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### Greece's Debt Crisis: Overview, Policy Responses, and Implications

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# Greece's Debt Crisis: Overview, Policy Responses, and Implications

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## Summary

The Eurozone is facing a serious sovereign debt crisis. Several Eurozone member countries have high, potentially unsustainable levels of public debt. Three—Greece, Ireland, and Portugal—have borrowed money from other European countries and the International Monetary Fund (IMF) in order to avoid default. With the largest public debt and one of the largest budget deficits in the Eurozone, Greece is at the center of the crisis. The crisis is a continuing interest to Congress due to the strong economic and political ties between the United States and Europe.

### **Build-Up of Greece's Debt Crisis**

In the 2000s, Greece had abundant access to cheap capital, fueled by flush capital markets and increased investor confidence after adopting the euro in 2001. Capital inflows were not used to increase the competitiveness of the economy, however, and European Union (EU) rules designed to limit the accumulation of public debt failed to do so. The global financial crisis of 2008-2009 strained public finances, and subsequent revelations about falsified statistical data drove up Greece's borrowing costs. By early 2010, Greece risked defaulting on its public debt.

### **Policy Responses with Limited Success**

EU, European Central Bank, and IMF officials agreed that an uncontrolled Greek default could trigger a major crisis. In May 2010, they announced a major financial assistance package for Greece, and the Greek government committed to far-reaching economic reforms. These measures prevented a default, but a year later, the economy was contracting sharply and again veered towards default. European leaders announced a second set of crisis response measures in July 2011. The new package calls for holders of Greek bonds to accept losses, as well as for more austerity and financial assistance.

These responses have prevented a disorderly Greek default, but the prospects for Greek recovery remain unclear. The economy is contracting more severely than expected, and, as a member of the Eurozone, Greece cannot depreciate its currency to spur export-led growth. Unemployment is close to 16%.

Additionally, the policy responses have not contained the crisis. Ireland and Portugal turned to the EU and IMF for financial assistance. In the summer of 2011, interest rates on Spanish and Italian bonds rose sharply.

### **Broader Implications**

Greece's economy is small, but its crisis exposes the problems of a common currency combined with national fiscal policies. Additionally, its crisis set precedents for responding to crises in other Eurozone countries; highlighted concerns about the health of the European financial sector; created new financial liabilities for other Eurozone countries struggling debt; and sparked reforms to EU economic governance. It has also revealed tensions among EU member states about the desirability of closer integration.

### **Issues for Congress**

- **Impact on the U.S. economy:** U.S. exports to the EU could be impacted if the crisis slows growth in the EU and causes the euro to depreciate against the dollar.

Through the first quarter of 2011, growth in the Eurozone was strong, but it may be starting to weaken. There has not been a clear depreciation of the euro against the dollar since the start of the crisis. As the crisis continues, increased perceptions of risk are impacting U.S. financial markets. If the crisis spreads in the Eurozone, the impact on the U.S. economy could be much greater.

- **Exposure of U.S. banks:** U.S. banks have little direct exposure to Greece (\$7.3 billion), but other potential exposures (derivative contracts, guarantees, and credit commitments) to Greece are much higher (\$34.1 billion). U.S. banks are more heavily exposed to Spain and Italy, with direct and other potential exposures totaling nearly \$450 billion.
- **IMF involvement:** Some Members of Congress are concerned about IMF involvement in the Greek crisis. In 2010, Congress passed legislation aimed at limiting IMF support for advanced economies (P.L. 111-203). In 2011, legislation was introduced in the House and the Senate to rescind some U.S. contributions to the IMF (H.R. 2313; S.Amdt. 501). The Senate voted down this legislation in June 2011.

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## Introduction

Since early 2010, the Eurozone has been facing a major debt crisis.<sup>1</sup> The governments of several countries in the Eurozone have accumulated what many consider to be unsustainable levels of government debt, and three—Greece, Ireland, and Portugal—have turned to other European countries and the International Monetary Fund (IMF) for loans in order to avoid defaulting on their debt.<sup>2</sup> The crisis now threatens to spread to Italy and Spain, respectively the third and fourth largest economies in the Eurozone.<sup>3</sup>

Greece has been at the center of the Eurozone debt crisis. It has the highest levels of public debt in the Eurozone, and one of the biggest budget deficits.<sup>4</sup> Greece was the first Eurozone member to come under intense market pressures and the first to turn to other Eurozone member states and the IMF for financial assistance. Over the past year, the IMF, European officials, the European Central Bank (ECB), and the Greek government have undertaken substantial crisis response measures. At the behest of European leaders in July 2011, holders of Greek bonds have also indicated that they will accept losses on their investments to alleviate Greece's debt payments in the short-run. If these plans are carried out, Greece will be the first advanced economy to default in almost half a century.<sup>5</sup>

The Greek debt crisis is of continuing interest to the U.S. Congress. The United States and the European Union (EU) have the largest economic relationship in the world, and there are concerns about how economic turmoil in Greece and the Eurozone more broadly could impact the U.S. economy. There has been particular concern about the exposure of U.S. financial institutions to Greece. Additionally, the United States has the largest financial commitment to the IMF of all the IMF members. Some Members of Congress have raised questions about whether Greece's IMF program is an appropriate use of IMF resources. These concerns have led to a number of congressional hearings and legislation in the 111<sup>th</sup> and 112<sup>th</sup> Congresses.

This report explains the causes of the crisis, the policy responses to the crisis, and assesses crisis response measures to date. It also highlights the implications of the Greek crisis for the broader Eurozone debt crisis and EU integration. It concludes with an analysis of issues of particular

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<sup>1</sup> The Eurozone refers to the 17 members of the European Union (EU) that use the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Spain, and Slovenia. The other 10 members of the EU do not use the euro as their national currency. Denmark and the United Kingdom were granted special opt-outs of the currency union and are legally exempt from joining unless their governments decide otherwise, either by parliamentary vote or referendum. Sweden has gained a *de-facto* opt-out through the use of various legal provisions. The other seven (Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, Poland, and Romania) are expected to adopt the euro as soon as they meet certain economic policy targets. For more on the Eurozone, see CRS Report R41411, *The Future of the Eurozone and U.S. Interests*, coordinated by Raymond J. Ahearn.

<sup>2</sup> The International Monetary Fund (IMF) is an organization of 187 countries that works to ensure the stability of the international monetary system. It makes loans to countries facing economic crises, undertakes surveillance of the international monetary system, and provides technical assistance to countries on matters related to its expertise.

<sup>3</sup> International Monetary Fund, *World Economic Outlook*, April 2011. Using forecasts for 2011.

<sup>4</sup> *Ibid.*

<sup>5</sup> Incidentally, the last advanced economy to have been in default was also Greece, which defaulted in 1932 and stayed in default until 1964. David Beers and John Chambers, "Sovereign Defaults at 26-Year Low, To Show Little Change in 2007," *Standard and Poor's*, September 2006, Table 6. Analysis uses the IMF's classification of advanced economies (i.e., see International Monetary Fund, *World Economic Outlook*, April 2011).

interest to Congress, including the impact of the Greek debt crisis on the U.S. economy, the exposure of U.S. banks to Greece and other distressed Eurozone economies, and IMF involvement in the crisis.

## The Build-Up to Greece's Debt Crisis

The Greek government has a long history of problems with its public debt—it has spent more than half the years since 1832, when it gained independence from the Ottoman Empire, in default.<sup>6</sup> Economists point to several deeply entrenched features of the Greek economy and Greek society in general that have prevented sustained economic growth and created the conditions underlying the current crisis. Chief among these are pervasive state control of the economy, a large and inefficient public administration, endemic tax evasion, and widespread political clientelism (see text box below). An influx of capital at low interest rates during the 2000s and the global financial crisis of 2008-2009 further exacerbated these problems, straining public finances to an unsustainable degree.

### Selected Features of the Greek Economy Underlying the Crisis

As recently as 1990, the Greek state controlled about 75% of all business assets in the country and tightly regulated other sectors of the economy. The state reduced its stake to about 50% by 2008. However, according to the Organization for Economic Cooperation and Development (OECD), much of the private sector continues to “suffer from weighty and complex regulations and from the lack of a coherent and systematic approach to rule-making.”

In the decade before the crisis, a significant portion of rising government expenditures was allocated to rising public sector wages and benefits. As recently as 2009, Greek government expenditures accounted for 50% of GDP, with 75% of (non-interest) public spending going to public sector wages and social benefits. According to the OECD, while spending on public administration as a percentage of total public expenditure has been the highest in the OECD, there has been “no evidence that the quantity or quality of the services are superior.”

Analysts often point out that Greek politicians have traditionally viewed the provision of public sector jobs and benefits as an important way to grant favors and thereby secure electoral support. Among other things, this tendency appears to have helped politically influential public sector unions consistently negotiate generous wage and pension agreements.

Clientelism may also be an important factor behind pervasive tax evasion and a complex tax code that grants exemptions to numerous professions and income brackets. According to Greek government officials, until the debt crisis, the state taxed only one-third of officially declared income, at an average rate of about 30%. This excludes profits from an unrecorded economy that some value at upwards of 30% of the official GDP.

Most analysts view tax evasion and deeply rooted political clientelism in Greek society as emblematic of a broader distrust of state institutions. In its 2010 Corruption Perceptions Index, Transparency International ranked Greece as the most corrupt country in the EU, just behind Bulgaria and Romania.

**Sources:** Economist Intelligence Unit, IMF, Library of Congress, and OECD country reports on Greece; James Surowiecki, “Dodger Mania,” *The New Yorker*, July 11, 2011; Greek Deputy Prime Minister and Finance Minister, Evangelos Venizelos, “The Greek Debt Crisis: Prospects and Opportunities,” remarks at the Peterson Institute for International Economics, Washington, DC, July 25, 2011. <http://www.iie.com/publications/papers/paper.cfm?ResearchID=1887>.

<sup>6</sup> Carmen Reinhart and Kenneth Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton, NJ: Princeton University Press, 2009), p. 99.



## **Euro Adoption, Capital Inflows, and Lax Enforcement of EU Fiscal Rules**

As Greece prepared during the 1990s to adopt the euro as its national currency, its borrowing costs dropped dramatically. Interest rates on 10-year Greek bonds were dropped by 18% (from 24.5% to 6.5%) between 1993 and 1999.<sup>7</sup> Investors believed that there would be widespread convergence among countries in the Eurozone. This belief was reinforced by the policy targets, called convergence criteria, that countries had to meet in order to be eligible to join the Eurozone. Additionally, the common monetary policy was to be anchored by economic heavyweights, including Germany and France, and managed conservatively by the ECB. EU member countries were also to be bound by rules in the Stability and Growth Pact that limited government deficits (3% of GDP) and public debt levels (60% of GDP). These limits were to be enforceable through fines of up to 0.5% of GDP.<sup>8</sup> All of these factors created new investor confidence in Greece and other Eurozone member states with traditionally weaker economic fundamentals compared to, for example, Germany.

The influx of capital and pursuit of meeting convergence criteria did not result in a fundamental change in how the Greek economy was managed or in investments that increased the competitiveness of the economy. The Greek government took advantage of greater access to cheap credit to pay for government spending and offset low tax revenue. The government also borrowed to pay for imports from abroad that were not offset by exports overseas. Government budget and trade deficits ballooned during the 2000s (see **Figure 1**) and borrowed funds were not channeled into productive investments that would generate future growth, increase the competitiveness of the economy, and create new resources with which to repay the debt.<sup>9</sup> Instead, the inflows of capital were used to fund current consumption that did not yield streams of revenue with which to repay the debt.

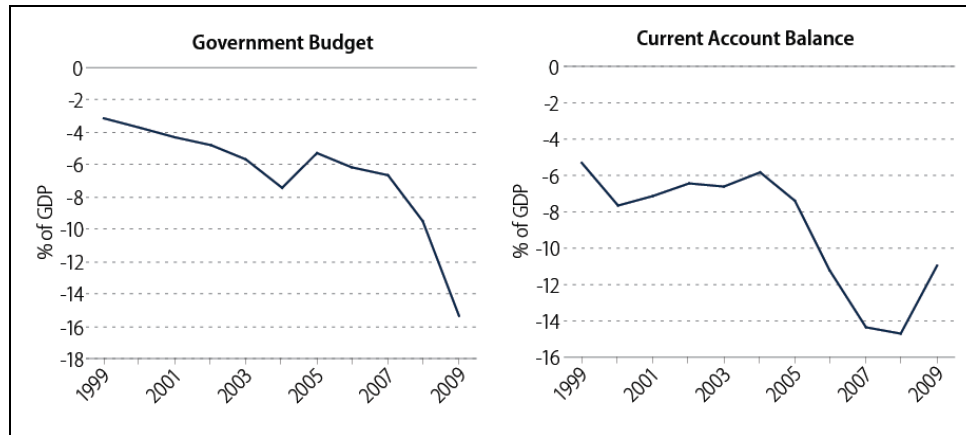
EU policies that had been put in place to provide a check on the accumulation of public debt failed to do so. Since 2003, the EU has initiated more than 30 cases against members in violation of the fiscal rules set out in the Stability and Growth Pact, including Greece. Through this process, EU institutions have reprimanded member states in violation of the deficit and debt limits and pressured them to consolidate public finances. It has never imposed a financial sanction against a member state in violation of these limits, however.

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<sup>7</sup> Global Financial Data.

<sup>8</sup> *Resolution of the European Council on the Stability and Growth Pact*, Amsterdam, June 19, 1997, *Council Regulation (EC) 1466/97*, and *Council Regulation (EC) 1467/97*, [http://ec.europa.eu/economy\\_finance/sgp/legal\\_texts/index\\_en.htm](http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm).

<sup>9</sup> Daniel Gros and Cinzia Alcidi, "Adjustment Difficulties and Debt Overhangs in the Eurozone Periphery," *Center for European Policy Studies*, Working Document No. 347, May 2011.

**Figure 1. Greece's "Twin" Deficits: Budget and Current Account Deficits, 1999-2009**

**Source:** International Monetary Fund, *World Economic Outlook*, April 2011.

**Notes:** Budget deficit and government debt for all levels of government (local, state, and central governments). Public debt levels is for gross debt (total financial liabilities), rather than net debt (total financial liabilities minus total financial assets).

## The Triggers: Global Financial Crisis and Revelations of Mis-Reported Data

The Greek government's reliance on borrowing from international capital markets to pay for budget deficits and trade deficits left it vulnerable to shifts in investor confidence. If investors lost confidence in the Greek government's ability or willingness to repay its debt, they would stop lending to the government or charge interest rates that were higher than what the Greek government could afford. Lack of access to new funds would make it difficult for the government to borrow to repay existing debt as it became due (called rolling over its debt), meaning that the government would have to implement austerity measures quickly or risk defaulting on its debt.

Starting in 2009, investor confidence in Greece's ability to service its debt dropped significantly. The global financial crisis of 2008-2009 and the related economic downturn strained the public finances of many advanced economies, including Greece, as government spending on programs, such as unemployment benefits, increased and tax revenues weakened. Greece's reported public debt rose from 106% of GDP in 2006 to 126% of GDP in 2009.<sup>10</sup>

Additionally, in late 2009, the new government, led by Prime Minister George Papandreu, revealed that previous Greek governments had been under-reporting the budget deficit. The new government revised the estimate of 2009 budget deficit from 6.7% of GDP to 12.7% of GDP.<sup>11</sup> This was shortly followed by rating downgrades of Greek bonds by major credit rating agencies. Allegations that Greek governments had attempted to obscure debt levels through complex

<sup>10</sup> International Monetary Fund, *World Economic Outlook*, April 2011. Debt for all levels of government (local, state, and central governments), and is gross debt (total financial liabilities), rather than net debt (total financial liabilities minus total financial assets).

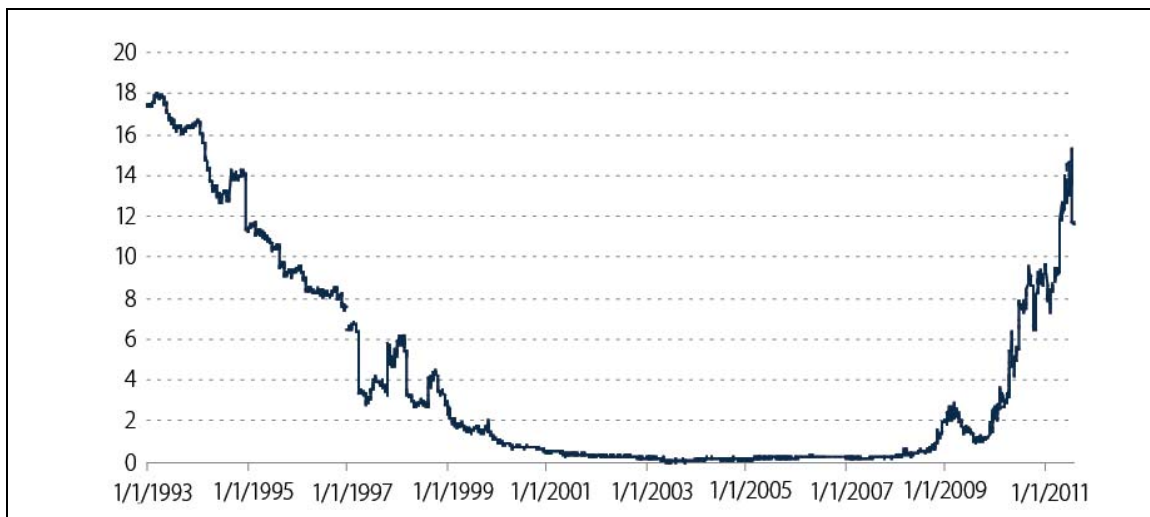
<sup>11</sup> "Is Greece Heading for Default?," *Oxford Economics*, January 29, 2010.

financial instruments contributed further to a drop in investor confidence.<sup>12</sup> Greece's 2009 budget deficit was subsequently revised upwards a number of times, finally to 15.4% of GDP.

As investors became increasingly nervous that the Greek government's debt was too high, and that it would default on its debt, they started demanding higher interest rates for buying and holding Greek bonds (see **Figure 2**). Higher interest rates compensated investors for the higher risk involved in holding Greek government bonds, but they also drove up Greece's borrowing costs, exacerbated its debt levels, and caused Greece to veer towards default.

**Figure 2. Greek Bond Spreads, 1993-2011**

Spreads on 10-year Greek bonds relative to 10-year German bonds (%)



Source: Global Financial Data.

## Crisis Responses

European leaders, the IMF, and the ECB agreed that an uncontrolled, disorderly default on Greek debt would be extremely risky and should be avoided at all costs. They feared that such a default could spark a major sell-off of bonds of other Eurozone members with high debt levels and that European banks exposed to Greece and other Eurozone governments would not be able to weather losses on those investments. Fear of contagion and financial turmoil drove a major policy response by the Europeans, the IMF, the Greek government, and central banks in May 2010 to avoid a Greek default. When Greece again veered towards default more than a year later, a second crisis response was announced in the summer of 2011. To date, the policy responses have succeeded in avoiding a disorderly Greek default. They have been less successful in putting Greece on a clear path to recovery and containing the crisis.

<sup>12</sup> For example, see Kerin Hope, Quentin Peel, and Tony Barber, "Greece Turns on EU Critics," *Financial Times*, February 13, 2009; Louise Story et al., "Wall St. Helped to Mask Debt Fueling Europe's Crisis," *New York Times*, February 14, 2009.

## May 2010

The first round of crisis response measures focused on financial assistance from the Eurozone and the IMF, paired with austerity measures and reforms implemented by the Greek government. Central banks also played a role in providing liquidity in the region.

### Financial Assistance from Eurozone and IMF

In May 2010, Eurozone leaders and the IMF announced a three-year package of €110 billion (about \$158 billion) in loans to Greece at market-based interest rates.<sup>13</sup> Of the €110 billion, the Eurozone countries pledged to contribute €80 billion (about \$115 billion) and the IMF pledged to contribute €30 billion (about \$43 billion). Disbursement of funds was made conditional on implementation of economic reforms, as discussed below.

Seeking to prevent the spread of the crisis beyond Greece, EU leaders also created in May 2010 a new European mechanism for providing financial assistance to Eurozone member states under market pressures. The mechanism consists of two temporary, three-year lending facilities that could make loans totaling €500 billion (about \$718 billion) to Eurozone members facing debt crises. EU leaders also suggested that the IMF could provide additional support. IMF and EU programs were subsequently provided to Ireland and Portugal (see **Table 1**). In March 2011, EU leaders agreed to create a permanent lending facility, the European Stability Mechanism (ESM), to replace the temporary facilities after they expired in mid-2013.<sup>14</sup>

### Fiscal Consolidation and Economic Reforms in Greece

As a condition of financial support from the IMF and Eurozone countries, the Greek government has undertaken ambitious fiscal consolidation measures and economic reforms. An austerity program outlined in May 2010 aimed to reduce the government's budget deficit by 11 percentage points through 2013, bringing it below 3% of GDP by 2014.<sup>15</sup> The program's immediate objectives were a deep cut to public spending and enhanced revenue growth through tax increases and a crack-down on tax evasion. Most spending cuts have been to the civil service, including a reduction or freeze on civil service compensation and a civil service hiring freeze. On the revenue side, the government raised the average value-added tax rate and increased taxes on certain commodities (fuel, tobacco, and alcohol). The government aimed to raise additional revenues through strengthened tax collection and higher contribution requirements for tax evaders.

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<sup>13</sup> Throughout the report, values denominated in euros are converted to U.S. dollars using the exchange rate on August 10, 2011: €1 = \$1.4367 (Source: ECB). However, the exchange rate has fluctuated over the course of the crisis, and dollar conversions should be used as approximations.

<sup>14</sup> See European Commission, DG Economic and Financial Affairs, *Treaty Establishing the European Stability Mechanism (ESM)*, signed, June 11, 2011, [http://ec.europa.eu/economy\\_finance/articles/financial\\_operations/2011-07-11-esm-treaty\\_en.htm](http://ec.europa.eu/economy_finance/articles/financial_operations/2011-07-11-esm-treaty_en.htm). The Eurozone members signed a treaty establishing the ESM in July 2011. The treaty must be ratified by the member states by the end of 2012. Non-Eurozone countries of the EU may contribute financial assistance to the ESM on an ad hoc basis.

<sup>15</sup> The annual budget deficit targets laid out in the May 2010 plan agreed by the Greek government and the EU/IMF were a 2.5% reduction in 2010; a 4.1% reduction in 2011; a 2.4% reduction in 2012; and a 2.0% reduction in 2013. See the International Monetary Fund, "Greece: Staff Report on Request for Stand-by Arrangement," May 2010, <http://www.imf.org/external/pubs/ft/scr/2010/cr10110.pdf>.

The government has begun to implement healthcare and pension reforms deemed vital to consolidating public finances. The Greek pension system, considered one of the most generous in Europe, has long been a target of advocates of Greek economic reform. In July 2010, the parliament agreed to pension reform to increase the average retirement age and reformed how pension benefits would be calculated.<sup>16</sup> Prime Minister Papandreou also launched a similar effort to reduce expenditures and strengthen accountability in what is considered an inefficient Greek healthcare system. Healthcare reforms have included a reduction in total expenditures and consolidation of hospitals. Structural reforms pursued in 2010 to boost Greek competitiveness were focused on the rigid and highly fragmented labor market.

## Central Bank Intervention

The ECB and the U.S. Federal Reserve (the “Fed”) have also played a role in responding to the crisis. The ECB announced in May 2010 that, for the first time, it would start buying European government bonds in secondary markets to increase confidence and lower bond spreads for Eurozone bonds under market pressure. Between May 2010 and June 2011, the ECB purchased government bonds totaling €78 billion (about \$112 billion), with the bulk purchased in the summer of 2010.<sup>17</sup> Market analysts estimate that more than half (€45 billion, about \$65 billion) of the ECB’s bond purchases were Greek bonds.<sup>18</sup> The ECB has also provided substantial liquidity support to private banks in Greece and other countries in the Eurozone, and has provided more flexibility in doing so than it did before the crisis.<sup>19</sup> ECB liquidity support for Greek banks climbed from €47 billion (about \$68 billion) in January 2010 to €98 billion (about \$141 billion) in May 2011, roughly 40% of Greece’s 2011 GDP.<sup>20</sup>

The Fed has supported the crisis response by re-establishing temporary reciprocal currency arrangements, known as swap lines, with several central banks in order to increase dollar liquidity in the global economy. These swap lines had been previously used during the global financial crisis. The swap lines were set to expire but have been subsequently extended until August 2012 amid continuing concerns about the Eurozone.<sup>21</sup> While the swap lines were used most heavily immediately after the Fed re-established them, there has not been any amount outstanding on the swap lines between the winter of 2010 and summer of 2011.

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<sup>16</sup> Ibid.; “Greece/EU: Athens Frets under Financial Supervision,” *Oxford Analytica*, February 17, 2010; European Commission, *Commission Staff Working Paper: Assessment of the 2011 National Reform Programme and Stability Programme for Greece*, June 7, 2011. A 2008 reform of the Greek pension system legally reduced the number of pension funds from 133 to 13 (with five basic funds and eight smaller and supplementary funds). However, some observers have noted that the 2008 reforms have yet to be fully implemented.

<sup>17</sup> Marc Jones, “ECB Bond Buy Freeze Continues, 1 Bln Euros Matures,” *Reuters*, June 20, 2011, <http://www.reuters.com/article/2011/06/20/ecb-bonds-idUSFLAKHE7OV20110620>.

<sup>18</sup> Ibid.

<sup>19</sup> Specifically, the ECB has accepted collateral in its liquidity operations with lower credit ratings than it did before the crisis.

<sup>20</sup> The IMF forecasted in July 2011 that Greece’s GDP in 2011 would be €228 billion. International Monetary Fund, “Greece: Fourth Review Under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria,” July 2011, <http://www.imf.org/external/pubs/ft/scr/2011/cr11175.pdf>.

<sup>21</sup> Federal Reserve Statistical Release, <http://www.federalreserve.gov/releases/h41/hist/h41hist13.htm>.

## **June and July 2011**

Starting in the spring of 2011, it became clear that the Greek economy was contracting more severely than expected and would require more assistance in order to avoid defaulting on its debt. After requiring Greece to adopt additional austerity measures, EU officials, the ECB, and the IMF debated for several weeks about what a second package for Greece would include. They quickly reached an agreement after a “speculative attack” on Italy in July 2011 (a rapid sell-off of Italian bonds, resulting in rising bond spreads on Italian bonds). European officials decided that in addition to more austerity measures and financial assistance, the holders of Greek bonds would also share in the crisis response by accepting some losses on their investments.

### **More Fiscal Consolidation and Economic Reform in Greece**

As economic conditions worsened in the spring of 2011, the Greek parliament approved an additional round of austerity measures and structural reforms in June 2011. These reforms were necessary to get the next disbursement of funds from the original Eurozone-IMF financial assistance package, as well as for securing a second assistance package. The cornerstone of Greece’s so-called medium-term fiscal strategy (MTFS) is a consolidation program through 2015 worth €28 billion (about \$40 billion, 12% of GDP), including €6.5 billion (about \$9 billion, 2.9% of GDP) of additional spending cuts and revenue measures to be implemented in 2011. In all, the MTFS, together with previously announced measures, is designed to bring the government budget deficit down to 0.9% of GDP by 2015. The newly proposed consolidation measures aim primarily to reduce over-staffing in the public sector, improve the financial performance of state-owned enterprises, and streamline social transfers.

The other major component of the new fiscal strategy—and its most contentious—is an ambitious privatization and public real estate development program designed to raise €50 billion (about \$72 billion) by 2015, including €15 billion (about \$22 billion) by 2013. Concerns about the Greek government’s administrative capacity have led to discussions that the sale of public assets will be, quite unusually, overseen by an independent privatization authority, which is expected to include EU and IMF representatives.

### **More Financial Assistance**

In July 2011, European leaders announced a second financial assistance package for Greece totaling €109 billion (\$157 billion). This second financial assistance program will provide loans to Greece on more favorable terms than the first package (lower interest rate and longer maturities), as well as extend the maturities on existing Eurozone loans to Greece. At the time of the announcement, it was unclear whether the IMF would be contributing to the second financial assistance package. The official European communiqué called on the IMF to “continue to contribute to the financing of the new Greek program” but subsequent news reports indicated that the IMF would refrain from contributing to the second package.<sup>22</sup>

To help contain the crisis, European leaders also announced that they would make the EFSF more flexible. Instead of just providing loans, they announced that the EFSF will be able to provide precautionary lines of credit to countries under market pressures, finance the recapitalization of

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<sup>22</sup> Alan Beattie, “IMF Poised to Take Backseat Role in Greece Rescue,” *Financial Times*, July 22, 2011.

Eurozone banks, and buy bonds in secondary markets with the consent of the ECB. These changes need to be ratified by national parliaments.

### **Losses on Greek Bonds**

In July 2011, European leaders and the Institute for International Finance (IIF), an association of private financial institutions, announced that holders of Greek bonds would contribute €50 billion (about \$72 billion) through 2014 to the crisis response. Specifically, they would participate, on a voluntary basis, in bond exchanges and bond rollovers (€37 billion, about \$53 billion) and debt buybacks (€12.6 billion, about \$18 billion) to lower Greek debt payments over the short-term. The IIF designed a menu of options for the bond exchanges and rollovers and expect 90% of private creditors to participate. Those that do participate are expected to take a loss of 21% in the net present value of their bond holdings.<sup>23</sup> When the exchanges and swaps are carried out, the major credit rating agencies are expected to classify the Greek government as officially in default, since bondholders will not get paid in full and on time as specified in the original bond contracts.

### **Evaluating the Policy Response**

The policy responses to Greece's debt crisis have not been taken lightly, and they have been reached only after months of negotiations among the ECB, Eurozone leaders, the IMF, and the Greek government. The policy measures aimed to prevent a disorderly Greek default, to restore debt sustainability in Greece, and to prevent the spread of the crisis to other Eurozone countries and the global economy. To date, they have succeeded in the first objective, but have had limited success in the second two.

### **Ongoing Debates About Policy Responses**

Providing financial assistance to Greece has been controversial. Many Eurozone countries, including Germany, had to overcome considerable political resistance to providing support to Greece. Opponents of EU assistance to Greece expressed exasperation with the idea of rescuing a country that, in their perspective, has not exercised budget discipline, had failed to modernize its economy, and had allegedly falsified financial statistics. Opponents also raised the issue of moral hazard and wished to avoid setting a "bail out" precedent. Likewise, providing IMF funds to Greece sparked intense debate, because the IMF has not lent to developed countries in recent decades and the IMF program for Greece is quite large relative to the size of its economy.

Economic reforms have also been difficult for the Greek government for domestic political reasons. Papandreou's Panhellenic Socialist Movement (PASOK) came to office in October 2009 on a platform of social protection, promising to boost wages, improve support for the poor, and promote redistribution of income. The policies his government has since pursued to cut the budget deficit have required a full-scale retreat from these campaign pledges and are proving increasingly difficult to see through. Tens of thousands of public sector workers and their supporters have taken to the streets to protest the reforms. An opinion poll in June 2011 indicated that close to 50% of Greeks wanted parliament to reject new austerity measures, with only 35% in

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<sup>23</sup> Assuming a 9% discount rate. The IIF does not explain why it chose this discount rate in its calculations.

favor of parliamentary approval.<sup>24</sup> Unemployment in Greece more than doubled between 2008 and 2011, rising from 7.7% to 15.8%.<sup>25</sup>

The inclusion of bondholders in the crisis response in July 2011 signaled a major shift in the approach to responding to the crisis, which previously had focused primarily on the provision of financial assistance to Greece and economic reforms in Greece. Private sector involvement in the crisis had long been resisted by some European officials and the ECB due to fears that it would spark broader contagion in the Eurozone. Others, including German Chancellor Angela Merkel, felt that the costs of the crisis should be shared with private creditors and not borne by Greek citizens and European taxpayers alone.

### **Limited Success**

The policy responses have effectively prevented a disorderly default by the Greek government. Greece has continued to pay its debts in full and on time. Investors are expected to take losses on their investments, but a plan has been laid out with input from the private sector, and is expected to proceed in a controlled manner.

To date, the policy response has not put Greece on a clear path to recovery. In July 2011, the IMF estimated that Greece's public debt increased substantially between 2010 and 2011, from 143% of GDP to 166% of GDP. It also forecasted that Greece's debt will rise again in 2012 to 172% of GDP, and only start declining in 2013.<sup>26</sup> Most analysts agree that the path to debt sustainability in Greece has been hampered by lack of growth in the Greek economy. Growth would lower Greece's debt and deficit levels as a percentage of GDP, make investors more inclined to resume lending to Greece, and offset the contractionary effects of fiscal reforms, making them more politically palatable. However, fostering short-term growth in the Greek economy has not been a central feature in the policy response to date, and growth in the economy is proving elusive, with the economy contracting at a faster rate than expected. In May 2010, the IMF estimated that the Greek economy would contract by 2.9% in 2011.<sup>27</sup> Revised IMF estimates now project a sharper contraction for 2011 of 3.9%.<sup>28</sup> Growth also contracted by 4.5% in 2010.<sup>29</sup> Growth is proving difficult because austerity measures have depressed domestic sources of growth. Moreover, Greece cannot easily rely on exports for expanding its economy. As a member of the Eurozone, it cannot depreciate its currency against its major trading partners to help spur exports.

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<sup>24</sup> Michael Winfrey and Renee Maltezou, "Greeks March to Protest Austerity Campaign," *Washington Post*, June 18, 2011.

<sup>25</sup> International Monetary Fund, "Greece: Fourth Review Under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria," July 2011, <http://www.imf.org/external/pubs/ft/scr/2011/cr11175.pdf>.

<sup>26</sup> Real GDP growth. International Monetary Fund, "Greece: Fourth Review Under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria," July 2011, <http://www.imf.org/external/pubs/ft/scr/2011/cr11175.pdf>.

<sup>27</sup> Real GDP growth. International Monetary Fund, "Greece: Staff Report on Request for Stand-By Arrangement," May 2010. <http://www.imf.org/external/pubs/ft/scr/2010/cr10110.pdf>.

<sup>28</sup> Real GDP growth. International Monetary Fund, "Greece: Fourth Review Under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria," July 2011, <http://www.imf.org/external/pubs/ft/scr/2011/cr11175.pdf>.

<sup>29</sup> Real GDP growth. *Ibid.*



Additionally, the policy responses to Greece's debt crisis have not provided enough assurance to bond markets to prevent the spread of the debt crisis to other Eurozone countries. Nervousness about Greece has caused bond spreads to rise for other Eurozone members with weak public finances. Higher borrowing costs exacerbate their debt situation. In December 2010, Ireland turned to the IMF and EU for financial assistance, with Portugal following in April 2011 (see **Table 1**). In the late summer of 2011, interest rate spreads on Spanish and Italian bonds started to rise. Belgium, Cyprus, and even France, whose fiscal position had been widely viewed as stable, have also come under scrutiny.

**Table 1. EU-IMF Assistance for Greece, Ireland, and Portugal**

	Date Agreed	European Financial Assistance	IMF Financial Assistance	Total Financial Assistance
Greece	May 2010	€80 billion (about \$115 billion)	€30 billion (about \$43 billion)	€110 billion (about \$158 billion)
Ireland <sup>a</sup>	December 2010	€45 billion (about \$65 billion)	€22.5 billion (about \$32 billion)	€67.5 billion (about \$97 billion)
Portugal	May 2011	€52 billion (about \$75 billion)	€26 billion (about \$37 billion)	€78 billion (about \$112 billion)

**Source:** IMF press releases.

**Notes:** Figures may not add due to rounding.

- a. The headline number used by the IMF and in news reports for Ireland's total financial assistance package was €85 billion. This includes €17.5 billion (about \$25 billion) from Ireland's cash reserves and other liquid assets. Resources used by national authorities in the crisis response are not included in the table above.

There are different, but not mutually exclusive, views on why the policy responses to Greece's debt crisis failed to put a stronger "firewall" around the country and prevent the spread of the crisis. Some fault European leaders for failing to act decisively during the crisis. It has been argued that their slow, piecemeal approach to the crisis response, and public disputes about appropriate crisis response measures, have exacerbated investor anxiety rather than reassured markets. It may also be the case that the crisis spread not because of what was happening in Greece per se, but simply because other Eurozone countries faced fundamental fiscal challenges that were unsustainable. For example, Spain suffers from a serious housing bubble; Ireland, a bloated banking sector; and Portugal, a decade of anemic growth.

## Broader Implications

Greece has a small economy, accounting for only 2.4% of total Eurozone GDP, but the implications of its crisis are far-reaching. Fundamentally, Greece's crisis has exposed some of the fears expressed by economists when the Eurozone was created. They worried about the tensions that could be created by a group of different countries sharing a common currency and monetary policy, while maintaining national fiscal policies. Greece's debt crisis showed that these concerns were valid and that European leaders and EU institutions were not prepared to swiftly respond to

such a crisis. The Greece crisis has sparked larger discussions about how to resolve the tensions between a common monetary policy with national fiscal policies, while keeping the monetary union intact.<sup>30</sup>

Greece's crisis has also raised a number of more specific economic and political implications, detailed below:

**First, the policy responses to Greece's debt crisis have set precedents for how the debt crises in other Eurozone countries have been handled.** The original crisis response for Greece focused on the provision of IMF and European financial assistance, in combination with austerity and structural reforms. This policy response was contentious and took weeks to negotiate. When Ireland and Portugal needed assistance, however, their programs were easier to negotiate, because Greece served as a template for designing the crisis response. Now that bondholders are being asked to share in the response to Greece's crisis response by taking losses on their investments, markets are concerned that there will be losses on Irish and Portuguese bonds in the future. European officials deny this to be the case.

**Second, Greece's crisis has exacerbated concerns about the health of the fragile European financial sector.** Several large European banks, such as BNP Paribas, Société Générale, Deutsche Bank, UniCredit, and Intesa, are believed to be major private holders of Greek bonds.<sup>31</sup> There have been continuing concerns about how these banks would be able to absorb losses on Greek bonds should Greece default or restructure its debt, particularly given widespread concerns that European banks may be undercapitalized.<sup>32</sup> Specifically, there are concerns that the crisis could be transmitted through the European financial sector, triggering broader instability and requiring governments to recapitalize banks. European officials conducted two rounds of "stress tests" on European banks in June 2010 and July 2011. These tests examined how well European banks could absorb losses on distressed Eurozone bonds. Most banks performed well under the various scenarios laid out in the tests, but some questioned whether the tests were stringent enough.

**Third, Greece's debt crisis has created new financial liabilities for other European countries.** Eurozone countries have extended bilateral loans to Greece, and made financial commitments to the broader European Financial Stability Facility (EFSF). If these financial commitments are called on, they could substantially raise the debt levels in Eurozone countries, many of which are grappling with their own debt problems. For example, France's total financial commitment to the rescue packages is 8% of GDP.<sup>33</sup> Increasing the size of the EFSF, as some argue is necessary to give it the firepower it needs to respond to a potential crisis in Italy, for example, could increase France's commitments to 13% of GDP.<sup>34</sup> If these commitments were called upon, France's debt level could rise to above 100% of GDP. Some argue that these commitments explain, at least in part, why French bond spreads have started to widen.

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<sup>30</sup> For more on tensions in the Eurozone, see CRS Report R41411, *The Future of the Eurozone and U.S. Interests*, coordinated by Raymond J. Ahearn.

<sup>31</sup> "Global Rates Weekly," *Barclays Capital*, June 17, 2011, Figure 1: Barclays Capital Estimated Top 40 Holders of Greek Government Bonds and Greek Debt; Edward Harrison, "The Largest European Banks by Assets," *Seeking Alpha*, June 20, 2010.

<sup>32</sup> I.e., see "Europe's Banks: Ignoring the Obvious," *Economist*, July 15, 2011.

<sup>33</sup> "The Midget and the Mighty: The Debt Saga Keeps Sucking in New Countries," *Economist*, August 6, 2011.

<sup>34</sup> *Ibid.*

**Fourth, the Greek crisis has highlighted the policy constraints on members of the Eurozone.**

Many analysts have suggested that Greece would be better off if it could exit the Eurozone and issue a new national currency. A new national currency, devalued against the euro, could spur Greek exports and help growth return to the economy. As long as Greece is a member of the Eurozone, it does not have the exchange rate in its policy toolkit for responding to the crisis. Others, including the Papandreou government, argue that leaving the Eurozone would be a terrible economic decision for Greece, triggering a severe banking and financial crisis. They add that because Greece's debt burden is denominated in euros, a new, devalued national currency would increase the value of its debt in terms of national currency.

**Fifth, the Greek crisis has sparked a broader re-examination of EU economic governance, in order to improve the long-term functioning and stability of the currency union.**

The EU has been working on new legislation that would introduce significant reforms to economic governance. A proposed package of reform measures would strengthen enforcement of the Stability and Growth Pact, introduce greater surveillance of national budgets by the European Commission, and establish an early warning mechanism that would prevent or correct macroeconomic imbalances within and between member states.<sup>35</sup>

**Sixth, Greece's debt crisis has posed challenges to and opportunities for deeper EU integration.**

In some ways, the crisis has highlighted limits to EU integration, revealing fundamental disagreements between member states about how much EU integration is desirable and highlighting the power that member states, particularly Germany and France, still leverage compared to EU institutions. On the other hand, the crisis has spurred tighter integration, through increased powers of the ECB and the creation of a permanent European lending facility.

## Issues for Congress

The Greek debt crisis has been an ongoing source of concern for some Members of Congress. The crisis has been referenced on the House and Senate floor a number of times, led to committee hearings, and resulted in legislation. Member concerns have concentrated on two aspects of the crisis: (1) the impact on the U.S. economy, particularly U.S. financial institutions; and (2) the appropriateness of IMF involvement in responding to the Greek crisis. Comparisons between the U.S. and Eurozone debt situations are addressed in CRS Report R41838, *Sovereign Debt in Advanced Economies: Overview and Issues for Congress*, by Rebecca M. Nelson.

## Impact on U.S. Economy

The bilateral economic relationship between the EU and the United States is one of the largest and strongest in the world,<sup>36</sup> and economic turmoil in Greece and the broader Eurozone could have negative implications for the U.S. economy. At the start of the crisis, it was expected that austerity measures would slow growth in Europe and lead to a loss of confidence in the euro,

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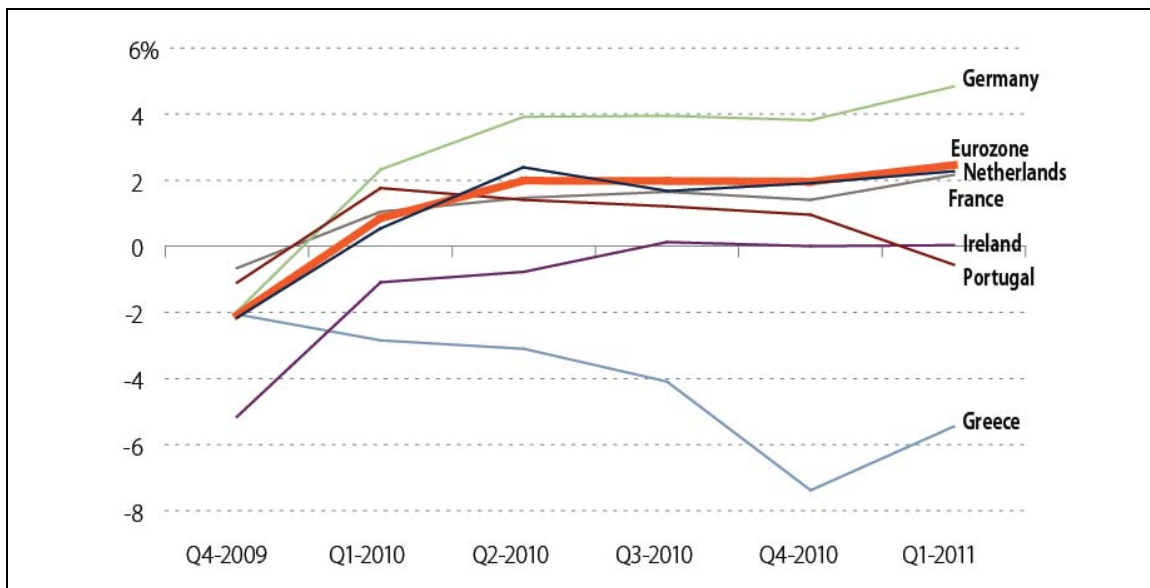
<sup>35</sup> See European Parliament, Economic and Monetary Affairs Committee, *Economic Governance Package Explained*, June 23, 2011, <http://www.europarl.europa.eu/en/headlines/content/20110429FCS18371/html/Economic-governance-package-explained>.

<sup>36</sup> For more information, see CRS Report RL30608, *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, by William H. Cooper.

causing a depreciation of the euro relative to the U.S. dollar. Both of these factors would depress demand for U.S. exports to the Eurozone and increase U.S. imports from the Eurozone, causing the U.S. trade deficit to widen. Likewise, slower growth rates in Europe could cause U.S. investors to look increasingly towards emerging markets for investment opportunities. On the other hand, a weaker euro could make European stocks and assets look cheaper and more attractive, attracting U.S. capital to the Eurozone.

**Figure 3** shows that even though growth has lagged in Greece, Ireland, and Portugal, the strong economic performance in the Eurozone “core” countries, including Germany, France, and the Netherlands, drove strong growth in the Eurozone through the first quarter of 2011. Real GDP growth in the Eurozone was 2.0% relative to the same quarter in the previous year in the second, third, and fourth quarters of 2010. Real growth increased to 2.5% in the first quarter of 2011, compared to the first quarter of 2010. Data releases for the second quarter of 2011, however, suggest that growth in the Eurozone may be starting to slow.<sup>37</sup>

**Figure 3. GDP Growth in the Eurozone, Q4 2009–Q1 2011**



**Source:** Organization for Economic Cooperation and Development (OECD), Quarterly National Accounts Dataset, accessed July 2011.

**Notes:** Real GDP growth, compared to same quarter of previous year.

There are a number of factors that affect the euro-dollar exchange rate (including U.S. policies, such as quantitative easing), and there has not been a clear, sustained depreciation in the euro against the dollar since the start of the crisis. **Figure 4** shows upwards and downward swings in the euro-dollar exchange rate since May 2010, when Greece’s financial assistance package was announced.

As the crisis has continued, however, increased perceptions of risk have affected U.S. financial markets. Concerns focus on the interconnectedness of the U.S. and EU financial sectors, and the

<sup>37</sup> I.e., see Jamie Chisholm, “Rally Faces after Weak German GDP Data,” *Financial Times*, August 16, 2011.

threat of the crisis spreading to larger Eurozone countries, including Spain or Italy. If the crisis does spread, the impact on the U.S. economy could be greater.

**Figure 4. US\$/Euro Exchange Rate, January 2010–July 2011**



**Source:** European Central Bank.

**Notes:** If the euro depreciates against the dollar, or the dollar appreciates against the euro, the US\$/euro exchange rate falls.

## Exposure of U.S. Banks

Given the interconnectedness of the U.S. and European financial sectors, another source of concern is how much U.S. banks could lose if Greece or other Eurozone countries were to default on their debts, or, in other words, how “exposed” U.S. banks are to Greece and other vulnerable Eurozone countries.

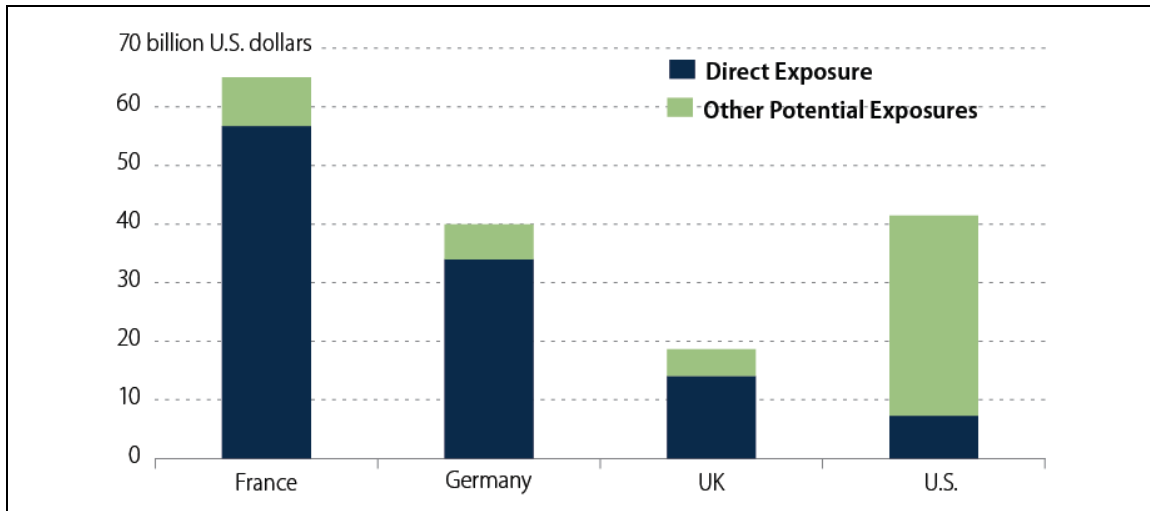
### Exposure to Greece

Direct exposure of U.S. banks to the Greek government is relatively small. According to the Bank for International Settlements (BIS), it totaled \$1.5 billion in December 2010.<sup>38</sup> Direct U.S. exposure to Greece more generally, including the Greek government and the Greek private sector, was \$7.3 billion in December 2010.

However, U.S. banks may be more heavily exposed to Greece through what the BIS calls “other potential exposures.” The BIS defines “other potential exposures” as derivative contracts, guarantees, and credit commitments. U.S. bank exposure to Greece through these more indirect channels totaled an estimated \$34.1 billion in December 2010, more than four times its direct exposure to Greece. By comparison, European banks have more direct exposure to Greece, and relatively less exposure through more indirect channels, than U.S. banks (see **Figure 5**).

<sup>38</sup> Bank for International Settlements (BIS), *BIS Quarterly Review: International Banking and Financial Market Developments*, June 2011, [http://www.bis.org/publ/qtrpdf/r\\_qa1106.pdf#page=100](http://www.bis.org/publ/qtrpdf/r_qa1106.pdf#page=100).

**Figure 5. Selected European and U.S. Bank Exposure to Greece**  
December 2010



**Source:** Bank for International Settlements (BIS), *BIS Quarterly Review: International Banking and Financial Market Developments*, June 2011, [http://www.bis.org/publ/qtrpdf/r\\_qa1106.pdf#page=100](http://www.bis.org/publ/qtrpdf/r_qa1106.pdf#page=100).

**Notes:** Exposure to Greece generally, not just the Greek government. “Other potential exposures” include derivative contracts, guarantees extended, and credit commitments. See text for more details.

It is generally believed that for the Eurozone, “other potential exposures” primarily captures bank exposure through credit default swaps (CDS).<sup>39</sup> CDSs provide insurance against default; if Greece defaulted on its debt, the sellers of CDS on Greek debt would be required to make payments to the buyers of CDS on Greek debt. Analysts disagree about whether the BIS data overstates U.S. exposure to Greece through CDSs,<sup>40</sup> or provides an accurate estimate.<sup>41</sup> Because the Greek bond exchanges and rollovers announced in July 2011 are to be provided on a voluntary basis, it is not expected to trigger payment on CDS contracts.<sup>42</sup>

### Exposure to the Eurozone

Broader contagion of the Greek debt crisis to the Eurozone poses a greater risk to U.S. banks. U.S. banks are much more heavily exposed to the other Eurozone countries under market pressure, particularly Italy, than they are to Greece (see **Figure 6**). The BIS reports that while direct U.S. bank exposure to Italy was \$36.7 billion in December 2010, “other potential exposures” exceeded \$230 billion. Total U.S. bank exposure to Greece, Ireland, Italy, Portugal, and Spain, including “other potential exposures,” is \$641 billion.

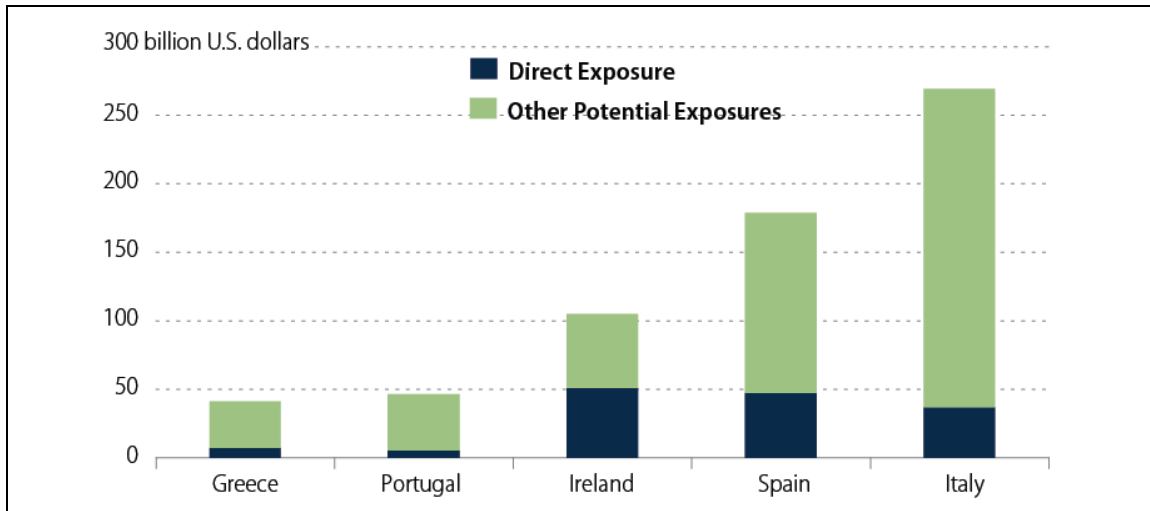
<sup>39</sup> For example, see Colin Barr, “Sizing Up the Greek Risk to U.S. Banks,” *Fortune*, June 9, 2011, <http://finance.fortune.cnn.com/2011/06/09/sizing-up-the-greek-risk-to-u-s-banks/?iid=Lead>.

<sup>40</sup> Tracy Alloway, “Who’s Selling Greek CDS, Again,” *FT Alphaville*, June 17, 2011.

<sup>41</sup> “US Bank Exposure to Greece, Part 3,” *The Street Light*, June 17, 2011.

<sup>42</sup> I.e., see Abigail Moses, “ISDA [International Securities and Derivatives Association (ISDA)] Says EU’s Aid Package ‘Shouldn’t Trigger’ Greece Credit-Default Swaps,” *Bloomberg*, July 22, 2011.

**Figure 6. U.S. Bank Exposure to Selected Eurozone Countries**  
December 2010



**Source:** Bank for International Settlements (BIS), *BIS Quarterly Review: International Banking and Financial Market Developments*, June 2011, [http://www.bis.org/publ/qtrpdf/r\\_qa1106.pdf#page=100](http://www.bis.org/publ/qtrpdf/r_qa1106.pdf#page=100).

**Notes:** Exposure to countries generally, not just the governments. “Other potential exposures” include derivative contracts, guarantees extended, and credit commitments. See text for more details.

## Data Limitations

U.S. bank exposure to Greece and other vulnerable Eurozone countries is only one part of total U.S. financial system exposure. Money market, pension, and insurance funds could also be exposed to Greece and other vulnerable Eurozone countries, but information on the exposures of these funds is limited. Likewise, data on secondary exposures, such as U.S. bank exposure to German banks, which are in turn exposed to Greek banks, is limited. Depending on the exposure of non-bank financial institutions and exposure through secondary channels, U.S. exposure to Greece and other Eurozone countries could be considerably higher.

There is some indication that U.S. financial institutions have responded to the ongoing economic turmoil in Europe by cutting their exposure to the region. It is reported that U.S. money funds, for example, have withdrawn all but extremely short-term lending to banks in the Eurozone.<sup>43</sup> It is also reported that they have reduced the availability of credit to Eurozone institutions, even in stronger countries such as France.<sup>44</sup>

## Use of IMF Resources

Of the 187 members of the IMF, the United States has the largest financial commitment to the institution. The IMF program for Greece has been supported by the Administration, but some Members of Congress have expressed concern about whether Greece’s IMF program is an appropriate use of IMF resources. The IMF program for Greece is unusual for a number of

<sup>43</sup> Dan McCrum and Patrick Jenkins, “Money Market Funds Cut Euro Bank Exposure,” *Financial Times*, July 24, 2011.

<sup>44</sup> Ibid.

reasons. First, the IMF has not generally lent to developed countries in recent decades. Second, the IMF loan to Greece is unusually large. The IMF has general limits on the size of its programs, but reserves the right to lend in excess of these limits in “exceptional” situations. The IMF loan to Greece represents exceptional access to IMF resources, at about 3,200% of Greece’s IMF quota. IMF quotas are the main financial commitments that countries make upon joining the IMF, and are broadly related to their size in the global economy. Third, because there are questions about the solvency of the Greek government, there is concern that the IMF is providing resources to a country that will not be able to repay its debt to the IMF and other creditors.

On the other hand, others argue that the IMF program for Greece is not unusual. The IMF lends to countries facing balance-of-payment difficulties, and it is widely agreed that Greece was facing substantial balance-of-payments problems when the original rescue program was agreed to in May 2010. Greece, as a member of the IMF, is entitled to draw on IMF resources, pending approval by the IMF management. Greece followed standard IMF procedures for obtaining the loan. The IMF also points out that the size of the loan to Greece is large, but that the policy reforms required of Greece to access the funds are just as large.<sup>45</sup> They add that the IMF has several safeguards in place to protect IMF resources, including making the disbursement of funds conditional upon economic reforms. They also argue that the IMF has a strong historical record of countries meeting their repayment obligations.

### **Legislation in the 111<sup>th</sup> Congress**

Member concerns about IMF resources being used to “bail out” Greece led to the passage of legislation in the 111<sup>th</sup> Congress as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010 (P.L. 111-203). Section 1501 of the law requires U.S. representatives at the IMF to oppose loans to high- and middle-income countries with large public debt levels (greater than 100% of GDP) if it is “not likely” that they will repay the IMF. Prospective IMF loans to low-income countries are exempted from this requirement.<sup>46</sup> If the IMF does approve a loan to a high- or middle-income country despite U.S. opposition, the law requires the Treasury Department to report regularly to Congress about conditions in that country. These reports would discuss the debt status of the country, economic conditions affecting its vulnerability, and its debt management status.

The law currently applies to a very small number of countries. According to IMF data from April 2011, only nine countries in the world meet the conditions set out in the legislation.<sup>47</sup> Some argue that the impact of the law will be limited, because the ability of a country to repay the IMF is already a fundamental requirement for IMF approval of a loan. Others argue that there could be instances in which the IMF and Treasury Department have different views on the likelihood of a country repaying the IMF. The law would have greater influence in these instances.

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<sup>45</sup> International Monetary Fund, “Frequently Asked Questions: Greece,” May 11, 2010, <http://www.imf.org/external/np/exr/faq/greecefaqs.htm>.

<sup>46</sup> Specifically, the law exempts countries that are eligible at the World Bank only for loans from its concessional aid facility, the International Development Association (IDA).

<sup>47</sup> International Monetary Fund, *World Economic Outlook*, April 2011. Calculations are based on gross general government debt, using IMF forecasts for 2011 debt levels. The nine countries that are not eligible for IDA assistance and have gross general government debt levels greater than 100% of GDP are (1) Japan; (2) St. Kitts and Nevis; (3) Greece; (4) Jamaica; (5) Lebanon; (6) Italy; (7) Barbados; (8) Ireland; and (9) Iceland.



Other legislation was introduced in the 111<sup>th</sup> Congress in response to the Greek debt crisis, but did not become law.<sup>48</sup> For example, H.R. 5299 and S. 3383, among other provisions, called on the Treasury Secretary to oppose any IMF loans to EU member states until all EU member states had public debt levels less than or equal to 60%. These pieces of legislation did not move out of committee.

### **Legislation in the 112<sup>th</sup> Congress**

Continuing concerns about use of IMF resources in the Greek debt crisis likely contributed, at least in part, to the introduction of legislation into the House (H.R. 2313) and Senate (S.Amdt. 501; S. 1276). These pieces of legislation call for rescinding the U.S. financial commitments to the IMF approved by Congress in 2009.<sup>49</sup> The Senate voted against the amendment on June 29, 2011. The House version of the legislation has been referred to committee. The language to rescind U.S. commitments to the IMF approved in 2009 is also included in a draft FY2012 State and Foreign Operations appropriations bill, posted on the House Appropriations website.<sup>50</sup>

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<sup>48</sup> For example, see H.R. 5299 and S. 3383.

<sup>49</sup> For more information, see CRS Report R40578, *The Global Financial Crisis: Increasing IMF Resources and the Role of Congress*, by Jonathan E. Sanford and Martin A. Weiss.

<sup>50</sup> [http://appropriations.house.gov/UploadedFiles/FY12-SFOPS-07-25\\_xml.pdf](http://appropriations.house.gov/UploadedFiles/FY12-SFOPS-07-25_xml.pdf), pp. 176-177. The legislation has not been introduced yet and thus does not have a LIS number.