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NEW POLICY BRIEF:

Did euro leaders say goodbye to the IMF?

This policy brief takes stock of the agreement by Eurozone countries in late June at the European summit. If this agreement survives (which is by no means certain) and is utilised, Eurozone governments will have opened the door to a flexible use of its bailout funds. In contrast to previous packages, such flexible use could involve direct recapitalisation of banks (bypassing sovereigns) or purchasing of government bonds in order to assist governments teetering on the edge of sovereign default. The primary concern of this paper, however, is that such use would be likely to close the door to cooperation between the Eurozone and the IMF in new rescue packages.

The IMF can only lend directly to members of the Fund. And its policy on conditionality does not fit with the easing of conditionality – or the ex ante conditionality – suggested in the Eurozone agreement from late June. Given the size of the Italian and Spanish economies, any involvement by the IMF in support to their governments would likely be subject to strict conditions on policy reform and economic performance.

This presents a problem for the Eurozone. The chief problem for the strategy it has chosen to address sovereign defaults and sovereign default risks is that the funds it has constructed to support this strategy are inadequate. Even if the recent attempts by the IMF to shore up the Fund's resources and build a bigger firewall have not been a complete success, the money it has raised would be critical in the event of both Italy and Spain needing support to fund their governments. Consequently, if the cost to the Eurozone for moving towards a flexible use of its bailout funds is that the IMF no longer can team up with it, then the June summit was a Pyrrhic victory.

Download the policy brief here

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