The IMF's eurozone woes

Christine Lagarde identifies the eurozone as biggest threat
91% of IMF commitments are to EU countries

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The International Monetary Fund (IMF) is involved in a deep, complex and potentially corrosive relationship with the European Union over the response to the eurozone's sovereign debt crisis. While the IMF has helped shape policy, thrown cash at the deepening problem and provided a useful channel for bail-outs by the backdoor, long-term involvement poses its own risks.

The IMF's close participation is a situation that has suited Europe's leaders. Europe gets a good deal from the Washington-based lender. That has been true since the institution was set up in 1945 and is even truer now. The eurozone crisis has served to highlight that still more. About 91% of its current commitments are to EU member states, an unprecedented share of the IMF's resources.

But the strain is beginning to tell. For how much longer will non-eurozone countries tolerate bailing out the eurozone? Christine Lagarde, the IMF's managing director, has identified the eurozone crisis as the biggest threat to the global economy and says that her institution needs far greater resources; but the world's emerging economies – countries such as India, Brazil and China – refuse to do so without a greater say in directing IMF policy. Disagreements within the IMF have been bad tempered. The US has balked at putting more cash into the IMF's coffers; they say that the eurozone is rich enough to sort out its own problems.

European influence on IMF
Despite the discontent, Europe still has a strong hand to play. The IMF continues to be heavily influenced by European countries and the US. That is mainly down to favourable voting rights. Countries get a share of votes roughly equal to the relative size of their economies. The EU's member states have about 32% of the vote. As other parts of the world have become wealthier, their share of voting rights has barely increased, despite reform in 2008 and 2010.

If emerging countries increase their contributions to the IMF they would attach strings that would not necessarily benefit the eurozone. "None of the rich countries want to dilute their voting rights," says Peter Chowla, of the Bretton Woods Project, an organisation that monitors the IMF's work. He says that under the current arrangement European politicians effectively "get to run the IMF". The IMF's deep involvement in Europe is not just about money; however. IMF officials have considerable influence due in no small part to the failure of the eurozone's leader to come up with credible and cohesive plans themselves.

"The IMF has been calling for financial-system reforms in Europe for many, many years," says Garry Schinasi, an IMF official from 1999 to 2010 and now an adviser to central banks and governments. "I could point to publications I offered ten or 12 years ago, even before the introduction of the euro, where the IMF was calling for crisis management reform, warning that there was no clear lender of last resort."

These calls fell on deaf ears. But as the crisis has deepened the IMF has found itself embroiled still more deeply. The IMF, rather thought, or was hoping, that Europeans understood what needed to be done and would marshal the political will to get it done, says Schinasi. "Over time that has proved to be a false assumption. The IMF today has had to become more forceful."

Not only has the IMF shaped politicians' responses; the European Commission has also leaned heavily over the past two years on the IMF's expertise in tackling economic turmoil. "They know that the IMF is the institution with the track record," says Benedetta Marzinozzo of Bruegel, a Brussels-based think-tank.

Access to cash
Access to IMF cash is convenient for the EU, too. The institution has an executive board with 24 members and a large majority is needed to approve a loan – but that is a lot easier than getting a tricky unanimous decision from all eurozone countries. It is easier for countries to bypass their national parliaments and channel money into the IMF – they committed an additional €110 billion in December – than to lend to struggling eurozone countries directly.

This convoluted arrangement, under which member states lend to the IMF and the IMF lends money back to the eurozone, from the Eurosystem, and in some cases to the IMF, was intended to replace it, to run in parallel from this year, the IMF is trying to persuade Germany to acquiesce and allow the European Financial Stability Facility, the eurozone's temporary rescue fund, and the Eurozone Stability Mechanism, the permanent fund that was intended to replace it, to run in parallel from this year, to run in parallel from this year, boosting the eurozone's lending capacity to about €435 billion.

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This step would have a more immediate effect than the tighter fiscal discipline demanded in the inter-governmental treaty currently being drafted by the EU. The IMF has been supportive of the EU's medium-term response to the crisis, including the need to create greater fiscal discipline, but, according to Schinasi, IMF officials have "now turned vocally very critical of delay after delay in taking the decisions to solve the current problem."

Even if the IMF can convince the eurozone's governments to rein in their spending, there is an acknowledgment that the IMF's relationship with Europe must change in the future. Some, even from within the IMF's own ranks, are calling for it to become less engaged in the eurozone's difficulties, "but they don't have the political power within the institution," according to Chowla.

That will change if the crisis deepens and inflicts the global economy, calling into question not just the policies of eurozone leaders, but also those of the IMF. The IMF will have to change tack. The risk is that if it becomes ever deeper entrenched in Europe, with the eurozone remaining dependent on the IMF's support to paper over its own structural cracks, the IMF's own capacity to lend will be compromised. The fund cannot allow that to happen. In other words, substantial IMF involvement in the eurozone cannot be seen as anything other than a short-term fix.