole allowing it to give large loans to a crisis-stricken country when there was a risk of "systemic spillovers" — that is, widespread financial turbulence threatening the stability of other countries.

For taking this approach, the IMF was castigated as a toady of Europe's big powers, especially once the unsustainability of Greece's debt became glaringly obvious. My CIGI colleague Susan Schadler, a former deputy director of the IMF's European Department, has been the most trenchant critic, accusing her former employer of having "bowed to short-sighted pressure from Europe" in making the rule change. Others have advanced similar arguments, and the Fund itself has acknowledged that the restructuring of Greece's debt to private bondholders, which finally took place in 2012, should have happened earlier.

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I have chronicled the IMF's role in the first Greek rescue in detail, and an article in the Wall Street Journal reported how deeply divided the Fund's board was in May 2010 about whether the bailout would work, based on confidential documents containing some of the directors' comments at the board meeting. But until now the full board minutes have been unavailable. In addition to providing extensive new evidence of the wariness on the board regarding the rescue, the minutes indicate that at the time of the meeting the directors did not understand the implications of the change in the No More Argentinas rule until the meeting was nearing its end. This raises concerns about the governance of an institution that is supposed to be accountable to the international community; board members were evidently not briefed beforehand about the rule change, which was tucked into a jargon-laden passage on the 19th and 20th pages of a long document prepared by the Fund staff.

Readers who want to get a glimpse into the IMF's inner workings at a momentous juncture in its history are invited to read the minutes and judge for themselves. But for those interested only in the most relevant bits, I offer the following draft account of the meeting for a book I am writing about the IMF's role in the euro zone crisis. (Readers who are already familiar with the Wall Street Journal article will find the newsiest material in the second half of this account.)

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An oval chamber sixty feet long and two stories high with plush blue carpeting and suede-and-wood paneling, the IMF boardroom is designed to convey the majesty of the international community passing judgment. There, the Fund's executive directors gathered on May 9, 2010, settling into their gray swivel chairs around a horseshoe-shaped table with microphones in each place, while staff members took seats a few feet away from the table. John Lipsky, the first deputy managing director, was presiding, since Dominique Strauss-Kahn, the managing director, was in Europe attending high-level crisis negotiations. The board's task was to consider the IMF program for Greece, about which each member had received copies in advance of the staff report, a 144-page document loaded with analysis, data, charts, and projections showing how the €110 billion rescue and Greek policy changes were supposed to work.

Given the combustible market environment, and the looming threat of a Greek default a few days later if Athens did not begin to receive bailout loans, there was no doubt that the board would approve the program in accord with the IMF’s tradition of consensus decision making. But it was equally certain that some incisive criticism and awkward questions would be forthcoming first. Preliminary statements by directors from outside the euro zone, circulated internally in advance of the meeting, reflected profound skepticism about the wisdom of imposing austerity on Greece without requiring the country's creditors to accept any losses. The board was also about to discover, near the end of the meeting, that buried in the staff report lay an unwelcome surprise.

The reservations expressed by some of the directors in their prepared statements are noteworthy for their prescience. Arvind Virmani, who represented India, fretted that the planned tightening of fiscal policy would be a "mammoth burden [that] could trigger a deflationary spiral of falling prices, falling employment, and falling fiscal revenues that could eventually undermine the program itself," so a default or debt restructuring might be "inevitable." More impassioned were the words of an Argentine director, Pablo Andres Pereira, who urged consideration of a debt restructuring sooner rather than later: "Harsh lessons from our own past crises are hard to forget," Pereira said. "In 2001, somewhat similar policies were proposed by the Fund in Argentina. Its catastrophic consequences are well known... Beyond economic theories, there is an indisputable reality that cannot be contested: a debt that cannot be paid will not be paid without a strong process of sustainable growth."

The assumptions in the staff report about Greek growth "seem to be overly benign," warned Rene Weber, a director from Switzerland who represented his own country and seven others. "Even a small negative deviation... would make the debt level unsustainable over the longer term." Weber exhorted management and staff "to prepare contingency scenarios... Among these contingency measures, serious consideration should be given to debt restructuring as a means to achieve fiscal sustainability and make private creditors shoulder some of the adjustment burden." Indeed, he asked, "Why has debt restructuring and the involvement of the private sector in the rescue package not been considered so far?"

Echoing similar sentiments, Christopher Legg, an alternate executive director from Australia who represented a constituency of 13 countries, said: "I understand why there is a huge reluctance to countenance any kind of debt restructuring... But it is clear that the markets are not convinced that the program will be sufficient. While we must not speak the unspeakable, certainly not outside this room, we need to be thinking the unthinkable."

Unsurprisingly to his colleagues, the most caustic comments came from Paulo Nogueira Batista, a Brazilian with swept-back salt-and-pepper hair who was the board's most outspoken detractor of the Fund's governance. Characteristically, his attack on the Greek program dispensed with the diplomatic niceties favored by his board allies; he used the term "Panglossian" to describe the staff report's projection of a V-shaped recovery. “We fear that growth may follow an L-shaped pattern, with a very sharp contraction of GDP in 2010 and 2011 and negligible recovery thereafter,” he said. The program, he continued, "may be seen not as a rescue of Greece, which will have to undergo a wrenching adjustment, but as a bailout of Greece's private debt holders, mainly European financial institutions.”

A point-by-point response came from the IMF’s mission chief for Greece, a Danish economist named Paul Thomsen. "From the outset of the discussion, the [Greek] authorities were firmly of the view that debt restructuring is not on the table," Thomsen told the board. "In this regard, one of the reasons was clearly that Greece was at a point where it needs to move away from a model very much dependent on the public sector and give much better conditions for the private sector. It would be a mistake not to honor contracts."

He continued by defending the rescue's success as plausible, however dicey it might be. "The key issue... is really the government's ability to overcome what undoubtedly will be fierce resistance from vested interests to structural reforms," he said. [Note: “Structural reform” refers to actions Athens pledged to take to loosen restrictions and bureaucratic obstacles in a host of markets, the aim being to make the economy more productive and competitive.] “This will be challenging... Even if Greece were to mobilize the political resolve to implement the fiscal program, if the structural reforms do not happen, the strategy will not be sustainable, and I think that the government is very mindful of that." Nonetheless, he argued, "our assumption is that we can put Greece over the hill in a couple of years and set it on a credible fiscal path that promises a gradual reduction in debt."

Strongly endorsing the staff's recommendation were a group of six European directors who issued a joint statement. "We are fully aware that this is a very challenging program, which is not free of risks," they said. "However, the current situation makes hardship unavoidable and this program is the only alternative left to prevent a significantly worse scenario from happening." Bolstering the case for plunging ahead, the Russian director, Alexei Mozhin, pointed out that despite the obvious worries about another Argentine-style failure, the Fund had given large loans to Brazil and Turkey in 2002 when those countries were struggling with seemingly unsustainable debts — and the programs had helped turn things around. "Now, I certainly realize that, in terms of pure numbers, the Greek program is perhaps even more difficult than any of those that I mentioned," Mozhin added.

Nobody voiced outright opposition to the program. Even Nogueira Batista said he would back it; he could do no more than thunder, "Our decision to go along with this problematic and risk-laden program should not be taken to mean that we will support it in the future."

But fresh controversy arose when realization spread that, along with the Greek program, the board was taking another important step that day — modifying the No More Argentinas rule. The manner in which this emerged aroused suspicion that approval for a significant change in policy was being sought without directors being properly alerted, which would constitute a breach of good international governance.

The issue came to the fore when Weber, the Swiss director, cited a passage on pages 19 and 20 of the staff report, which he had noticed while poring over the document on a long plane flight to Washington. He said he "had some difficulties finding that spot and realizing that this is a proposed policy change." The passage read as follows:

> *On balance, staff considers [Greece's] debt to be sustainable over the medium term, but the significant uncertainties around this make it difficult to state categorically that this is the case with a high probability. Even so, Fund support at the proposed level is justified given the high risk of international systemic spillover effects. Going forward, such an approach to this aspect of the exceptional access policy would also be available in similar cases where systemic spillover risks are pronounced.*

In plain English, this language effectuated a compromise that had been struck in previous days after a hard-fought battle within the staff over how strictly to enforce the No More Argentinas rule and how candid the staff report should be about Greece's debt situation. Under the compromise, the IMF would create a new exception to the rule for cases involving major risks of financial contagion, provided the same approach would apply in the future, not just in Greece's case. Normally, a policy change of this sort would be subject to careful deliberation, perhaps over the course of several board meetings, as it had been when the original rule was approved in 2003. Instead it had been inserted into a jargon-filled passage of the staff report, apparently without directors receiving an advance briefing.

Confusion clearly reigned among many if not all of the board members about the implications of this passage. "I admit I did not pick this up either in my quick read of the documents," Meg Lundsager, the US director, told her colleagues. Several others, including Canadian director Thomas Hockin, declared themselves prepared to exempt Greece from the No More Argentinas rule as long as no precedent was necessarily being set for future crises. But staffers at the meeting said that such a case-by-case approach wasn't permissible.

Sean Hagan, the IMF's general counsel, explained that "uniformity of treatment" among member countries — a fundamental IMF principle — required consistent applicability. "When a general policy is established, it must be applied in all cases to all countries," he said. "If in fact a situation arises where a country does not meet that policy, the board has no authority to make an ad hoc exception." In the case of the Greek program, he added, the board could either make a determination that Greece met the "high probability" standard for debt sustainability, "or alternatively, [the board] must change the policy and, as a result... those changes would be applicable to future cases."

An indignant Nogueira Batista suggested that the policy change was being snuck past the board. Noting that directors would have misunderstood what they were doing had Weber not pressed the issue, he demanded: “Should we not have a separate decision...instead of just a sentence on page 19 of the staff report, which would then be used as a precedent?” Weber chimed in too, complaining that the rule change was "kind of hidden."

The best gloss that can be put on this series of events is that it was a lamentably fast-and-loose way to do what had to be done. The Greek rescue had to proceed. Great haste was required. IMF rules could not be grossly flouted, but they could be fudged, and there was no time for the kind of debate that would normally precede an important change in policy. The board went along with creating the loophole in the No More Argentinas rule, once it understood such a step to be inseparable from approval of the Greek program.

Seeking to bring the meeting to a close, Lipsky played down the fuss about the change in the No More Argentinas rule. "Ideally, it would have been better to have held a discussion separately. That point should be self-evident," he said. "We are meeting on Sunday, because of the need for urgent action. So, we have dealt with it as best we can."

Then the IMF's No. 2 official pronounced himself "a little disturbed by the suggestion that the Fund program should obviously have involved debt restructuring or even default." There were good reasons for eschewing such an approach, according to Lipsky, who had been one of the most powerful opponents of debt restructuring during the IMF's internal debates that spring. "Greece has a very large — very large — primary [budget] deficit that would have remained even if all debt payments were suspended," he said. "Such an action would have had immediate and devastating implications for the Greek banking system, not to mention broader spillover effects."

That prompted a rejoinder from Nogueira Batista, who said Lipsky's comments "reveal what we suspected — that management had been looking carefully at the issue of debt restructuring... perhaps an eventual Plan B."

"There is no Plan B," Lipsky shot back. "There is Plan A and a determination to make Plan A succeed; and this is it."

*The opinions expressed in this article/comments are those of the author(s) and do not necessarily reflect the views of CIGI or its Board of Directors.*