Lagarde Consumed by Crisis Steers IMF Tough Love to EU

By Sandrine Rastello on July 05, 2012

Discussing climate change was a welcome break for Christine Lagarde from the European debt crisis that has consumed her first year as director of the International Monetary Fund.

“I’m very pleased to be here today, not only because we’re not going to talk at all about the euro zone, not at all about Greece, not at all about Spain,” she said in a June 12 talk to the Center for Global Development in Washington, drawing laughs from her audience.

Then Europe caught up with her, again. Four days after the event, Lagarde, 56, canceled plans to join leaders at a summit on sustainable development in Rio de Janeiro. Instead, she flew to Luxembourg to urge finance ministers of the 17 euro countries to take further steps to save their monetary union, which has already required almost 500 billion euros ($629 billion) in funds for indebted nations and their banks.

So it’s gone for the former French finance minister. Over the year, she has signed off on a second Greek bailout, called for European banks to be recapitalized and traveled from Brasilia to Beijing to obtain more lending resources as Europe’s turmoil threatens global growth.

The challenge of leading a global institution that’s increasingly focused on one continent isn’t over. With 80 percent of the IMF’s credit set to be tied up in Europe by 2014, the region represents a growing risk to the fund’s resources and reputation among non-European nations, just as Greece seeks to renegotiate the conditions attached to its bailout.

Established Independence

“Lagarde took over the head job at the IMF as the European representative but quickly and forcefully established her independence,” said Eswar Prasad, a senior fellow at the Brookings Institution in Washington. She “has maintained a delicate balance between keeping the IMF involved in the euro zone debt crisis without inflicting too much damage to the institution’s credibility.”

The crisis has engulfed two more countries since Lagarde assumed the fund’s top job one year ago following the resignation of former chief Dominique Strauss-Kahn, who quit after being arrested in New York on charges including attempted rape. Those charges were later dropped.

She inherited loans to Greece, Portugal and Ireland that are administered with other “troika” members, the European Commission and the European Central Bank, along with an informal agreement that the IMF would finance a third of future bailout packages. Spain sought a bailout from Europe in June and Cyprus has requested aid from Europe and the IMF.

Europe's Expectations

Lagarde also carried expectations among the European policy makers who had supported her candidacy that she would be an ally. The expectations didn't last.

Less than two months into the job, Lagarde called on the Europeans to urgently recapitalize their banks or face a liquidity crisis. The German and Spanish governments rejected the idea the next day, saying enough had been done already.

She advocated a larger bailout fund, jointly issued euro bonds and steps toward a banking union. In a shift from the Strauss-Kahn era, she also scaled down the share of IMF funding in Greece's second loan and said Europeans alone would have to fill the gap if the country's program went off track.

"In the end she was more of a prod by telling things quite clearly at the right time" to Europeans, said Gilles Moec, co-chief European economist at Deutsche Bank AG in London.

Last week's summit of European leaders, who eased lending and aid conditions, was "of more significance" than past attempts to stem the crisis, Lagarde told Bloomberg contributor Judy Woodruff in a July 3 televised interview.

'New Direction'

"They need to move towards fiscal union as well, which will take probably more time, more summits, more illusion, disillusion," Lagarde said. "But they're heading in a new direction together and that's a clear sign that things are changing."

To some outside Europe, Lagarde's prodding isn't enough.

Canadian Finance Minister Jim Flaherty said he's told Lagarde he's worried that the IMF's room to maneuver is constrained by the "troika" system.

"That's not the traditional way the IMF operates," Flaherty told reporters in Washington on April 19. "Traditionally, the IMF would direct what needed to be done." In past crises, including in Asia in the late 1990s, the IMF and central banks would sit on opposite sides of the negotiating table.

Emerging Markets

Also scrutinizing Lagarde are leaders of emerging-market countries, many of which contributed to an increase in the fund's resources and are demanding voting rights that better reflect their economic size. The $456 billion raised between April and June fell short of her original goal of $600 billion as the U.S. declined to chip in.

A 2010 agreement boosting the clout of countries including China and South Korea is still pending approval by the U.S. Congress and others just as the IMF's 188 member nations brace for another round of voting-rights negotiations.

"Many countries, including Brazil, voted for her with the expectation she would follow through with the reforms of the fund," said Paulo Nogueira Batista, who represents Brazil and eight other countries at the IMF board and said he was speaking only for himself. "So far the reforms are moving slowly. She is deeply involved in the European process," he said by telephone.

Still, Mexican central bank governor Agustin Carstens, who himself had been a candidate for the IMF post, campaigning on breaking Europe's hold over the leadership, said Lagarde has done a "very good job given the circumstances."

Future Willingness

The IMF’s future role “will depend on the willingness of the countries to request the support of the fund,” he said in an interview yesterday in Mexico City.

Lagarde has also spent time in the past year traveling to seek contributions for her war chest. She jokingly waved her purse at delegates to the World Economic Forum in Davos, Switzerland, including U.K. Chancellor of the Exchequer George Osborne and Bank of Canada Governor Mark Carney, saying she had brought her “little bag to actually collect a bit of money.”

The first woman to head the IMF and one of the few non- economists to head the institution, Lagarde vowed to increase the number of women and the diversity of nationalities among IMF staff to catch up with lenders such as the World Bank.

While she has appointed a few women to top management positions including at the IMF Institute, which trains government officials, key departments such as strategy and research remain in men’s hands. She also named the first Chinese deputy managing director, Zhu Min.

Wheelchair-Bound

Board officials describe her working style as more formal than Strauss-Kahn’s and say she intervenes less during discussions. On a March day she arrived at a board meeting in a wheelchair from a sports injury and made no mention of what had happened to her, according to two officials who declined to be named because the meetings are not public.

Lagarde’s training as a lawyer -- she was chairman of Chicago-based law firm Baker & McKenzie LLP for six years -- is reflected in her choice of words. Asked by Vogue which economist she felt affinity with, she said she was “with Adam Smith.”

She did trip over a question on Greece in a May interview with the Guardian, saying many people in the country were “trying to escape tax all the time.” The remark provoked thousands of comments on her Facebook page. She later told the board she regretted her comments had been misunderstood.

In November she turned to a veteran staffer, Reza Moghadam, to head the European department. He replaced Portuguese national Antonio Borges, a former vice chairman at Goldman Sachs International appointed by Strauss-Kahn. Borges resigned for “personal reasons” a month after making comments that implied the fund could intervene in bond markets. He later retracted.

While Lagarde didn’t mention that shakeup in her Washington speech on climate change, she did say her law-firm experience gave her training for her current post: “I was told that if I was capable of managing 600 partners I could herd as many cats in the world as was required.”

To contact the reporter on this story: Sandrine Rastello in Washington at srastello@bloomberg.net

To contact the editor responsible for this story: Chris Wellisz at cwellisz@bloomberg.net

Christine Lagarde, managing director of the IMF, arrives to speak about the IMF's annual report on the U.S. economy at a news conference in Washington, on July, 3, 2012. Photographer: Joshua Roberts/Bloomberg Christine Lagarde, managing director of the International Monetary Fund (IMF). Photographer: Joshua Roberts/Bloomberg