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Financial Crisis

IMF Is Out Of It

Brian Wingfield and Deborah Orr 10.13.08, 6:00 AM ET

Following a packed weekend of meetings here, many of the world's top economic officials are returning to their home countries Monday to deal with the next stage in the ongoing financial crisis.

There are an array of lessons to be learned from the last few days, which included the annual meetings of the International Monetary Fund and the World Bank, as well as separate summits of finance ministers and central bankers from the world's leading economies. One of the biggest: the IMF--an organization designed to serve as a lender of last resort to ailing countries--is not an active player in resolving this crisis. And its influence might be waning.

"Where was the IMF?" asks Mohamed El-Erian, co-CEO of the California investment firm PIMCO and a former IMF economist who was in the running to head the fund four years ago. "This is the sort of crisis that should be at the heart of what the IMF was set up to do, but no one in the U.S. or in other G-7 countries seems to turn to the IMF for advice."

To be sure, the IMF's lack of involvement is not entirely its fault. It can only loan to its member countries that have asked for assistance. So far, the primary actors in this crisis--the United States and the European Union--have not needed IMF help.

But even tiny Iceland, where the banks are collapsing, turned not to the IMF as a lender of last resort but to Russia. At a panel discussion about the future role of the IMF, one British banker stood up and shouted, "We have been talking about the IMF for almost an hour and no one has mentioned Iceland. The Americans don't need you. The Chinese, African and Middle Eastern countries don't have the voting rights they should. Are you going to become a think tank."

The IMF is funded by member countries that are granted voting rights that--in theory--correspond to their size in the world economy. That has left its decisions largely in the hands of the U.S. and euro-land countries. Voting rights have changed little in the last decade, which rankles some emerging markets and doesn't reflect the huge foreign reserves that have accumulated in countries with a savings glut. China, for example, has only 3.7% of the vote while the U.S. has 16.8%. To the rest of the world, the IMF, with its headquarters a few blocks from the White House, is a U.S.-centric organization.

But the IMF is likely the last place Washington would turn for help. One reason: The IMF doesn't have the financial resources to help much. Compared to the size of a global financial system in which trillions of dollars in derivatives and currencies change hands every day, the IMF is tiny. Its loanable funds? Only $201 billion, of which only $18.3 billion is actually lent out. But the IMF isn't making enough money off its loans to support itself. Earlier this year, the fund announced plans to sell off some of its gold reserves to meet budget shortfalls.

Nonetheless, last week IMF Managing Director Dominique Strauss-Kahn said the fund was ready to lend through its emergency financing mechanism, which has been used just six times since it was put into place in 1995.

"He wouldn't have made that point if he didn't expect the financing mechanism to be used," says Bill Murray, an IMF spokesman.

Preventing financial crises is supposed to be the IMF's bread and butter. The organization was created to deal with balance of payments and currency issues that were crippling trade and economic recovery after World War II.

The last time the IMF had a major role in world markets was the Asian financial crisis a decade ago. The fund doled out loans to Thailand, South Korea and other countries facing massive capital withdrawals and collapsing currencies. In return, the IMF insisted on policy prescriptions that were painfully contractionary at a time when markets were already in panic mode. Governments were forced to reduce spending, throw their markets open and float their currencies.

The policies were so unpopular--and emerging economies have been so prosperous--that most countries with IMF loans paid them off as quickly as they could. That left the IMF not only short on interest income, but, some would say, without a reason to exist.

Strauss-Kahn has outlined a four-step plan for countries embroiled in the current crisis to deal with it, including government purchases of toxic assets and capital infusions into banks. The U.S. already has plans to do this. On Sunday, European leaders agreed to inject public capital into their banking systems for up to five years.

"The idea is to get the IMF back in the game," Rasheed M. Al Meraj, governor of the Central Bank of Bahrain, told Forbes.com. "Now the new economies are very much influenced by capital markets, so you need more attention paid to this," he says.

Michel Camdessus, a former IMF managing director, told a panel advising the fund on its future that it should be given the power to monitor capital markets, not just current accounts.

However, that might not be enough. Eswar Prasad, a senior fellow at the Brookings Institution in Washington, says there's a good chance the IMF could be increasingly marginalized as the economic order of the 21st century unfolds. With the U.S. and Europe hobbled by their credit crises, countries such as China and the Gulf States, which have money to lend, will want to assert their influence in smaller states looking for cash.

"It's definitely going to speed up the process," Prasad says.

But perhaps the most telling signal of the IMF's future influence is the fact that virtually no one is calling on the organization to take the lead in resolving this financial crisis. Rather, the world's top economic minds are looking to individual governments to provide their banks with capital and in the case of the United States, to stabilize the housing market. That at least seemed to be the consensus at the final event of the IMF/World Bank weekend, a panel that included El-Erian and billionaire investor George Soros.

"This is a way to turn around the rot," said Soros.