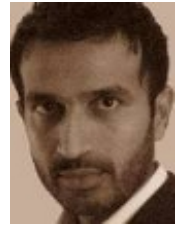


A Eurozone-wide IMF programme could save both

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In past decades, the International Monetary Fund has had a potent reputation, especially in the developing world. In its programmes in Europe, however, the IMF has had to take a back seat to the desires of the European Commission and the European Central Bank, whose policies have thus far been less than successful. In light of this, [Sony Kapoor](#) makes the case for a eurozone-wide IMF programme, which would move away from the current piecemeal solutions focused on the economies of Europe's periphery. He argues that a successful Eurozone-wide IMF programme would deliver a more symmetric method of restoring competitiveness, an EU-wide approach to stabilising the banking system, a greater focus on restoring aggregate demand, a deepening of the single market and a credible road map for the Eurozone.



The IMF, historically the purveyor of crisis management for countries in financial trouble, is stuck in Europe. The IMF has, as last week's [Charlemagne column in the Economist](#) points out, become the junior partner in the 'Troika' arrangement and is often over-ruled, as was clear from the [leaked IMF report on Greece](#). It was not always so.

The IMF is a body that is used to being in-charge. It has, over several decades, dictated policies to tens of countries that found themselves in a financial pickle. A visit from the IMF was an unpleasant experience and often involved a school-masterly dressing down of a country's policy-making elite. For example, [this image](#) of the then IMF Managing Director Michel Camdessus standing, arms folded, over Suharto, [appearing to dictate terms](#) on the bailout during the Asian crisis is burned into the collective memory of Indonesians. It was even credited with helping hasten the end of the dictatorship.



President of the European Council Herman Van Rompuy, IMF Managing Director Christine Lagarde and European Commission President José Manuel Barroso Credit: francediplomatie (Creative Commons BY NC SA)

However, in its on-going programs in Europe, the IMF is often made to swallow humble pie. It has to agree to terms and policies dictated by a European Commission that knows little about structural reforms, bank restructuring and conditionality, and a European Central Bank (ECB) that has no business dictating fiscal policy. All of this might just be acceptable, if the European Commission and ECB led 'Troika' programs were actually working, [but they are failing](#). Recent commentary that 'the Eurocrisis is back' is not accurate; the crisis had never gone away.

The longer the IMF remains embroiled in the Eurocrisis in this subordinated position, the more damage its reputation and credibility, particularly with the all-important emerging countries, would sustain. But it is so deeply enmeshed that it cannot just walk away leaving the Eurozone mess behind either. It is caught between two equally unappetising options.

Might there be a better way forward? Particularly, one which may work better for both the IMF and the Eurozone? In fact, there is. This involves deepening and broadening the Fund's engagement with the Eurozone in a manner that will both put the IMF back in the driving seat and likely provide a systemic solution to the [systemic Eurozone crisis](#). The piecemeal country level solutions that focus asymmetrically on troubled economies propounded so far [have reached their limit](#).

[We need an IMF programme for the whole of the Eurozone](#). When Re-Define had first formally suggested this in 2011 and then [publicly called for it in the Financial Times](#), we were flooded with angry emails from the European authorities and governments, and sympathetic ones from the IMF, the US and emerging economies. Since then, the deepening of the crisis, the divisions within the Troika that have been exposed, and mounting evidence that adjustment needs to be slower and more symmetric, have all only bolstered our case.

But is such a programme really necessary for the Eurozone? And will it actually work? The Eurozone is now stuck in a [death spiral](#), as the failure to clean our banking system combines with unduly harsh austerity to choke the real economy. The record-high and still rising levels of unemployment, collapse of investments and dismal growth prospects have [shrunk political space and endangered the social fabric](#) in crisis economies. A continuation of flawed current policies expounded by the European Commission, the ECB and perhaps most of all, [Germany](#), will almost surely take us over the brink. The question is no longer whether the next acute crisis will come, but more what form will it take. Financial problems can be addressed, for example, by flooding the system with liquidity, but political and social breakdown would be impossible to reverse.

Hence, a change in strategy is urgently needed and the IMF's prescriptions have been sensible. Before the crisis, the IMF had come to be seen as a pariah by the developing world, but it appears to have learnt lessons from past follies. In the Eurozone crisis, for example, its suggestions for an [early restructuring of Greek debt](#), faster bank reform and a slower pace of austerity have been better than those expounded by the European Commission and the European Central Bank – the other members of the “Troika”. However, the IMF's ideas have been ignored, even as European leaders use its presence as political cover for continuing to peddle ill-conceived and failing policies.

The IMF, with the support of the US, the G-20 and crisis Eurozone countries, needs to boldly propose a Eurozone-wide programme where it takes the lead and threatens to walk away if the Commission, the ECB and countries such as Germany and France resist it. Some would argue that the Eurozone's current account (nearly balanced), trade account (mild surplus), overall fiscal deficit (manageable) or indebtedness (moderate), all indicate that its problems are internal, so solutions must necessarily come from within. Hence, the IMF must play only a limited role. But this argument portrays a fundamental misunderstanding of the IMF's role. Historically, while the IMF's resources have been important, [its role in pushing for urgently needed reforms for which the political will could never have been mobilised from within](#) has been even more important.

The Eurozone is struck in a political trap, where surplus countries such as Germany want to inflict the whole burden of internal rebalancing on crisis economies. This must change and only an external neutral arbiter such as the IMF can break the logjam. As I wrote [in the Economist recently](#), creditor countries must share the burden of adjustment. An IMF programme for the Eurozone is necessary both because it will push for more sensible policies and because it offers a more balanced path to rebalancing. Charles Goodhart and I think that [the IMF must intervene to save the Eurozone from itself](#).

How might such a program actually work?

The failure to agree Europe-wide mechanisms for capitalising banks thus far, or providing funding guarantees to the

banking system made sense for certain Member States, but was disastrous collectively. The harmful delay in the restructuring of Greek debt and EU leaders' insistence on self-defeating harsh austerity measures also fall in the same category. Having the IMF in-charge would mean fewer collective action problems. A system-wide view of the crisis, which only the IMF can bring from outside, would be invaluable.

As discussed above, an IMF programme would also bring a reversal of fiscal tightening, a more coherent approach to bank restructuring and a sharper focus on growth-enhancing structural reforms in product and service markets. Importantly, this would happen not just in crisis economies, but also in countries such as Germany, the Netherlands and France, with positive spill-overs for the rest of the Eurozone. The European Commission, the European Investment Bank and the ECB would be natural counterparts for the IMF providing fiscal, investment and monetary support respectively to facilitate necessary adjustments.

Conditionality would not only apply to countries such as Greece and Spain, but also to France and Germany. Even more importantly, EU institutions such as the ECB will also be at the receiving end of conditionality that ought to ask for looser monetary measures targeted specifically at crisis economies. The current asymmetric and incomplete adjustment plan for the Eurozone, which focuses solely on the peripheral economies, [is self-destructive](#) and the ECB/EC-driven fiscal tightening is wrong-headed. Under such a strategy, the IMF must insist on making sure the European Stability Mechanism, the crisis fund, can directly inject equity into troubled banks and provide temporary funding guarantees. EIB resources must be at least doubled to drive an EU-wide infrastructure investment programme and the IMF should force the EU countries to co-operate on imposing [stringent anti-tax avoidance/evasion measures](#) that would deliver a much-needed boost to revenues. The IMF must also overcome French and German resistance to a deepening of the single market in services. Last but not least, the IMF should demand a clear and credible road map for reforming the functioning of the Eurozone as a whole, perhaps by putting forward a [grand political bargain](#).

Given the Fund's historical mandate on exchange rates, the Eurozone is the natural counterpart for the IMF, not euro-area Member States. Discussion of a single seat for the Eurozone on the IMF board also follows this logic, and the programme would help bring that about. While the Eurozone is not a country and this may bring about legal issues, these obstacles can be overcome by having co-ordinated country level programs for Eurozone economies in the first instance. The EC, EIB, ECB and ESM can all sign on to separate memorandums with the Fund in parallel.

The successful Eurozone-wide IMF programme would deliver a more symmetric method of restoring competitiveness, an EU-wide approach to stabilising the banking system, a greater focus on restoring aggregate demand, a deepening of the single market and a credible road map for the Eurozone. Last but not least, this may be one of the few remaining ways that the Fund can salvage its reputation and bolster support amongst non-European members, while at the same time helping tackle the increasingly intractable Eurocrisis.

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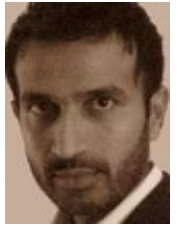
Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

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