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The IMF and the euro-zone rescue

High stakes

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What has the fund got itself into by participating in Europe's bail-out?

THE IMF's star has risen steadily through the global economic crisis. Contributions from its members have tripled its firepower. It has rescued economies from Hungary to Pakistan. Yet despite these achievements, its activities did not extend into the heart of the rich world.

That is now changing. Although initially sidelined by the European Union (EU), the IMF eventually cofunded and devised the terms of Greece's massive bail-out. And on May 10th the EU announced that the IMF is to provide up to €250 billion ($317 billion) to supplement its own €500 billion stabilisation fund to prop up the euro area's weaker members.

But the details of the IMF's promised contribution are far from clear. The fund is keen to emphasise that no money has actually been set aside for the rescue. Its deputy chief, John Lipsky, stresses that the €250 billion figure is "a hypothetical or theoretical number" based on the fund's role in recent joint EU-IMF rescues, where the IMF has provided about a third of the cash on offer.

The amount is hypothetical for a very good reason. Having to set that amount aside immediately would leave the IMF unable to lend to any other country that got into trouble. As of May 6th, its total remaining lending capacity for the year ahead was $272 billion, or €215 billion. It has never lent as much in one go as it would if the euro-area package were to be activated in its entirety (see chart).

The fund could, of course, find more money. Its board recently approved an extension of its standing arrangements to borrow from governments and central banks by more than $500 billion. But about half that amount is already included in its current lending capacity. Activating the rest would require many governments to seek legislative approval.

There are other options. The IMF will get some extra cash at the end of the year from a general increase in quotas, the maximum amounts countries are obliged to supply to the fund. Last year it also issued $250 billion of Special Drawing Rights (SDRs), its own quasi-currency. These sit in countries' reserves in proportion to their quotas. Dominique Strauss-Kahn, the fund's chief, thinks countries could lend some of this money to others. But there is no precedent for SDRs being transferred on such a massive scale.

The fund could also approach some reserve-rich emerging countries to top up its kitty. Some have already lent to the fund. China bought $50 billion of notes the fund issued last year; Brazil, Russia and India each bought $10 billion. But some of these countries are miffed that the fund did not consult them before rushing to the rescue of the euro area. Emerging Asian economies have bitter memories of the harsh conditions the IMF imposed on them during the Asian crisis; they are concerned about the fund making a huge commitment of resources without clearly setting out what potential borrowers would have to do to get the money.

Eswar Prasad, a former chief of the fund's China desk, says that all this is once again leading to questions about "whether the IMF's ultimate fealty is to its main shareholders, the US and the EU". Such concerns repeatedly arise because European countries as a group have the biggest chunk of votes in the IMF, and are over-represented relative to their economic heft.

Some also wonder whether the political ambitions of Mr Strauss-Kahn, who is widely rumoured to be considering a run for the French presidency, were behind the IMF's eagerness to step in. Simon Johnson, once the fund's chief economist, says that "a former French finance minister is the worst possible person to be leading the IMF into negotiations designed to save the euro. The conflicts of interest are overwhelming." The fund's European adventures may help Mr Strauss-Kahn. Their consequences for the institution he heads are less clear.

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