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IMF’S Lagarde Enjoys Funds Victory Exposing Europe Rifts

By Sandrine Rastello and Simon Kennedy on April 23, 2012

Three months after waving her purse in front of global finance chiefs, Christine Lagarde filled it with more than $430 billion in pledges for the International Monetary Fund. She may not enjoy her victory for long.

The lender’s spring meetings ended yesterday in Washington with a doubling of its war chest and a number of sores exposed among its 188 members. Managing Director Lagarde fell short of her original $600 billion goal as the U.S. declined to chip in, while Canada proposed making it harder for Europe to tap aid. Big emerging markets demanded more power at the IMF before writing checks.

The tensions leave Lagarde pushing her home continent to justify the show of solidarity with greater efforts to fight the crisis, as Spain’s interest rates soar and Dutch austerity talks flop. If Europe resists, she could find it harder to rally support for sending the region more money or face criticism for bailing out undeserving governments.

“Any further lending to euro zone economies is likely to be under even greater scrutiny from the IMF’s other members,” said Eswar Prasad, a former IMF official now at the Brookings Institution in Washington. “Lagarde faces a difficult balancing act.”

Italy, Spain

Concern that Italy and Spain are slowing down in cutting budgets and overhauling their economies reignited the turmoil, which prompted Lagarde’s drive to ensure the IMF is able to protect troubled countries and global growth. Spain’s notes last week extended their longest decline since 2007 and Italian bonds rose for a sixth week.

“I need to have the umbrella in case the clouds break into a nasty rain,” Lagarde told Bloomberg Television.

The euro was little changed, at $1.3181 as of 3:10 p.m. in Tokyo. Asian stocks headed for a third straight session of losses, with the MSCI Asia Pacific Index down 0.3 percent.

Lagarde’s fillip still doesn’t lift the combined European IMF firewalls enough to protect Spain and Italy for long if they falter, said Megan Greene, head of European economics at Roubini Global Economics LLC.

“It’s enough to keep Spain and Italy out of the markets for maybe two years, but not much longer,” she said. “It’s enough to buy a little time, but not to make a real difference.”

November Rebuff

A former French finance minister and lawyer, the 56-year- old Lagarde was hinting at a need for larger coffers within a month of joining the IMF in July. After being rebuffed by the Group of 20 nations in November amid irritation Europe wasn't doing enough itself, she resumed her push in January.

She traveled to large emerging markets, and on the stage of the World Economic Forum in Switzerland showed her handbag to delegates including U.K. Chancellor of the Exchequer George Osborne and Bank of Canada Governor Mark Carney.

Lagarde said she had brought her "little bag to actually collect a bit of money."

The omens weren't good as the U.S., the IMF's biggest shareholder, balked on the grounds that the lender and Europe had enough resources and because congressional approval would be impossible in an election year.

After Europe increased its own defenses and Lagarde pared her target a breakthrough came when Japan committed $60 billion on April 17.

"It's like a dinner," she told broadcaster Charlie Rose hours after striking the April 20 deal. "You say to someone 'why don't you come because so and so is coming.' You're not too sure that so-and so is coming. And they all come. Japan was exactly that. Japan did it first."

Diplomatic Skill

Lagarde's diplomacy won praise from Jacob Kirkegaard, a research fellow at the Peterson Institute for International Economics in Washington. He noted the amount is close to the unprecedented $500 billion pledge the IMF won in 2009.

"It is a victory for Lagarde," said Kirkegaard.

It nevertheless came at a price as governments used the replenishing to raise old and new concerns and set conditions for helping out.

"Countries that are contributing to the IMF's resource boost have become quite explicit about what they anticipate in return," said Prasad.

Japan, for one, wants to have a larger say within the IMF and to send more officials to its Washington headquarters. Emerging markets, most vocally Brazil, want the U.S. and other nations to ratify a 2010 deal that would hand them more votes at the fund, given their increased heft in the world economy.

BRIC Concerns

Some countries "are more enthusiastic about asking money from emerging markets than carrying out the quota reform, because these are the countries that will lose," Brazilian Finance Minister Guido Mantega said as his nation, along with Russia, China and India delayed details of their commitments.

The G-20 aimed for implementation of the reforms by an October meeting in Tokyo and agreed that votes "should better reflect the relative weights of IMF members in the world economy." Change may still not come that fast given the U.S.'s November election.

"Enticing emerging market support by offering governance reform is getting to be an old joke, and is tricky to achieve in the IMF," said Daniel Heath, a former U.S. alternate director on the IMF board. Such promises could "risk Lagarde's future effectiveness," he said.

Canada also wants a voting revamp. At present, the IMF's 24-member Executive Board is dominated by European accents, causing Canadian Finance Minister Jim Flaherty to suggest a conflict of interest given 80 percent of the fund's credits will be located in the euro area by 2014.

Canada's Proposal

He wants future loans to Europe to be voted on twice, first by euro-zone members and then by the rest. He also wants the IMF to take more control of aid programs rather than monitor them alongside European authorities through the so-called troika.

Seeking to deflect criticism and maintain flexibility should more economies need her assistance, Lagarde pressed Europe not to relax its own rescue efforts. She stressed the IMF's money won't be earmarked for any economy and that future loans will come with tough conditions.

The IMF's advice for Europe includes lower interest rates from the European Central Bank, austerity balanced with measures to improve growth, having rescue funds inject capital into weak banks such as Spain's and selling euro bills to deepen fiscal integration.

ECB Rebuff

ECB President Mario Draghi nevertheless said in Washington that "none of the advice that the IMF is offering has been discussed by" monetary policy makers lately. German Finance Minister Wolfgang Schaeuble said Europe's $1 trillion shield showed "the Europeans have met their commitments."

There is also the risk that indebted countries backpedal on reforms if they think there is a stronger safety net, said Kirkegaard. Italy and Spain have yet to fully deliver their policy promises, while Dutch Prime Minister Mark Rutte faces the likelihood of early elections after deficit talks led his minority government to splinter. France's presidential election is going to a May 6 run-off.

"Incentives -- especially political -- are critical," said Kirkegaard.

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