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IMF aims to help bystanders

By Alan Beattie in London and Peter Spiegel in Cannes

The International Monetary Fund is proposing to create a new lending instrument aimed at boosting liquidity in well-run countries hit by financial contagion, but nations like Italy would most likely not be eligible, according to officials.

The proposal could be coupled with a plan to create billions of dollars by issuing "special drawing rights" (SDRs), a form of reserve asset used by the IMF, to boost global liquidity.

IMF staff circulated a proposal last week that would allow countries to rapidly access short-term loans of around six months if they were "crisis bystanders" during financial turmoil – a category which would likely not include Italy.

Officials familiar with the discussions said the new facility, if approved by the IMF's shareholder countries, would supplement existing credit lines – the flexible credit line (FCL) and precautionary credit line (PCL) – which are available to countries with a good policy record and with relatively few conditions attached.

"The existing PCL is minimum one year," said one official familiar with the discussions. "This new proposal would consider making the resources available for a six-month period for countries that have very short-term needs".

IMF experts said the proposal was aimed at mollifying emerging market countries, some of which have become increasingly concerned about the large amounts of IMF lending going to western Europe. An issuance of SDRs, which go to the IMF's member countries in proportion to their contributions to the fund, would increase European governments' resources, particularly if they decided to pool their allocation. SDRs are based on a basket of the major tradable currencies and can be used for transactions between governments.

"This has been in the works as a way to provide some assurance to emerging markets that their interests won't get completely sidetracked if the Fund focuses on Europe in its lending operations," said Eswar Prasad, a former IMF official at the Brookings

Institution think-tank in Washington. "It is a savvy move by the G20 and IMF to justify an SDR allocation and other mechanisms to add to the IMF's resource pool by signalling that the new resources won't be devoted entirely to saving Europe," he said.

The flexible credit line, for which well-run countries can pre-qualify before a crisis hits, is given out with very few strings attached. Poland, Mexico and Colombia have all qualified for the credit facility, though none has yet drawn down any money.

The IMF has been puzzling how it can increase its firepower without going back to shareholder countries for fresh contributions – a plan that would likely receive a chilly welcome from the US, where congressional opposition to using US funds to bail out Europe has been rising.

Some eurozone politicians have also suggested that China and other big emerging market countries could contribute money directly to a bail-out, but several nations including Brazil, India and Russia said they will only contribute via the IMF.

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