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Name : Vasileiadis George

Supervisor : Professor Paraskeuopoulos Christos

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Abstract

This dissertation is about the role of the external institutions like the IMF and the ECB in the financial crisis of Greece, but also about the role which France, Germany and the European Union had in this crisis. Firstly, in chapter I I analyze the role which the European Monetary Union had during the Greek crisis. The analysis is based mostly on the failures of the legal framework, the Basel III Agreement but most importantly in the imbalances among Euro-zone members and lastly the reforms that should be made.

Furthermore, one has to look for the causes of this crisis, which in chapter II are described mostly in three categories: the dramatic financial situation in Greece, which has been hidden for years, a chained reaction to the international financial crisis which erupted in 2007 and the economic imbalances among EU member states.

In chapter III I analyze more about the role of the IMF and the ECB in Greece. Moreover one can see in the third chapter the pros and cons of these 'interventions' and that Europe as a whole made a mistake of taking IMF on board for trying to resolve the Greek crisis. IMF, as successful as it was with implementing its programs in other countries, made huge mistakes in Greece which the near future will show how important they were.

On the other hand ECB relied on its new role as a lender of last resort buying governmental bonds in the secondary markets and lending continuously tremendous amounts of money in the Greek banks through the ELA. The European Central Bank is one of the most important actors in the Financial Crisis and the sovereign debt crisis. The way, how the ECB was operating before the crisis was strictly based on the monetarist concept of central banking, reducing central banks to the guardian of consumer price inflation. Inflation of financial asset prices was ignored, not to speak of financial stability, growth and employment. This reflects basic faults in the design of the ECB, in particular its monetarist obsession with consumer price inflation. Through that we can identify ECB as a player, which contributed with its monetarist approach even to a certain extent to crisis, especially through its participation in the so called Troika.

In chapter III I also refer to the role which Germany and France had in the Greek crisis. One would need thousands of pages to describe the relationships among German and Greeks politicians through the years of the crisis and back and forth policy recommendations, so I refer mostly to the no bailout clause which Germany strongly recommended in the beginning of the Greek crisis and that French interests have aligned with German interests for the majority of the crisis period.

Introduction

Politics is recently consumed by the discussions of the economic crisis in the Euro-zone. Though the euro itself remains strong, Greece has required multiple bailouts from Euro-zone Member States, and on the other hand quite few economies across Europe have achieved minor economic growth since the financial crisis of 2008. Shelby Woods refers to this situations as a situation while the European Union was designed as a political project meant to promote economic growth, unite the countries of Europe and ensure peace and democratic rule, the "European project" has also produced polarization between those who wish to see the EU succeed and those who want Member States to retain power. [1]

In the years before the Greek crisis, the euro was seen as a symbol of success of the European project, but the failure of the euro to ensure economic stability throughout Member States – particularly peripheral countries like Greece – has now become a symbol of EU failure. This crisis, therefore, presents a challenge to European cohesion and to the ability of democracy to respond to international problems. What was the role of external constraints in the resolving of the Greek crisis? In order to answer these questions, one must first examine the role of EMU in the Euro-zone crisis and in the Greek crisis in particular, but also the theoretical framework in which the role of these institutions takes place.

[1] The Greek Sovereigh Debt Crisis,Politics and economics of the Euro-zone, Shelby Woods, University Washington, p.3

Theoretical Framework

This dissertation is an analysis of the role of external institutions/key players in the Greek debt crisis. I first identified the major actors involved in the crisis and researched their interests and constraints. One should relate with many theories to examine further this recent subject. The main theories which can be applied in this dissertation are the theories of intergovernmentalism, supranationalism and historical institutionalism. Historical institutionalism mediates the debate between functionalists and intergovernmentalists over European integration. However, intergovernmentalism does not effectively explain why Member State interests shift over time. Thus, historical institutionalist scholarship is compelling because it recognizes that political development 'must be understood as a process that unfolds over time' and that institutions –'formal rules, policy structures, or norms'– help determine the viewpoints of rational actors within the European system.[2]

Furthermore, the concepts of intergovernmentalism and supranationalism are fundamental to understanding discussions surrounding sovereignty in the European Union, which is extremely important when discussing about memorandums among countries and external institutions like the IMF for example and thus essential so as to be able to obtain a thorough grasp of EU integration theory.

As Nugent suggests[3], intergovernmentalism refers to arrangements "whereby nation states, in situations and conditions they can control, cooperate with one another on matters of common interest". Under such circumstances states are free to cooperate (or not) and are able to the set the level or cooperation. Such circumstances involve no loss (or pooling) of sovereignty. States cooperate when they want and don't cooperate when they don't want to. However, supranationalism refers to governance arrangements where states decide to delegate some responsibility for decision making to a body or decision-making forum that stands above the nation state.

[2] Paul Piercon, The new Politics of the Welfrare State, 1996, John Hopkins University Press,p 126
[3] Nugent N., Government and politics of the European Union,p.475

In these circumstances states may have to go along with a policy that contravenes their particular preferences in a given instance. As Nugent[4] notes 'supranationalism takes inter-state relations beyond cooperation into integration, and involves some loss of national sovereignty'.

No structure in the EU is perfectly intergovernmental or supranational and different institutions can be more or less intergovernmental/supranational at different times. The Commission, for example, (thought of as supranational) sometimes follows the lead of member states (in some external matters for example) while at other times the Commission is the driver of European policy, taking the lead ahead of national capitals. Furthermore, while the EU has become more supranational in general as time as gone on, states still try to reach a unanimous consensus in supranational forums, even when technically speaking they don't have to. The fact that supranationalism entails a loss of sovereignty raises the question of why states would agree to enter in to such governance arrangements. Indeed, this is the question that animates a very large part of the theoretical literature on EU integration. EU integration and the Euro-zone crisis are closely connected as the latter fully affects the first.

[4] Nugent N., Government and Politics of the European Union,p 476

CHAPTER I

EMU and its actions against the Greek crisis

Crisis management in the Euro area

Prior to the Greek crisis, the EU as a whole had had a mixed record in responding to the banking crisis after the collapse of Lehman Brothers on 14 September 2008. Moreover, the Maastricht Treaty had not provided for exceptional crisis management. While the Euro system assumed the success of preventive rules, it was not so equipped to deal with a crisis like that of 2010, lacking the capacity for speedy reaction, policy discretion and centralized action[5]. These attributes were amazingly absent in the response to the Greek crisis. Indeed, the dilemmas faced by German Chancellor Angela Merkel's government amply attest to the domestic constraints posed on EU-level bargaining stressed by the 'liberal intergovernmentalist' conceptual framework.[6] The public reaction in Germany to the Greek crisis was wild and hostile. The press was vociferous in its condemnation. Merkel faced a difficult election in North-Rhine Westfalia on 9 May 2010, just prior to the point when Greece faced the refinancing of its debt, and this was widely seen as encouraging her to delay any bail-out. More generally, the German Constitutional Court in its adjudication of the Maastricht Treaty had emphasized that the transfer of sovereignty was justified as long as the new euro currency was couched in a regime of monetary stability. Rescuing Greece out of its fiscal problems threatened such principles and risked a domestic legal challenge. On the other hand, many observers commented that Merkel was a different kind of German chancellor, more confident in protecting her national interests.[7]

Equally, however, Merkel displayed a consistency of view with the 'narrow' German stance at Maastricht – a stance that Kohl had himself reached beyond. The EMU agreement bequeathed a German ordo-liberal emphasis on each government applying

[5] Pisani-Ferry and Sapir, Banking Crisis Management in the EU: An Interim Assessment, Working Paper 2009, p.5
[6] Journal of European Public Policy 6:1 March 1999: Review section symposium: The choice for Europe: Social purpose and state power from Messina to Maastricht, Andrew Moravcsik, p.175
[7] Kevin Featherstone: The Greek Sovereign Crisis and EMU: a failing state in a skewed regime, London School of Economics, Journal of Commo markets, June 2011, p.9

tough rules of 'sound finances'. The insistence on there being no 'bail-out' of states with excessive deficits was fundamental to the German negotiators at Maastricht and had been accepted quite readily by its partners.[8] There was an imbalance of rules and instruments: whilst Article 104 (now 125) provided that there would be no bail-out of states in fiscal difficulty and for an 'excessive deficit procedure', on the other hand, it gave no legal basis for the expulsion of an errant state, provided nothing beyond 'broad policy guidelines' in the way of policy co-ordination and offered no further instruments to deal with the 'moral hazard' issues of states not following the rules. The fiscal rules were soon attacked as unenforceable without prior political integration,[9] but the imbalance was a political compromise that would remain. The logic was of stability increasing the credibility of the arrangements.

Consistent with uncertainty, when faced with Greek crisis, the Euro governments and the ECB displayed slowness and division. Ecofin's first response was that Greece should sort itself out. It required Greece (under Article 126(9)) to cut its deficit and correct its divergences, thereby 'removing the risk of jeopardizing the proper functioning of EMU' (Council of the European Union, 2010), turning a 'deaf ear' to calls for a rescue plan.[10] On 9 March, the Commission then assessed Greece as abiding by the Council's instructions (Commission, 2010a), but it was clear that Greece was losing its position in the markets. It was not until 26 March 2010 that the euro area leaders, meeting at the European Council, agreed the principles of a rescue deal for Greece (based on funding being shared between the International Monetary Fund (IMF), contributing one third, and EU states two-thirds).

However, this would only be available to Greece if all states agreed it and if all other options had been clearly exhausted. Greece's progress would then be subject to quarterly monitoring. One month later (23 April), the Greek premier, George Papandreou, faced with severe market pressure, announced that Greece needed the bail-out deal to be activated. After a certain and risky delay, the euro area finance ministers did instigate the €110 billion loan to Greece with its strict conditions on 2 May. Paradoxically, however, by trying to stay out of a rescue, EU governments had

[8] Dyson and Featherstone: The Road to Maastricht, Negotiating Economic and Monetary Union, Oxford University Press, 1999, p. 382
[9] Buiter et al., 1993, pp. 58, 90
[10] http://www.ft.com/intl/cms/s/0/190b32ae-d49a-11df-b230-00144feabdc0.html#axzz3kNiB6cBs

been dragged more deeply into it. The German government was obliged to accept the choice of bailing out Greece or bailing out its own banking system. Some €80 billion of loans (via the EU Commission) were underwritten by Germany (a 27.9 per cent share), France (21.0 per cent), Italy (18.4 per cent) and other euro area governments (BNP Paribas, 2010).

EMU governance had become less predictable. The 'no bailout' rule had been circumvented: as De Grauwe (2010) had argued, it did not prevent Member States volunteering help[11] and this could be covered by the 'emergency' clauses in the Treaty referring to the impact of natural disasters and 'exceptional occurrences' (Article 100 92). Moreover, despite the concern of much of the literature as to the excessive independence of the ECB (posing questions of accountability and worsening the EU's democratic deficit)[12], in the event its leadership intervened in the markets to buy the government bonds that no one else wanted. ECB acted to increase liquidity in the banking system by easing the standards it applied to loans for asset-backed securities. The ECB's actions created a sense of uncertainty as to how it might react in the future.[13] Moreover, the recourse to the IMF also created doubts about the governance of the Euro system.

The lack of solidarity among EMU member states

The Greek crisis has shown at least up to a certain point a lack of solidarity among EU member states. The important question is what we mean by solidarity. In general terms we can define solidarity as the willingness to help other members and in particular providing financial support for governments in trouble, without any 'clear' return.

However solidarity can mean a variety of things, from the implementation of the monetary union to the macroeconomic stability. The Greek crisis has in fact shown an unwillingness to pay a single Euro in rescuing other countries, which particularly

[11] Paul De Grauwe, The Financial Crisis and the Future of the Euro-zone, Department of European Economics Studies, 2010
[12] Dyson and Featherstone: The Road to Maastricht, Negotiating Economic and Monetary Union, Oxford University Press, 1999
[13] AMY VERDUN, Economic Developments in the EU, JCMS, 2009

expressed by the German people towards Greece[14]. More than a denial of solidarity, these attitudes suggest a surfacing new concept of solidarity which is blended with that of perceived proximity or similarity among EMU member States from the economic, political, structural and religious point of view.

In other words if we analyze the Greek crisis as previously described it seems that a restricted definition of solidarity looks like to prevail in the EMU: the willingness to help applies on countries which perceive themselves economically, politically and culturally close to each other. But isn't that the way the world is operating so many years? Did someone actually believed that Germany, France or even the USA with their interventions from time to time, would help Greece either financial or either politically without any return? The last months Euro zone is full of Euro groups where someone could clearly see the different alliances which formed in the Euro zone. On one hand there were the North countries, which consider themselves strongly economically independent and on the other hand the periphery countries which are in strong need of financial help and structural reforms. The common citizen of the European Union suddenly realized that this is not the EU of solidarity and democracy where the vote of a 'small' country is equally important as the vote of a 'big' country.

All that leads to a perception that the Union is 'owned' by the strong economically countries. Moreover, this restricted solidarity can be shored up by the need to maintain macroeconomic stability and prevent any opportunistic behavior.

Thus, if the member state in trouble is not a member of the club of the strong economically countries like the 'poor' and less competitive Greece, the rescue problem could be in jeopardy by one or more countries of the club which claim they are acting with the sole goal of the Union's stability. As a result the problem can be overcomed only by the political will of the leaders in the Euro-zone as happened in the European Council in 2010 or in the Euro groups of 2015.

The Failures of the Legal Framework

First, and most significantly, the EMU's biggest problem was in the reality that the European Union had not prepared for the possibility of a sovereign debt crisis. This is

[14] it is confirmed by the Financial Times/Harris poll, according to which Germans are more hostile the other Europeans(Financial Times,22 March 2010:1)

exemplified through the Maastricht Treaty, whereby government bailouts are specifically prohibited.[15] In addition, the Lisbon Treaty of 2007 had further provided a "no-bailout" clause, which stated that "the Union shall not be liable for or assume the commitments of central governments."[16] As a result, in order "to allow the Greek bailout, the 'no-bailout' clause was overruled and the Lisbon Treaty's 'exceptional occurrences' clause was used instead."[17] Under the exceptional occurrences clause, "where a member state is in difficulties or is seriously threatened with difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, union financial assistance to the member state."[18] Second, when the ECB issues bonds, they are typically structured to be governed by local laws, rather than one supranational law. Therefore, when Greece was forced to take drastic measures to reduce its deficit in February 2012, it made the decision to change its laws so as to permit the Greek government to impose a loss of as much as "75% on all investors who owned bonds governed by Greek law."[19]

The implications of Greece's drastic move are far reaching as it now poses the risk that other struggling countries might do the same. For instance, "more than 97% of the outstanding bonds of Spain, Italy, Portugal, and Belgium are governed by local law. In theory, these countries could enact legislation similar to Greece's and thus pass on the cost of reducing their debt to well-heeled bondholders, rather than to retirees and civil servants."[20]

Third, the SGP has been breached so many times with little or no repercussions, Member States may refuse to recognize its legal personality. Although the SGP has been reformed twice to impose stricter sanctions for breaking the rules, its credibility has nevertheless been diminished and its future is uncertain. Although each of these failures played a significant role in causing the Greek Debt Crisis, and the subsequent

[15] Stephen Clarke & Claire Daley, The Euro zone Crisis 4, http://www.civitas.org.uk/eufacts/download/TheEurozoneCrisis (Oct2010).pdf
[16] Lisbon Treaty of 2007, Art. 125; see also Clarke supra n. 121, at 4.
[17] Clarke, supra n. 121 at 4.
[18] Lisbon Treaty, Art. 122.
[19] Thomas, supra n. 64.
[20] Thomas, supra n. 64.

European Debt Crisis, the European Union has worked to develop new measures to correct and prevent them from reoccurring.

New Measures

To combat the contagion from spreading any further into Europe, the European Union responded to the crisis with a series of new measures. The most significant of these measures included:

- reforming the SGP.
- establishing the European Financial Stability Facility (EFSF),
- creating such institutions as the European Systemic Risk Board (ESRB) and
- the European System of Financial Supervisors and
- formulating the Basel III Agreement.[21]

Reforming the SGP

After the SGP took effect, many of the Member States had difficulty following its rules. When it was breached in 2003 by both France and Germany, the largest economies in the Euro-zone, the Commission did not take any significant action against them, which thus made the SGP look weak.[22] For this reason, the SGP was suspended and later reformed in 2005 to allow more flexibility. Nevertheless, the SGP was again challenged in 2007 when France "looked to revitalize the French economy outside the SGP framework."[23] As the economy started to sour toward the end of the decade, the SGP became more susceptible to breach. "In 2009 alone, 14 Euro-zone states breached EU rules limiting public debt and annual budget deficits . . . ."[24] As it has been widely recognized, the SGP did not accomplish its goal and thereby "contribute to fiscal policies consistent with membership of a single currency."[25] Moreover, "peer pressure to correct imbalances was largely absent."[26] As such, the

[21] Clarke, supra n. 121 at 6.
[22] Civitas, EU Facts: Stability and Growth Pact, www.civitas.org.uk/eufacts/FSECON/EC10.htm (last updated Apr. 12, 2012).
[23] Id
[24] Clarke, supra n. 121, at 2.
[25] European Central Bank, ECB: Economic governance and financial stability, http://www.ecb.europa.eu/press/key/date/2011/html/sp111013_1.en.html (Oct. 13, 2011).
[26] Id

2011 reforms to the SGP have sought to tighten control, making it difficult for Member States who breach the rules of the SGP to avoid financial sanctions.

The European Financial Stability Facility

In May 2010, in response to the growing concern as to the instability of the euro, the 16 Member States that make up the Euro-zone set up the EFSF, a Euro-zone-wide fund. The EFSF was meant to "remove the fear that weak Euro-zone states wouldn't be able to repay their debt."[27] As such, the money raised can only be lent to Euro-zone member states. The EFSF raises funds by selling bonds to investors guaranteed by euro-area members. "If a country does draw funds from the EFSF, the IMF will begin an investigation and the country will no longer have an obligation to contribute to the facility."[28] Overall, the EFSF acts as a safety net for the 16 Euro-zone states.[29]

The Basel III Agreement

To prevent another global financial crisis, in September 2010 the Bank for International Settlement agreed to impose new, stricter rules on banks. The new rules (known as the Basel III Agreement) aim to prevent banks from incurring major losses in financially hard times. To accomplish this goal, all banks will be required to increase their capital ratio from 2% to 7%. This way, during a financially difficult time banks may reduce their capital ratio to 4.5%. However, should a bank choose to make this reduction, it will be forced to restrict the bonuses and dividends it pays out until it returns to the regular 7%. Banks will have until 2019 to fully implement the Basel III Agreement. That being said, the Basel III Agreement only sets the minimum standard that all banks are required to comply with. Should a national government choose to set a higher standard, it will be permitted to do so.

In order to understand better the Greek crisis it is equally important to examine its causes, before we get to see the role of the institutions such as the IMF and the ECB but also some other key players such as Germany and France.

[27] Clarke, supra n. 121, at 5.
[28] Clarke, supra n. 121, at 5.
[29] At the time when Clarke wrote his article the Euro-zone states were 16

CHAPTER II

The causes of the Greek crisis

As De Grauwe claims, 'the crisis in Greece can be summarized in just a few sentences. Mismanagement and deception by the Greek authorities made the crisis possible'.[30] Moreover, the causes of the Greek crisis can be identified in brief as the following:

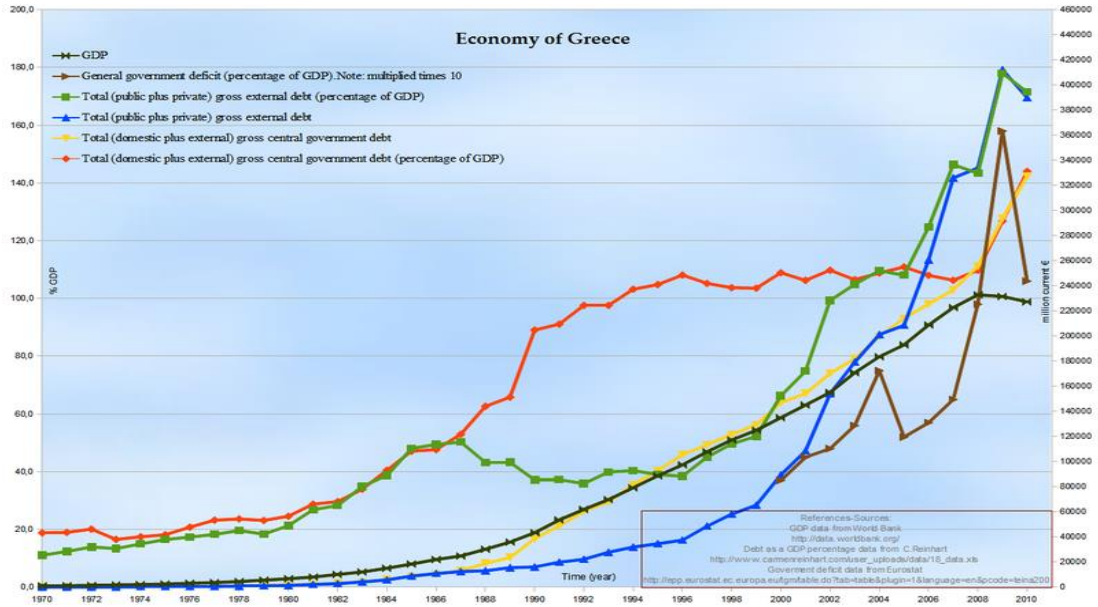
1) The dramatic financial situation in Greece, which has been hidden for years
2) A chained reaction to the international financial crisis which erupted in 2007
3) The economic imbalances among EU member states

The hidden debt levels

The European statistics agency, Euro-stat, sent 10 delegations to Athens with a view to improving the reliability of statistical figures related to the Greek national account, but apparently to no avail. In January 2010, it issued a damning report which contained accusations of falsified data and political interference.[31]

In February 2010, the new government of George Papandreou(elected in October 2009), admitted a flawed statistical procedure previously had existed, before the new government had been elected, and revised the 2009 deficit from a previously estimated 6%-8% to an alarming 12.7% of GDP. In April 2010, the deficit increased to almost 14% and at the time of the final revised calculation by Euro-stat's standardized method had been performed, it ended at 15.7% of GDP, which proved to be the highest deficit for any EU country in 2009.

[30] Paul De Grauwe, Crisis in the Euro-zone and how to deal with it, 2010, p.1
[31] http://ec.europa.eu/eurostat/help/new-eurostat-website



A former employee at the Greek statistics office subsequently argued in January 2013, that it caused "incorrect results" to use the same standardized Euro-stat methodology, as all other EU member states currently use.[32] We can already see at that time that the deficit would be too huge to be maintained to sustainable levels. The last forty years in Greece have been a catalyst in the worsening of the financial situation and the 2010 was the period of realizing that the 'party' of all those years has come to a closure.

The 2007 international financial crisis

The international banking crisis of 2008 is closely linked to the Greek sovereign debt crisis. The specifics of the banking crisis are different in different countries but Stan Maes, a member of the Chief Economist Team of the Directorate General Competition, writes:

"In light of the heavy regulation that applies to banks and their role in the monetary system, the main causes of the crisis indeed seem to be monetary policy, flaws in the regulatory design... and inadequate supervision".[33]

The financial crisis was particularly important in Greece because of the country's uncompetitive economy, administrative weaknesses, and rampant tax evasion in key

[32] http://www.ekathimerini.com/4dcgi/_w_articles_wsite1_1_22/01/2013_479717
[33] Maes & Kiljanski, Competition and the financial markets: Financial sector conditions and competition policy, 2009, p.13

sectors. When the international credit crisis spread in 2008-2009, Greece's "record of low reform capacity was matched by inherited economic weaknesses that made Greece very vulnerable. Thus, the Greek economy has lacked competitiveness and sustained significant current account deficits in foreign trade and commerce".[34] When the Greek government subsequently became incapable of paying back their debts, "lower than anticipated returns on the Greek project gradually reduced the price of Greek bonds, with losses accelerating significantly in the wake of the global credit crunch".[35] In the wake of the credit crisis, however, the Greek government took no corrective action, perhaps in anticipation of the upcoming Greek elections. In other words, the Greek government acted irresponsibly with its fiscal policy and debt accumulation, the consequences of which were accelerated by economic weaknesses that became apparent during the global credit crisis.

The imbalances among EU members

The role of external imbalances is a big issue among EU member states and especially for Greece. In countries like Greece, account deficits turned into external liabilities and high public debts.[36] External liabilities have characterized Euro-zone for a long period of time, but on the other hand some countries managed to gain profit of this, countries like Germany. Germany has a long current account surplus, while most of the other countries of the Euro-zone report large deficits, and that is due to the fact that Germany has high percentages of productivity and competitiveness.

With that being said we can see that Germany is among the few countries which can exploit their competitiveness and the huge deficits of the other countries, especially the South ones, and can gain from this macroeconomic situation in EMU. The question here is this: Can someone really blame Germany for using its competitiveness to gain profit this particularly difficult period in Europe? In my opinion we cannot blame Germany for everything and especially for the fact that, in Greece we import the majority of our products. In the end we were never the country that was highly competitive. The point here is that we can blame Germany for using

[34] Kevin Featherstone, The JMCS Annual Lecture: The Greek sovereign debt crisis and EMU, A failing State in a Skewed Regime, 2009, p.198
[35] Arghyrou & Tsoukalas, The Greek debt crisis: likely causes, mechanics and outcomes, 2011, p.180
[36] Pompeo Della Posta & Leila Simona Tallani, Europe and the Financial crisis, 2011, p.146

‘blackmails’ and its highly economic independence to undermine and make policies for countries that are in need of the country’s co-operation. No one can blame the countries who have their economic and political situation in place and can perform well even in financial crisis periods. But these imbalances among these countries are something that undermines the future of the Euro-zone and the European Union as a whole.

CHAPTER III

The role of external constraints regarding the Greek crisis/key players

In this chapter we are going to see more about the roles of the two key players in the Greek crisis, the International Monetary Fund and the European Central Bank. Alongside with the European Commission, these institutions are called Troika and contributed the maximum to change the financial situation in Greece(either in a bad way or a good way). There are many parameters of the policies which were implemented throughout these eight years such as the economic one, the political one and others like social and humanitarian parameters, which many could argue that worsened the economic situation. In this essay we are going to focus more in the economic and political parameters of the role of these institutions and moreover the role of other key countries such as Germany and France.

The role of IMF in the Greek debt crisis

Right from the beginning, the International Monetary Fund (IMF) was involved in the rescue actions of the European Union (EU) to fight the sovereign debt crisis that emerged end of 2009 in several European Monetary Union (EMU) countries. The IMF participated in the financial assistance and economic adjustment programs for Greece, Ireland and Portugal by contributing around one third to the emergency funds. In a "Troika", together with the European Commission (EC) and the European Central Bank (ECB), the IMF elaborated the economic adjustment programs for these economies and closely monitored their progress through quarterly reviews based on economic missions.

The active role of the IMF raises a series of questions: (1) Why did the IMF participate in the rescue programs in Greece? Was it a sign of weakness of the European institutions to solve their problems alone and/or did the Europeans want to use the outstanding expertise of the IMF in elaborating and monitoring economic adjustment programs with conditionality? (2) What are the pros and cons of taking the IMF on board? (3) Has the IMF even worsened the Greek crisis? These questions are discussed in the following essay whereby the analysis concentrates on the IMF's role

in the monitoring of Greece in crisis. The IMF and prominent representatives of the IMF have also made a lot of proposals and were involved in many discussions on other measures to fight the sovereign debt crisis and prevent future crisis within the Euro-zone.

Firstly we should make clear of, what the IMF is and which are its responsibilities in order to understand its role in the Euro-zone crisis and more specifically its role in the Greek debt crisis. Its responsibilities and actions are widely known in the global governments and that is something that seemed not so well known in the Greek government back in 2009 or it seemed like that.

> *The International Monetary Fund (IMF) promotes international financial stability and monetary cooperation. It also seeks to facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. Created in 1945, the IMF is governed by and accountable to the 188 countries that make up its near-global membership.* **The IMF's responsibilities:** The IMF's primary purpose is: to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The Fund's mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability.[37]

In October 2008, shortly after the beginning of the worldwide financial/banking crisis, Hungary requested a Stand-By Arrangement (SBA) from the IMF. The Hungarian program set a milestone as it was the first joint EU/IMF-program, a precedent for programs that followed. In collaboration with the IMF the EU developed internal guidelines for the implementation of future joint programs with the IMF based on the lessons of the Hungarian program. Such programs should use the comparative expertise of both organizations, whereby the IMF draws on its extensive cross-country and financial crisis expertise and the EU helps to embed the financial assistance programs in a broader policy context set by the different institutional framework in the EU compared to other regions of the world.

[37] http://www.imf.org/external/np/exr/facts/glance.htm

In October 2009, the newly elected Greek government raised its projections for the 2009 budget deficit from 3.7 % to 12.5% of GDP.[38] In the following months Greek's budget problems grew further – despite national reform measures and EU reactions in form of a closer monitoring.[39] Financial markets reacted heavily fearing a Greek default. Rating agencies cut Greek's rating from (A-) in early December 2009 to junk bond status end of April 2010 and Greek bond rate spreads widened dramatically in spring 2010.[40] Several other EMU countries (Portugal, Ireland, Spain and Italy) also got in trouble as their fiscal deficits grew and sovereign debt refinancing costs rose dramatically. On April 11, 2010, the EU joined by the IMF announced financial support for Greece and an economic adjustment program.[41] The increasing interest rate burden of several Euro area economies and the fear of a collapse of European banks that had not fully recovered from the 2008/2009 financial markets and economic crises prompted a collective reaction of the EU and the IMF.

The pros and cons of IMF involvement

In what follows, we will discuss the pros and cons, as well what motivated the IMF to 'intervene' in the debt problems of Greece. This discussion has to be assessed against the background of the official tasks of the IMF, laid down in the Bretton Woods Articles of Agreement, which are in addition to its important consultative and surveillance functions, especially providing resources to member countries experiencing temporary balance of payments problems under strict conditionality.[42] An IMF supported program is typically initiated when a country faces the need for external adjustment. The IMF provides (co-)financing and the country puts in place a program of policies to redress actual or potential external imbalances. Continued lending depends on progress in implementing the program, which in turn is assessed on the basis of preset conditions (performance criteria) to be met by specified dates in

[38] EEAG, "The EEAG Report on the European Economy, Governing Europe," Munich, 2011, p. 111. Finally, the deficit happened to be 15.4 % of GDP.
[39] Council of the European Union, "Council gives notice to Greece to correct its government deficit by 2012,
setting out a timetable for corrective measures," Press notice, Brussels, February 16, 2010.
[40] EEAG, "The EEAG Report," op. cit., p. 111. End of April 2010, 10-year Greek bond spreads over German bonds reached 755 basis points.
[41] IMF, "Statement by IMF Managing Director Dominique Strauss-Kahn on Greece," Press Release No. 10/143, April 11, 2010.
[42] Bordo, Michael D.; James, Harold, "The past and future of IMF reform – a proposal," in: Charles Wyplosz (ed.), The new international monetary system, London et al., Routledge, pp. 9f.

the context of periodic reviews.[43] This raises the need to adapt programs designed to change the country's economic conditions while preserving uniformity of treatment.

To qualify the role of the IMF in the Greek debt crisis the mere size of the financial contributions of the IMF have to be taken into account, too. In the past, the typical loan to quota ratio averaged 300 %, reaching an exceptional high of about 2,000 % for South Korea in the late 1990s during the Asian crisis. In comparison, the first IMF loan to Greece was equivalent to 3,200 % of Greece's quota.[44] At the end of 2011, the biggest debtors to the IMF were Greece, Ireland and Portugal. A worsening of the fiscal problems in Italy and Spain and emergency lending to these countries would clearly overburden the IMF.

The pros

Independence, credibility and reputation

At the beginning of the Greek crisis, the official EU opinion was to try to solve the problem within the EU or even within the euro area, but without external help. Asking for external help was seen as a sign of weakness of EU institutions. In effect, especially IMF intervention was opposed by the ECB. Early in March 2010, Trichet, the then President of the ECB, denied the need for IMF help and referred to the balance of payments financing mechanisms and the deficit rules of the Stability and Growth Pact.[45] At last, IMF involvement was a precondition for German chancellor Merkel to agree to financial assistance for Greece.[46] It was interpreted as the last exit option as all other opportunities had been exhausted. The principal problem that prevented a “European solution” was that the prescriptions of the EU Treaty were insufficient or not followed and that the EU Commission had no credibility and experience in handling severe national fiscal problems. The joint EU and IMF rescue

[43] Jeanne, Olivier; Ostry, Jonathan D.; Zettelmeyer, Jeromin, “A theory of international crisis lending and IMFconditionality,” IMF Working Paper 08/236, Washington D.C.

[44] IMF, “IMF reaches staff-level agreement with Greece on € 30 billion Stand-By Arrangement,” Press Release No. 10/176, May 2, 2010. Ireland's and Portugal's loans from the IMF amounted to 2,400 % and 2,300 % of their quotas,respectively.

[45] Confronted with a question if Greece should knock on the IMFs door he answered: “I do not want to enter into some kind of fantasy scenario. Let me just say that belonging to the euro area is something which helps you considerably. When you are in the euro area, you have a kind of automatic financing of your current account. And when you have a current account deficit, as has been the case for Greece for a long period of time, you get the financing of your current account deficit, because the other economies of the euro area take care of that.”

[46] Spiegel Online, “Top Banker attackiert Merkel,” 23. March 2010, available at: http://www.spiegel.de/wirtschaft/soziales/0,1518,685443,00.html.

actions during the EMU and the Greek debt crisis were political decisions under enormous pressure from financial markets. The IMF was ready to participate in the rescue actions, but the EU leaders alone announced financial help and economic adjustment programs with IMF participation, starting with the first Greek program in May 2010. The IMF Executive Board that ultimately has to decide about financial assistance programs and conditionality could only follow and approve the general decisions that were made by the heads of governments of the EU.

The US government also urged the IMF to fight against the crisis mainly by pumping additional funds into the endangered countries as they feared that the crisis could spread to the US.[47] Political reasons could also have played a role. The US has an interest to stabilize Greece, a NATO member which has an important geopolitical spot that hosts US military bases. In the past, the US never denied help to a country with a US military base.[48] The strong political will of the EU and the United States to bail-out Greece put the IMF under pressure. In the IMF Executive Board the EU countries (around 32 %) and the US (16.75 %) together have the majority of voting power and dominate IMF decisions. Together with the regional identity of the managing directors this facilitated EU-IMF cooperation.[49]

But there was also an economic rationale behind the decision to take the IMF in the boat. The IMF is an international organization with now 188 member countries. It has experience for more than 60 years of lending money and encouraging reforms to help countries with balance-of-payments problems and in financial crises. In this respect, the IMF has built up reputation and expertise. It is also evident that the IMF functions as a kind of external scapegoat for the countries under reform pressure.[50] The actual

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[47] several statements by President Obama on this issue, e.g. US News, "Obama directs EU to act on debt,"
November 29, 2011.

[48] Hale, “A mutual satisfactory solution for Iceland and Obama,” Financial Times, February 2010; Gros, Daniel; Mayer, Thomas, “How to deal with the threat of sovereign default in Europe – Towards a Euro(pean) Monetary Fund,” *CEPS Policy Brief* No. 202, February 2010, p. 1.

[49] Henning, C. Randall, “Coordinating regional and multilateral financial institutions,” Peterson Institute for International Economics, Working Paper Series WP 11-9, March 2011, available at: http://www.iie.com/publications/wp/wp11-9.pdf, p. 12.

[50] Nelson, Rebecca M.; Nanto, Dick K.; Sanford, Jonathan E.; Weiss, Martin A, “Frequently asked questions about IMF involvement in the Euro zone,” in: Farkas, Hannah J.; Murphy, Daniel C. (eds.), The Euro zone: Testing the monetary union, New York, NY: Nova Science Publishers (Global economic studies), pp., 43ff.

realized historical default rate of IMF lending is nearly zero.[51] IMF lending to emerging market countries has always been repaid.[52] As an international organization, the IMF enjoys a preferred creditor status in that IMF loans to Greece will be repaid prior to all other creditors. Whereas it seems that in the first place the IMF was driven and marginalized to a certain extent by political decisions in Europe to grant financial assistance, it had a leading role in elaborating and negotiating the details of the economic adjustment programs. The programs bear the signature of the IMF as the countries have to undergo strict fiscal adjustment processes and to improve their international competitiveness.

European institutions have lost reputation and credibility to solve effectively problems like the sovereign debt crisis mainly due to their inability to enforce EU member countries to reduce their budget deficits and to their failure to force EMU members to comply with the rules of the European Stability and Growth Pact.[53] As we have seen during the crisis since mid-2010, even the independence of the ECB, which is independent by law, is in doubt. In this direction the advantage of having the IMF on board is that the IMF can stronger resist partial political influence than regional institutions and is therefore able to enforce tougher programs.[54] Cooperation and involvement of the IMF should give additional impetus for the necessary reform process in the countries under concern. As the negotiations on the rescue packages used to be hard and time-consuming, IMF participation also helped to agree more easily and quicker on the terms and conditions of the programs. In a globalized and integrated world with spillover effects and contagion risks, the involvement of a multilateral organization like the IMF seems also to be necessary to agree and stipulate macroeconomic policies that are not only in the interest of a single country, but also in global interest. It is not likely that an ad hoc coordination between debtor

[51] Rogoff, Kenneth, "Moral hazard in IMF loans – how big a concern?," Finance and Development, Vol. 39, No. 3, September 2002
[52] Jeanne, Olivier; Ostry, Jonathan D.; Zettelmeyer, Jeromin, "A Theory", op. cit., p. 4. IMF lending for poor countries involved debt relief.
[53] Professor Dr. France Seitz, Professor Dr. Thomas Jost, The role of IMF in the European debt crisis, Discussion Paper No.32, Januar 2012.
[54] Henning, C. Randall, "Coordinating," op. cit., p. 26

and donor countries will lead to an agreement on a common set of policy rules, nor is it probable that peer pressure alone will convince countries to cooperate.[55]

Moral hazard and conditionality

Financial support for countries in crisis always raises moral hazard problems. In the Greek debt crisis moral hazard is even stronger than in all crises in emerging markets of the last two decades. The heads of Governments of France and Germany, the politically and economically strongest EMU members, have endlessly repeated that a default and an exit of a country from the Euro-zone must and will be prevented. The German chancellor Merkel permanently declared - to a skeptical public at home - that "Europe will fail if the Euro fails".[56] The necessary financial resources to finance the sovereign debt of the member countries that were not able to finance themselves on the market or only to interest rates that were felt too high were provided by the European Union and its member states added by a potentially unlimited support by the ECB through outright purchases of sovereign bonds.

Even as unlimited financial support of France and Germany got into doubt after the then Greek Prime Minister Papandreou (in October 2011) announced a referendum in Greece and the leverage of the EFSF did not work as it was originally planned, the countries in crisis could be confident that their European partners would do everything to save them. Such a situation is especially prone to serious moral hazard. The only way to reduce it in the case of a massive bail-out is strong and credible conditionality as the IMF programs are intended to be. The disbursement of each tranche of the IMF loans and EU financial packages depends on the fulfillment of agreed reform steps approved by the Troika of IMF, European Commission (EC) and ECB officials. Additionally, there is also a high stigma attached to asking the IMF for financial support. In the Greek debt crisis it is hard to imagine that the EC alone had been able to combine financial help with convincing conditionality. In the past, many countries that were in a program as well as the public often accused the IMF for tough measures and strong conditionality. But, the macroeconomic, financial and budgetary

[55] Rajan, Raghuram, "Can soft power help the IMF make the world more stable?," Review of World Economics, Vol. 147, 2011, p. 1.
[56] Deutscher Bundestag, "Entschließung zum EU- und Euro-Gipfel verabschiedet," 26.10.2011, available at: www.bundestag.de/dokumente/textarchiv/2011/36282875_kw43_de_regierungserklaerung/index.html

conditionality of the programs makes sense.[57] Often, the IMF was successful with its programs because they were targeted to fight the causes of the crisis and enforced necessary economic reforms. On the other hand, Gros and Mayer (2010), critics of an IMF involvement in the EMU debt crisis, argue that the IMF cannot enforce a program as it cannot punish a country except by withholding the next tranche of the financial rescue package.[58] In their opinion, the EU could urge more pressure as it could stop funding from various other EU transfer mechanisms, like the structural funds, and as the ECB could stop to accept sovereign bonds of the respective country in their monetary policy operations. The IMF programs, rumored to be harsh, have been implemented in Greece for the last 5 years. The economy has not changed in a better way neither the macroeconomic suggestions are good enough. At one point in 2012 an IMF official negotiating Greek austerity measures, admitted the so-far implemented measures were harming Greece in the short term, and cautioned that although further spending cuts were certainly still needed, it was important the fiscal consolidation was not implemented with an excessive pace, as time should now also be given for the implemented economic reforms to start to work.[59]

Finally, IMF involvement in trying to solve national fiscal crises acts as an insurance mechanism supplementing the EFSF, EFSM and other funds. The risks that are caused by the crises are shared by all the member states of the IMF and not only the EU. This is something that few countries consider to think unfair as we saw many times, expressing, through their governments, that this bail-outs are not the solution in a country that does not want to change.(Greece)

The cons

The tasks of the IMF

The IMF's main goal is to ensure the stability of the international monetary and financial system. It helps resolve crises and works with its member countries to achieve its goal. It has three main tools at its disposal to carry out its mandate:

[57] Bordo/James, "The past," op. cit., p. 10. Conditionality and tough policy prescriptions were often criticized. Stiglitz was one of the most prominent critics of the IMF's role in the Indonesian crisis. See Beaufort Wijnholds, Onno de, "Fighting financial fires - An IMF insider account," Basingstoke, Hampshire: Palgrave Macmillan, 2011, pp. 45 ff.
[58] Gros, Daniel; Mayer, Thomas, "How to deal," op. cit.
[59] http://www.theguardian.com/business/2012/feb/01/imf-austerity-harming-greeve

surveillance, technical assistance and training, and lending. Bilateral surveillance on a regular basis consists of conducting in depth appraisals of each member country's economic situation. The main focus is whether there are risks to the country's domestic and external stability that would argue for adjustments in policies. IMF's technical assistance helps member countries strengthen their capacity to design and implement effective policies. It is offered in several areas, including fiscal policy, monetary and exchange rate policies, banking and financial system supervision and regulation. In the event that member countries experience difficulties in financing their balance of payments, the IMF is also a fund that can be tapped to facilitate recovery. A policy program supported by financing is designed by the national authorities in close cooperation with the IMF. Continued financial support is conditional on the effective implementation of this program. A decisive factor is the design of the Fund as a "monetary fund", which defines its unique character as a cooperative and monetary institution and sets it apart from other global institutions.[60]

Although Greece had large current account deficits before the outbreak of the crisis, the source of their problems was not a balance of payments disequilibrium which could not be financed due to a lack of foreign currency reserves.[61] Greece has deep structural problems together with weak governance and unsound fiscal balances. It may be argued that it is not the task of the IMF to finance national public debt in domestic currency. Moreover, the IMF does not have strong experience of how to solve such debt crises. To cite Deutsche Bundesbank: "In line with its mandate, it may use the provided foreign reserves only to help overcome short-term balance of payments difficulties and thus cover a temporary need for foreign currency. By contrast, any financial contribution by the Fund to solve structural problems that do not imply a need for foreign currency – such as the direct financing of budget deficits

[60] Deutsche Bundesbank, "Financing and representation in the International Monetary Fund," *Monthly Bulletin*, March 2010, p. 60.

[61] Buiter and Rahbari argue that Greece clearly has a balance-of-payments problem interpreted in a broader sense. Its low private and public sector saving rates have resulted in persistent external current account deficits, which have cumulated into a large negative net external investment position. And the IMF is ideally set up to address precisely these kinds of difficult conditions. Buiter, Willem; Rahbari, Ebrahim, "Greece and the fiscal crisis in the EMU," Centre for Economic Policy Research, *Policy Insight* No. 51, October 2010.

or financing of a bank recapitalization – would be incompatible with its monetary mandate."[62]

Decision making and availability of funds

Greece's, program with the IMF is unusual for its relative magnitude. The IMF has general limits on the amount it will lend to a country which may be relaxed in "exceptional" circumstances. The 27 EU members together have a voting power in the Executive Board of the IMF of more than 32 %. In combination with the fact that the managing director of the IMF has always been a European, this explains why IMF involvement has been approved so quickly. Thus, EU-IMF cooperation was facilitated by the numerical dominance of EU countries in the Executive Board as well as the regional identity of the managing director.[63] If no additional and adequate funds can be raised by the IMF in the future, there will be less funds available to other countries, especially in Asia, Africa and the countries of the former CIS. But these are especially the countries for which the tasks of the IMF are more suited for. If bigger countries like Italy and Spain will get into trouble, this will overburden the IMF. In any case, the funds currently available to the IMF will not be enough.

Political economy arguments

During the Greek debt crisis there was a strong axis of political decision makers from France and Germany driving the rescue process. The influence of the French government also spread into the IMF as the former IMF managing director Strauss-Kahn as well as his successor Lagarde represented French positions. Such a political pressure could undermine the independence of the IMF as the IMF could be seen as a vicarious agent of European politicians in their crisis management. The unprecedented large financial rescue packages did not raise serious opposition of emerging and developing countries. These countries also had an interest in stabilizing Greece and EMU in general but it could cause trouble in the future if the joint mission will fail and IMF resources will get lost. In this case, the IMF would lose credibility like in the past when its policy failed in Argentina and Russia.[64] However, despite different and conflicting views on how to manage the Greek crisis, the EU countries - except the United Kingdom - always agreed on a common policy on their various EU

[62] Deutsche Bundesbank, 'Financing', op. cit., p. 61.
[63] Henning, C. Randall, "Coordinating,", op. cit., p. 12.
[64] Beaufort Wijnholds, Onno de, "Fighting financial fires," op. cit.

summits. Within the IMF there were different views about how to deal with the Greek and EMU debt crisis. In November 2011, Antonio Borges, the former Portuguese central banker and head of the IMF's European department which is responsible for the economic adjustment programs, resigned "for personal reasons". Before, Borges proposed that the IMF could directly buy sovereign bonds of Italy and Spain to take pressure from the market which promptly raised criticism as the IMF can only grant loans but not intervene directly in the markets.[65] Until the outbreak of the financial market crisis in 2007, a need for the IMF was more and more questioned.

The two last big crises - the global financial crisis which started in 2007 and the sovereign debt crisis in Europe since 2010 - have also enhanced the IMF's role in crisis management and given it a key place in current efforts to reform the world financial system. The IMF has regained and augmented its power (both politically and financially) as well as widened its tasks. But was it successful? The answer so far is no.

The involvement of IMF in the Greek crisis was unnecessary. It is true that its programs worked in favor of other countries. both fiscally, financially and politically but Greece had much larger problems than the financial ones. I am afraid that the IMF is the suitable institution to take on board in countries that have sustained only those financial damages, which can be fixed through harsh but simple fiscal reforms. Greece is suffering by years of political corruption and also it has experienced many scandals, lots of money has been stolen from the public cashiers and the most important of all: the system does not work properly. There is absence of political will for reforms, people were not ready for those sudden reforms and unequal cuts in their salaries and pensions and generally, Greece is a country, which I feel the IMF cannot help other than providing loans. To conclude was it really necessary for us Greeks to have the IMF on board? Couldn't we just do the reforms ourselves? This isn't the IMF's fault that the memorandums didn't succeed in Greece. This responsibility, in my opinion lies 99% with the previous Greek governments and subsequently all those people who passionately supported the political parties to survive in their jobs, or even get in jobs where they did not have the qualifications to be in. These are the ones

[65] FAZ, 'IWF wechselt Europa-Direktor aus', 17.11.2011

that neither IMF, ECB nor Commission programme can fix. The other 1% of responsibility can lie with the IMF in the case that the IMF as the prestigious institution that it is should have forecasted that big amounts of loans and harsh reforms could not work in Greece in the short term. We are now almost 8 years deep in the crisis and we can only see Greece going deeper and deeper in the recession. The IMF should admit at this point that its general strategy against the Greek debt crisis and its co-operation with the EU was hopeless and wrong.

The role of ECB

The European Central Bank (ECB) is one of the most important actors in the Financial Crisis and the sovereign debt crisis in the Euro-zone. The way, how the ECB was operating before the crisis was strictly based on the monetarist concept of central banking, reducing central banks to the guardian of consumer price inflation. Inflation of financial asset prices was ignored, not to speak of financial stability, growth and employment. This reflects basic faults in the design of the ECB, in particular its monetarist obsession with consumer price inflation. This section makes an assessment of the ECB's role in the Greek financial/debt crisis and identifies it as a player, which contributed with its monetarist approach even to a certain extent to crisis, especially through its participation in the so called Troika. After the ECB had recognized that there was a crisis, it served as lender of last resort with some biases toward the interests of the financial industry and started indirect government financing. Other could argue that ECB's role in the Greek debt crisis was exactly the one that needed to be and the main responsibility for the crisis lies with the structural weaknesses of the Greek political and financial system. Firstly it is important to fully understand how the ECB operates and which are its tasks and objectives.

ECB's tasks: The tasks of the European System of Central Banks (ESCB) and the Euro-system are laid down in the Treaty on the Functioning of the European Union. They are specified in the Statute of the European System of Central Banks and of the European Central Bank. The Statute is a protocol attached to the Treaty.

The Treaty on the Functioning of the European Union generally refers to the ESCB rather than to the Euro-system, since it was drawn up on the premise that all EU Member States would eventually adopt the euro. The Euro-system is made up of the

ECB and the national central banks (NCBs) of the EU Member States whose currency is the euro, whereas the ESCB comprises the ECB and the NCBs of all EU Member States (Article 282(1) of the Treaty). As long as there are EU Member States whose currency is not the euro, it will be necessary to make a distinction between the Euro-system and the ESCB.

Objectives: Article 127(1) of the Treaty defines the primary objective of the Euro-system: "The primary objective of the European System of Central Banks […] shall be to maintain price stability". It continues as follows: "Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union." The European Union has multiple objectives (Article 3 of the Treaty on European Union), which include the sustainable development of Europe based on balanced economic growth and price stability, and a highly competitive social market economy, aiming at full employment and social progress. Consequently, price stability is not only the primary objective of the ECB's monetary policy, but also an objective of the European Union as a whole. Thus, the Treaty on the Functioning of the European Union and the Treaty on European Union establish a clear hierarchy of objectives for the Euro-system, making it clear that price stability is the most important contribution that monetary policy can make to achieve a favorable economic environment and a high level of employment.

Basic tasks: According to Article 127(2) of the Treaty on the Functioning of the European Union, the basic tasks to be carried out through the Euro-system are:

- the definition and implementation of monetary policy for the euro area
- the conduct of foreign exchange operations
- the holding and management of the official foreign reserves of the euro area countries (portfolio management)
- the promotion of the smooth operation of payment systems

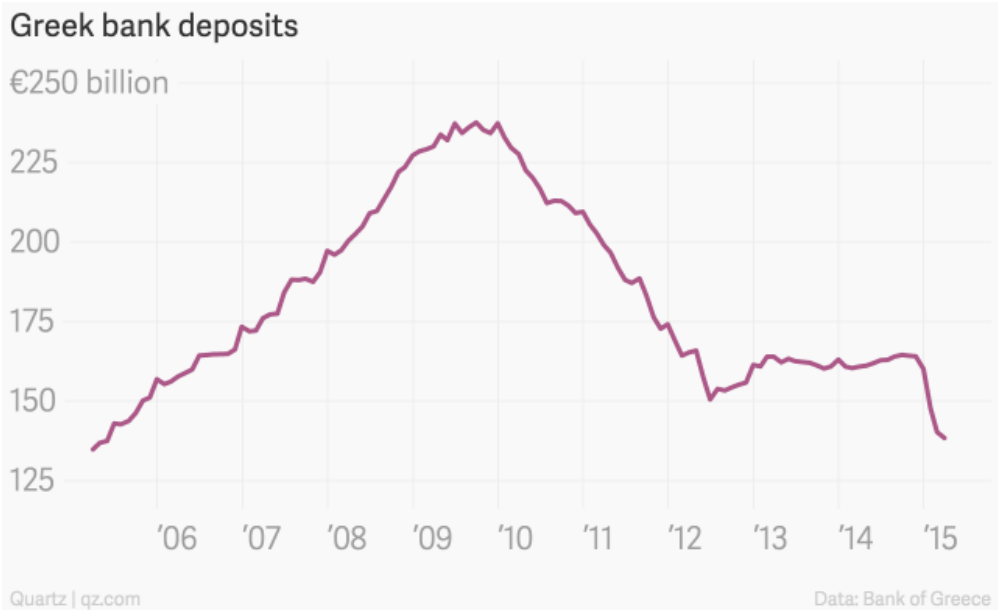
Further tasks:

- Banknotes: the ECB has the exclusive right to authorize the issuance of banknotes within the euro area.

- Statistics: in cooperation with the NCBs, the ECB collect statistical information necessary in order to fulfill the tasks of the ESCB, either from national authorities or directly from economic agents.
- Financial stability and supervision: the Euro-system contributes to the smooth conduct of policies by the competent authorities as regards the prudential supervision of credit institutions and the stability of the financial system.
- International and European co-operation: the ECB maintains working relations with relevant institutions, bodies, both within the EU and at the global level, in respect of the tasks entrusted to the Euro-system.[66]

For the past 5 years, the Greek economy undergoes a deep recession and although there are many official claims that strict austerity measures did not succeed there is a huge debate on the path the country should follow so that to exit out of this debt crisis. EU member states and IMF insist on further austerity measures as the country did not manage to properly restructure its economy and most of the support money ended up repaying the debt and not actually invested in the real economy. The current Greek government, elected in January 2015, had a strong anti-austerity approach but did not manage to convince the country's creditors ending up with an almost collapsed banking system. So, some might wonder who is to blame for the bank holidays and capital controls enforced that further worsened the economic situation in Greece. The ultimate question in this situation is what is the role of the European Central Bank in the banking crisis of Greece and the general financial crisis taking as a point that ECB is a member of Troika who participates in the decision making policies regarding the situation in Greece.

[66] https://www.ecb.europa.eu/ecb/tasks/html/index.en.html



The ECB has a crucial role in transforming the financial/banking situation in Greece and throughout the years of crisis it did it by mostly four ways: 1) the securities markets program, 2) quantative easing, 3) through the ELA and 4) through the combined policy recommendations with the other Troika members.

Securities Markets Programme(SMP)

Securities Markets Programme was one of the most controversial sovereign bond buying operations ever implemented by a central bank. It was also the precursor to the "Outright Monetary Transactions" (OMT) programme, which has been central to the ECB's strategy to resolve the Euro-zone crisis since September 2012. The ECB purchases were large and very concentrated. In total, more than €42.7 bn of Greek bonds were taken out of the market, which is 17% of the total Greek bond market in 2010. More than 70% of these purchases occurred in the first 8 weeks of the programme according to market sources. At the same time, the amount of outstanding debt was essentially fixed since the Greek government was excluded from capital markets from April 2010 onwards. Second, the asset purchases took place during a time of severe market distress and with an imminent risk of a Greek default. In such an environment, with low liquidity and risky arbitrage, bond supply shocks expected to have particularly large effects, at least from a theoretical perspective, and they did.

The SMP's objective was to contain the debt crisis in specific Euro-zone countries, not to ease monetary conditions in the Euro-zone.

This stands in contrast to the QE programmes of the Federal Reserves and the Bank of England which where a tool for monetary expansion with the aim to lower long-term interest rates. Officially, the SMP's purpose was to restore the appropriate transmission of monetary policy and "to ensure depth and liquidity in those market segments which are dysfunctional."[67] ECB board members repeatedly emphasized that all bond purchases would be sterilized. SMP purchases were highly concentrated, taking place mostly in weeks with severe distress. In Greece, the bulk of purchases occurred in May and June 2010.

ECB's Independence and the no-bailout clause

The enforcement mechanism of the European fiscal rules works this way: Member states must curb their public deficits and to force them to do so, monetary funding of their deficit as well their bailouts are formally banned. The no-bailout clause rules out any rescue of member states in trouble and the independence of ECB is crucial to make this ban credible. it would oblige member states to fiscally correct behaviors, preventing unsustainable public debt and moral hazard. It is worth remembering here that ECB independence was required to win over strong German resistance to joining EMU, since it was seen as necessary conditions to ensure price stability. The ban on bailouts and the independence of the ECB are the two sides of the coin.

But, according to many economists the no bail-out clause is inevitably meaningless. Indeed, when a member State is experiencing a speculative attack and impaired access to private credit, it is difficult to conceive how the ECB or other Member states could refuse to rescue it. The question which being raised here is the following: can the ECB refuse to purchase the national bonds under speculative attack putting the future of the EU as a whole at risk or more simply can the ECB act as a lender of last resort? This question has been raised many years before the Greek crisis and still finds its way to the recent economics.

[67] http://www.ecb.int/press/pr/date/2010/html/pr100510.en.html.

The lesson for EMU that can be drawn from the Greek crisis is quite obvious. The no-bailout clause, the ban on purchasing governmental bonds can put in jeopardy the future of the Union as a whole. The Central Bank has been pushed under political pressure from the European Council and the Ecofin to purchase Greek bonds in order to stabilize the markets. It has been a shock to the Central Bank's credibility due to the fact that the Central Bank as a key player in the right operation of the Union as a whole should not act as a lender o last resort.

The Greek sovereign debt restructuring of 2012

To identify the bonds bought by the ECB we take advantage of the historic Greek sovereign debt restructuring, which was implemented between February and April of 2012. The operation was the largest sovereign bond exchange in history and restructured all outstanding Greek government bonds owed to private creditors, namely eighty-one Hellenic Republic titles with an eligible volume of €195.7 bn.

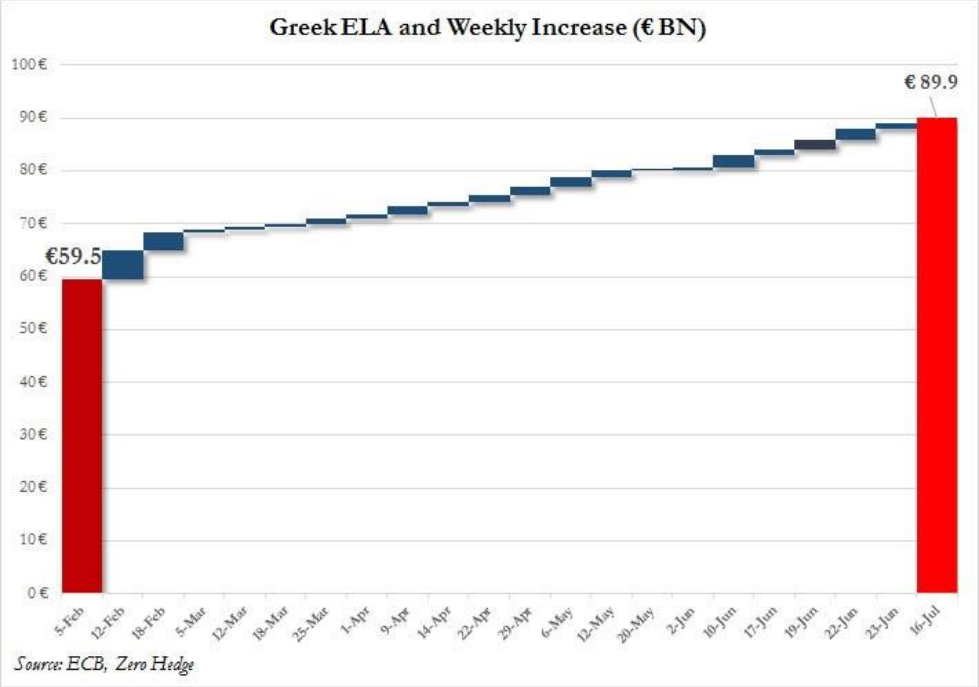
The essential feature of the Greek debt exchange is that the ECB did not participate in it. Technically, the exemption took the form of a "silent" debt swap: between February 17 and February 21, 2012, all bonds held by the ECB and other Euro-system central banks were exchanged into new bonds which were exactly the same as the old ones (same nominal amount, coupon payments and repayment dates) but had different serial numbers (ISINs). The instruments involved in this "silent" swap were not eligible in the Greek debt restructuring proposal of February 24, 2012. The old bonds (with original ISINs) were exempt because they had been transferred to Greece in the swap and were subsequently cancelled. The new, central bank owned ones (with new ISINs) were exempt because the debt restructuring offer only targeted bonds issued "prior to 31 December 2011", thus excluding those issued in the February 17 swap. With this simple operation the ECB, National Central Banks (NCBs), and the European Investment Bank (EIB) avoided taking a haircut and made their bonds disappear from the stock of tradable Greek debt.

ELA mechanism (Emergency liquidity assistance)

Banks usually resort to ELA when they face a cash crunch and do not have adequate collateral to draw liquidity from the European Central Bank, their main funding tool. ELA is particularly costly as it carries an interest rate of 1.55 percent, against just 0.05 percent for ECB funding. Bank officials commented that lenders are resorting to ELA earlier than expected, which reflects the deteriorating liquidity conditions in the credit sector. Besides the decline in deposits, banks were dealt another blow with the scrapping of the euro cap on the Swiss franc. Bank estimates put the impact of the euro's drop on the local system's cash flow at between 1.5 and 2 billion Euros.

Deposits recorded a decline of 3 billion Euros in the previous December – a month when they traditionally expand – while in the first couple of weeks of January the outflow continued, although banks said it was under control. A major blow to the system's liquidity has come from the repeated issue of T-bills: In the previous November the state drew 2.75 billion Euros in this way, in December it secured 3.25 billion Euros, and it has already tapped another 2.7 billion in January. Of the above amounts, a significant share – amounting to 3 billion Euros according to bank estimates – was in the hands of foreign investors who are not renewing their stakes, so Greek banks have to step in to buy them.

Local lenders had also resorted to ELA in 2011 to cope with the outflow of deposits and consecutive credit rating downgrades of the state (and the banks) that made Greek paper insufficient for the supply of liquidity by the Euro-system. In June 2012, due to the uncertainty of the twin elections at the time, the ELA being drawn by local banks to handle the unprecedented outflow of deposits reached a high of 135 billion Euros. By May 2014, Greek banks had reduced their ELA financing to zero. The European Central Bank four months ago decided to raise the funds available to Greek banks from the Emergency Liquidity Assistance (ELA) system by 1.5 billion Euros, to 75.5 billion Euros and at this time right after the referendum and the political agreement among the Greek government and its creditors this number has reached approximately 98 billion Euros.



Despite Greece's troubled financial sector, its banks had received liquidity from the ECB at the same rate as all other euro-zone countries since 2010, as long as Greece complied with its bailout requirements. After newly elected Prime Minister Alexis Tsipras put Greece's cooperation in doubt, however, the ECB limited this cheap access to capital.

Criticism regarding the role of ECB in the Greek crisis

There were many the accusations for the President of the ECB about its role in the Greek financial crisis. European Central Bank president Mario Draghi has defended the ECB's role in the current Greek crisis, rebutting accusations that the bank had "blackmailed" or terrorized Greece.[68] According to Mr. Draghi the ECB had more than € 100 billion of exposure to Greece, more than twice its exposure in December.

"The ECB has €104 billion of exposure to Greece. This is equal to 65 per cent of Greek GDP, which is the highest exposure in the euro zone . . . so what sort of blackmail is this? We haven't created any rule for Greece, rules were in place and they've been applied."[69]

[68] http://www.bbc.com/news/world-europe-33393759
[69] https://www.ecb.europa.eu/press/key/date/2015/html/sp150323_1.en.html

Mr. Draghi numerous times warned that Greece had to "fully honor its debt obligations". He has said the financial situation of Greece under the last government "was not the fault of the troika, not the fault of the ECB". The contagion risk posed was also much lower than during the last crisis, he said, although he stressed that he was only speaking of the short term. While Mr. Draghi repeated his belief that Greece would at some point in the future be in a position to partake in the ECB's quantitative easing programme, he said it still had to fulfill several conditions.

While raising concerns about the liquidity of the banks, the ECB chief has claimed that the banking system was not facing a solvency crisis. "Greek banks are this time in a much better state than they were on the occasion of the last crisis." And the Greek banks were compliant with a number of "minimum regulatory requirements. At the same time the liquidity situation . . . has been deteriorating and therefore the banks' dependence on ECB funding has increased." The ECB has been propping up Greek banks with emergency funding known as emergency liquidity assistance.[70]

Though the ECB is an avowedly non-political institution, Greece's reliance on ELA gave the bank an unavoidable role in the fraught negotiations over a new Greek bailout. As the crisis intensified, more people withdrew their money from Greece's banks, making them increasingly reliant on the ECB, whose emergency liquidity support surpassed 88 billion Euros ($98 billion) by June 2015. In the 2010 Ireland and 2013 Cyprus bank crises, the ECB effectively forced compromises by threatening to cut off ELA altogether. But as Greece has come to the brink of exiting the euro-zone, the ECB has so far sought a balance. It capped ELA, forcing Greece to impose capital controls, but it has not halted its support—leaving its role in resolving the continent's persistent debt crises both larger and more uncertain than ever.

Regarding the issue of the debt restructuring the ECB is in a Debt Denial situation. The ECB's record in Greece indicates that this may simply be an indication that they are out of touch with reality. From the first moment that it became clear that Greece's public debt problem may be unsustainable ECB officials remained adamantly opposed to the idea that any sovereign debt restructuring was desirable or conceivable. The

[70] http://www.irishtimes.com/business/economy/draghi-defends-european-central-bank-s-role-in-greek-crisis-1.2150493

mistakes of the ECB regarding its role in the Greek crisis come to end with the Liquidity Supply Threats. While the ECB has been willing to supply enormous amounts of liquidity to the European banking system over the past few years, they have also been willing to use the threat of the denial of liquidity as a bargaining chip. As in Ireland, the various threats to remove Greek banks as eligible counterparties or to remove Greek debt from its eligible collateral list contributed to undermining confidence in the stability of the banking system.[71]

The role of Germany and France

The meeting in Deauville

One of the clearest examples of the mismanagement of the crisis was the decision to create credit risk in the euro area markets on 18 October 2010. The decision was made at a meeting between French President Sarkozy and German Chancellor Merkel in Deauville. Germany and France together represent more than half of the euro area and other governments often appear unwilling to oppose decisions proposed by these two. Remarkably, in light of how costly this decision was for other member states, other governments went along. Notably, the agreement was reached despite warnings and objections by the ECB. Deauville introduced the Private Sector Involvement (PSI) doctrine for euro area sovereign debt. The concept was that whenever a euro area member state faced liquidity pressures (as opposed to solvency concerns), losses would be imposed on the private creditors of the sovereign debt of that member state before the other euro area governments agreed to provide any temporary assistance. Effectively, a haircut would be imposed on the private sector even if the country that needed a loan was solvent. The PSI doctrine reversed long-standing IMF principles for providing temporary assistance. The message to potential investors of euro area sovereign debt could not be clearer: Euro area sovereign debt should no longer be considered a safe asset with the implicit promise that it would be repaid in full.

The introduction of credit risk in sovereign debt raised the cost of financing for most euro area member states. A first casualty was Ireland which lost market access within weeks of that decision. That was followed by Portugal a few months later. Deauville

[71] Karl Whelan, Direktorate General for Internal Policies: The ECB's role in Financial Assistance Programmes, European Parliament, June 2012

was a blunder for the euro area as a whole. However, the PSI doctrine proved beneficial to Germany, the country whose government had proposed it. Damaging the market for euro area sovereigns perceived as 'weak' introduced a safety premium to German bunds since Germany was perceived as 'strong' among the euro area member states. The global demand for euro-denominated sovereigns was adversely affected. This was costly for the euro area as a whole. But the relative demand for German bunds was positively affected, which was beneficial to Germany.[72] This was a serious and clear indication that an adversarial approach to the crisis was taking hold among the member states.

It is equally important to refer to a recent survey which conducted from the Institute of Leipzig in Germany and show the estimated benefit of Germany during the Greek crisis. The German public sector balance benefited significantly from the European/Greek debt crisis, because of lower interest payments on public sector debt. This is due to two effects: One, in crisis times investors disproportionately seek out safe investments ("flight to safety"), bidding down the returns on safe-haven assets. It seems that German bunds strongly benefited from this effect during the Greek debt crisis. Second, while the European Central Bank (ECB) monetary policy stance was quite close to an "optimal" monetary policy stance for Germany from 1999 to 2007, during the crisis monetary policy was too accommodating from a German perspective, due to the emerging disparities across the Euro area. As a result of these two effects, the calculations suggest that the German sovereign saved more than 100 billion Euros in interest expenses between 2010 and mid-2015. That is, Germany benefited from the Greek crisis even in case that Greece defaults on all its debt (a total of 90 billions) owed to the German government via diverse channels (European Stability Mechanism [ESM], International Monetary Fund [IMF], or directly).

Germany

The situation for Germany, like Greece, is complex. Led by Chancellor Angela Merkel, German leaders hope to minimize moral hazard in the Greek debt negotiations (preferably with no bailout whatsoever), ensure Euro-zone stability

[72] Boysen-Hogrefe (2012) and Broyer, Petersen and Schneider (2012) present quantitative evidence of the benefit to Germany due to the crisis.

through preventing contagion, prevent investors from accepting undue losses on Greek debt holdings, and please domestic constituents to ensure political survival. As the largest economy in the Euro-zone, Germany can offer substantial financial assistance to Greece, which affords it significant negotiating power. The constraints on Chancellor Merkel, though, come from two conflicting levels like those in Greece. On one hand, wanting to protect investors and ensure Euro-zone stability lends itself to offering bailout loans to Greece. Uncertain financial markets can spread contagion, which is bad for economies across Europe. On the other hand, moral hazard is inherent in bailouts and German voters.

Merkel has so far chosen a middle path between preventing contagion and preventing moral hazard. As there is virtually no popular support for a Greek bailout, she has balanced her preference of preventing too many losses to German banks with the necessity of pleasing domestic constituents, and has reluctantly agreed to grant bailout money only after extracting as many concessions from Greece as possible. Her indecisiveness has exacerbated uncertainty and contagion, but this has come as a direct response to the political constraints she faces.

France

Roughly speaking, French interests have aligned with German interests for the majority of the crisis period. Like Merkel, French President Nicolas Sarkozy and Francois Holland later on have had an interest in preventing moral hazard and contagion, preventing investors from taking huge losses on Greek debt, and ensuring political survival with support from domestic constituencies. Since these preferences require tradeoffs, both have been likely to choose a middle ground between the two. However, there are some notable differences between France and Germany. The first is that France sits on the side of preventing contagion, rather than preventing moral hazard. Part of this might be because French banks hold more Greek debt than investors from any other country.

At the beginning of the crisis, France and Germany combined were exposed to over half of all Greek debt, but France alone held a plurality (Bank for International Settlements, 2011). Additionally, France has a weaker economy than Germany and some commentators speculate that it could be the next center of the euro crisis, after

the “GIIPS” countries of Greece, Italy, Ireland, Portugal, and Spain. It is therefore conceivable that it would be in the French interest to establish a precedent for EU Member States to come to the aid of struggling countries, which could also help explain its continued support for helping Greece and preventing contagion relative to Germany.

President-elect François Hollande, elected on a platform that emphasizes making room for growth rather than enforcing austerity measures, will likely have a slightly different set of interests. His victory does not change the analysis of the policies that have already been adopted, but in the future, his plans will “be seen as a challenge to the German-dominated vision of economic austerity as a way out of the euro crisis”.[73]

Conclusions

All things considered, one could give his own explanations regarding the external constraints in the Greek crisis and what went wrong. There are plenty of politicians or academics, who claim that the only viable solution right now in Greece is to exit the Euro-zone and return to its old currency, the drachma. This is pure ignorance on their part to claim that Greece would face six months of difficulties and afterwards everything would be just better without the 'bad Europeans'.

At this point everyone recognizes that something is wrong within the Euro-zone both politically and economically. Europe has changed and in my opinion betrayed its values after the burst of the Greek debt crisis. Values such as solidarity and democracy were lost somewhere among the competitiveness of the strong against the weak countries and the weaknesses of the banking system. Personal politics have managed to coordinate policies regarding the future of people that have seen their lives changed from one day to another.

The role of IMF can be considered by many as necessary at that particular time, but in the long run we saw that its policies and its co-operation with the EU regarding the Greek crisis have led the Greek people in worse situation than they were two years

[73] http://www.nytimes.com/2012/05/07/world/europe/hollande-and-sarkozy-in-crucial-runoff-in-france.html?_r=0

before. On the other hand, ECB made some descent moves, but given its role in the European system we should expect more. Yes we live in a capitalistic system and everything goes around money, but this money never ended in the pockets of those in need of it. The banks' capitalization was very important in order for things to continue to work properly but no one really needs to stress that if the people do not have money, the banks will close eventually and not be able to maintaine the economic balances of the country. In addition the role of France and Germany was really important in a way. France was quite supportive of the fact that Greece needs to stay in the Euro-zone at any cause. The shares and risks of French banks in the Greek banking system were huge at one point and that played its role because that would mean huge losses for the French economy as a whole if Greece was ever about to exit the Euro-zone.

On the other hand the role of Germany is considered harsh and divided. Germany and especially its finance minister has managed to divide again the Europe. But is really Germany to blame for the Greek crisis? The answer here is no. We shouldn't be blaming Germany for trying to gain profit of Greece's crisis but we should really blame EU which did not try to impose some measures on the unreasonable profit, and eventually take actions against it. The role of EU in general in the Greek crisis was not the expected one. Reforms came too late and at the time when reasonable actions needed to be taken, the EU chose the role of the ‘bad parent’ who makes an example of his kids actions in order to stop them from doing it again the wrong thing. The reforms in Greece were too harsh, without any ‘real’ plan for the future. But that does not mean that we should exit the Euro-zone and return to our ‘glory’ days. The fault of the crisis lies with the Greek governments of the last 40 years. Of course the EU and the other institutions made mistakes and took part into some politics that do not belong in this level, but in order to change things one should really look into change himself. The solution to the crisis lies to the European politicians as well the institutions, internal and external. Europe was designed in order to exchange ideas and broaden our horizons and also to bring solidarity among the member states. There lies the solution to the crisis, to values such as solidarity and in the need of changing things from inside out.

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