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Europe Urged to Quell Crisis as IMF Wins $430 Bln Boost

By Simon Kennedy and Sandrine Rastello - Apr 21, 2012

European policy makers were urged to be tougher and more agile in their efforts to end two years of debt turmoil as the International Monetary Fund won more than $430 billion to safeguard the world economy.

IMF Managing Director Christine Lagarde's push for a doubling in lending power paid off despite complaints from emerging markets wanting more say in how the fund is run and calls from some richer nations for aid to be more tightly controlled.

That left finance chiefs from the Group of 20 stressing that Europe must now justify the show of solidarity by doing even more to restore fiscal health, help banks and spur economic growth. Failure to do so could make it harder for countries such as Spain to secure aid if they falter and imperil a global recovery the G-20 labeled modest and subject to downside risks.

Europe's leaders and central bankers must deploy their "tools and processes creatively, flexibly and aggressively to support countries as they implement reforms and stay ahead of the markets," U.S. Treasury Secretary Timothy F. Geithner said today in Washington at the IMF's spring meeting.

Although Geithner made no specific proposals, the IMF this week advised the European Central Bank to cut interest rates and inject capital directly into banks. Brazil yesterday pressed Germany, Europe's linchpin economy, to spend more and the U.K. today backed a proposal for euro-area governments to issue joint debt.

More Work

"The firewall is a necessary, but far from sufficient condition to resolving this crisis," said Tharman Shanmugaratnam, the finance minister of Singapore who chairs the IMF's policy panel. "The real solution has to do with the fiscal and structural reforms that address the real causes of this crisis."

European officials chafed at criticism they have not done enough weeks after they bowed to overseas pressure by lifting their own rescue funds to the symbolic $1 trillion level. The ECB also lent banks more than that amount in long-term loans.

"We can tell the world with full conviction that the Europeans have met their commitments," German Finance Minister Wolfgang Schaeuble said. ECB President Mario Draghi argued Spain and Italy have done "remarkable work" in tackling their fiscal woes and that the ECB officials have not recently considered heeding the IMF's call for more stimulus.

"The problems in Europe can't be solved by monetary policy," Bundesbank President Jens Weidmann said in an interview today. "Monetary policy has already made a great contribution to stabilize the situation and is expansionary for the euro region as a whole."

Negotiations over the second replenishing of the IMF's coffers in three years dominated yesterday's meeting in Washington of G-20 finance chiefs. It didn't come without a fight and fell short of Lagarde's initial goal of $600 billion in new resources to bolster a lending capacity currently at $380 billion.

U.K., Australia

While countries from the U.K. to Australia pledged money, emerging markets from China to Brazil held back details of their commitments as they tied them to securing more heft within the IMF. A 2010 plan to reduce the power of rich nations has yet to be ratified, leading Brazilian Finance Minister Guido Mantega to complain that progress "has been limited and slow."

The G-20 conceded in a statement that votes at the fund "should better reflect weights of IMF members in the world economy, which have changed substantially in view of strong growth in dynamic emerging markets."

Such economies also are concerned that the latest boost of cash will lessen pressure on European authorities to take the "painful and politically difficult reforms" still needed, said Eswar Prasad, professor of trade policy at Cornell University and a former IMF official.

Rich Nations

Some rich countries including the U.S. have also balked at contributing more, arguing the IMF already has enough cash and that the relatively-rich Europe should do more to save itself.

With 80 percent of the IMF's credits set to be tied up in Europe by 2014 and its executive board heavy with voices from that continent, Canadian Finance Minister Jim Flaherty proposed non-Europeans wield a veto over future aid to the region. He also attacked the IMF for acting alongside European authorities in orchestrating loans to the likes of Greece.

"Every borrowing country should be treated the same," Flaherty said. "This means that conditionality for any program should be set solely by the IMF."

Lagarde stressed the new money won't be earmarked for Europe, noting "the fund is here for all the membership" and future loans will come with tough conditions.

Bigger Backstop

The promise of an even bigger financial backstop failed to placate investors as Spain's notes extended the longest run of weekly declines in five years amid questions about whether the euro-area's fourth largest economy can slash its budget deficit. The country's 10-year bond yield this month neared the level which triggered bailouts of Greece, Ireland and Portugal.

The combined IMF and euro-area cash piles are still not enough to save Spain and Italy if both required help, said Andrew Kenningham, an economist at Capital Economics Ltd. in London. Countries will also struggle to make spending cuts and tax increases without driving their debts even higher by harming growth, he said.

"If the crisis does re-escalate in earnest, we suspect it will not be contained to just one of the two countries," said Kenningham, a former U.K. government official. "We doubt that a combination of austerity and large bailouts will solve the region's problems."

To contact the reporters on this story: Simon Kennedy in Washington at skennedy4@bloomberg.net; Sandrine Rastello in Washington at srastello@bloomberg.net

To contact the editor responsible for this story: Chris Wellisz at cwellisz@bloomberg.net