

## The IMF and the euro

# Cash for credibility

### Laundering European rescue funds through the IMF

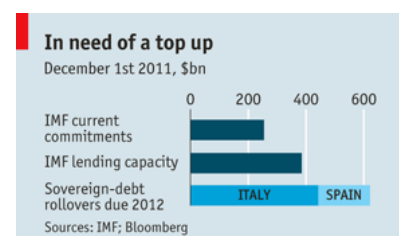
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AS A new game plan for saving the euro by enforcing fiscal discipline takes shape (see [article \(http://www.economist.com/node/21541414\)](http://www.economist.com/node/21541414)), there is growing speculation that Europe's central bankers could help in another way—by channelling rescue funds through the IMF.

The ECB is not allowed to fund member governments, but it or national central banks could lend to the IMF. Those national central banks have provided resources to the fund before, which is why the ultra-orthodox Bundesbank does not object to filling the IMF's coffers—even if that money were then used to provide rescue funds for countries such as Italy or Spain.

In many ways this money-laundering would be a clever wheeze. It gets around the central bankers' hang-ups. It provides discipline, since the fund's conditionality would help to keep Europe's peripheral economies on track. And it could elicit funds from others. America won't contribute anything more to the IMF, but big emerging markets seem willing to top up the fund's resources, provided the Europeans do so too. With Europe's own rescue fund—the European Financial Stability Facility—floundering, the IMF may be the best route to raising real money.

How much could be raised is still up for grabs. Eswar Prasad, an economist at Cornell University who follows the IMF closely, reckons that if Europeans come up with \$150 billion-200 billion, then emerging economies might add a similar sum to the pot. Those are the kind of sums that would be needed. The IMF currently has some \$390 billion of lendable cash in its kitty (see chart). That's enough to deal with smaller economies, but not to back stop Italy and Spain, which need to refinance some €320 billion (\$430 billion) and €142 billion respectively in 2012.



Unfortunately, like many clever wheezes, this one is full of pitfalls, both for the Europeans and for the IMF. The fund, which already has over half of its outstanding loans in the euro zone, would become even more heavily exposed to one region. For Italy or Spain, borrowing from the IMF is not the same as the ECB buying their bonds. The IMF is a preferred creditor, which means it always gets paid back first. Thus the more the fund lends to a country, the bigger the write-down for private creditors if there were ever a default.

An IMF rescue plan could spook investors rather than reassure them, particularly if parallels were drawn with Greece, Portugal and Ireland, which have already had rescue packages from the IMF and the Europeans, and show no sign of regaining access to financial markets. The experience of those countries does not bode well for the IMF's credibility either. In each case the Fund's

technocrats are not in sole charge. Against their better judgment, they have often compromised on reform plans with European rescuers, who usually push for harsher austerity.

The same danger exists for Italy or Spain. Even if the Europeans launder rescue funds through the IMF, they are unlikely to outsource fiscal oversight entirely. The inevitable compromises could easily lead to rescue plans that fail. If the euro then falls apart, the IMF, the one institution that could pick up the pieces, will lack both the cash and credibility to do the job.

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