FINANCIAL TIMES

July 15, 2012 6:49 pm

IMF faces balancing act over eurozone

By Robin Harding in Washington

Austerity: a man begs in Barcelona. One of the fears is that Spain will need an international bailout

The great shadow over the world economy is the fear that Italy or Spain will need an international bailout. But it is also an ominous prospect for the International Monetary Fund, an institution that would have to respond with speed and conviction.

A rescue for a large European economy would be so big that, once begun, it would be almost impossible to back away from. That would pose certain challenges to the fund: how to enforce the terms on which it lends; how to satisfy developing countries while committing so many resources to Europe; and how to avoid setting precedents that could haunt it when other countries need programmes in the future.

It is the old axiom about bank borrowing, scaled up a few orders of magnitude: if you owe the IMF a billion dollars then that is your problem; if you owe a hundred billion then it may be the fund's.

"There is this very delicate balance to strike between staying involved and staying credible," says Eswar Prasad, a former head of the IMF's China department and now a senior fellow at the Brookings Institution in Washington.

If a big European country were to ask the IMF for help then it would have an obligation to respond. "The IMF should not turn its back on members individually or collectively," says Ted Truman, a former senior official at the US Treasury, now at the Peterson Institute in Washington, echoing a view that is widely held within the institution.

The unusual nature of the eurozone's woes – sovereign debt crises but within a single currency area – makes the challenge especially complicated. In Europe, the fund is just one part of the "troika" managing the crisis, alongside the European Central Bank and the EU.

Inability to devalue a currency such as the Greek drachma means that the eurozone's ills will take more time and more pain to cure. The IMF's credibility is therefore being tested especially hard, most obviously by Greece, which has wriggled and wriggled over the terms of its deal and will struggle to sustain debt payments even if it does everything that it is supposed to.

After initial missteps, where the fund seemed to be led along by its European partners, Mr Prasad gives it good marks. "The IMF has managed to stay credible by being quite forceful in asserting its positions about what Europe has to do," he says.

Another challenge for the fund in a future eurozone programme would be to keep developing countries such as China and Brazil on side even as it deploys much of its resources in the wealthy eurozone.

Officials from the large developing countries still think that the eurozone should be doing more to help itself, but at the same time they recognise the damage the crisis is doing to their own economies, and see the fund as one of their only policy tools to respond. If they are going to commit resources to Europe via the IMF, however, they want that to translate to greater power within the institution.

"I think there is serious concern amongst the major emerging markets that although the IMF and its leadership are committed to governance reform, they may not be able to navigate all of the political constraints," says Mr Prasad.

For example, the last round of IMF quota changes have still not come into effect, and any increase to IMF resources is unlikely to get through the US Congress during an election year.

You may be interested in

Troika says Dublin on track to meet targets

Greece cuts company executive rewards

Athens cabinet pressed to deepen cuts

Banking union is a priority, says IMF

Bailout supervision will root out banks' bad habits

Printed from: http://www.ft.com/cms/s/0/e4e08f84-ce97-11e1-9fa7-00144feabdc0.html

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© THE FINANCIAL TIMES LTD 2012 FT and ‘Financial Times’ are trademarks of The Financial Times Ltd.