IMF secures additional bank bailout funds

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Two key features of the world economy emerged clearly from the spring meeting of the International Monetary Fund and the World Bank, held in Washington over the weekend.

Firstly, the global financial system remains extremely fragile, with a crisis in Spain, Italy or some other country threatening to set off international turmoil that would go far beyond the meltdown experienced after the collapse of Lehman Brothers in September 2008.

Secondly, the differences among the major capitalist powers over economic and financial policy are widening.

IMF managing director Christine Lagarde emerged from the meeting hailing the success of her call for the provision of additional funds to the IMF to build a "firewall" against financial crisis, or, as she put it, to open an "umbrella" to protect the financial system against a storm.

At a meeting of the G20 finance ministers, held the day before the IMF-World Bank discussions, Lagarde secured a commitment of $430 billion in additional contributions, almost doubling the amount available to the IMF for bailout operations.

Lagarde said the pledges signalled "the strong resolve of the international community to secure global financial stability and put the world economic recovery on a sounder footing." In view of criticism that the funds were raised specifically for Europe, she added that the funds would be used for "crisis prevention" and that they would be available "to meet the potential financing needs of all IMF members." However, no one regards this rider as anything other than window dressing.

In the lead up to the meeting, Lagarde described Europe as the "epicentre" of the risks to the world economy and warned that "dark clouds" were on the horizon. Days before the meeting, interest rates on Spanish debt had climbed to around 6 percent, generally considered to be a danger level. The spike in rates was widely interpreted as a sign that the boost to financial markets resulting from the injection of €1 trillion by the European Central Bank (ECB) into the European financial is starting to wear off.

Lagarde's comments reflected those of the head of the IMF's Monetary and Capital Markets Department, Jose Vinals. He warned that while current policies had so far prevented a "credit crunch," the intensification of financial stress and significant debt reduction by European banks could do "serious damage to asset prices, credit supply in Europe and beyond."

The outgoing president of the World Bank, Robert Zoellick, also warned that the ECB's "extraordinary" actions—in which funds have been made available to the European banks at the ultra-cheap rate of 1 percent—might not be enough.

"We are now in a phase where, after the ECB provided very attractive financial resources to a number of banks to be able to buy government debt … they are about at the end of that point and limit, so I think further actions are going to be called for," Zoellick said.

Rather than providing a solution to the crisis, the ECB's actions have the potential to deepen it in the longer term. The funds are provided to weaker banks unable to obtain resources through normal market operations. These funds are then invested by the banks

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in government debt, enabling them to make quick profits. But the overall impact is to bind weaker banks and governments with large sovereign debts closer together, creating the potential for increased financial turbulence.

While Lagarde was able to point to the immediate success of her call for additional funds, she could not cover over the differences among the leading nations. The United States and Canada both pointedly refused to make any contribution.

In a speech to the Brookings Institution, US Treasury Secretary Timothy Geithner said "Europe is a rich continent" and had to play "the dominant financial role" in resolving its own crisis. Having provided hundreds of billions of dollars to boost American banks, the US is demanding that the European powers do the same for their own banks, fearing that any major default will impact on American financial institutions.

Canadian Finance Minister Kim Flaherty told a news conference that Canada and the US were not supportive of additional funds for Europe and that the region had the capacity to deal with its sovereign debt crisis.

The new bailout operation also drew criticism from Brazil and other countries that insufficient progress had been made in changing the IMF quota system of voting rights, which ensures the dominance of the US, Europe and Japan. Brazilian Finance Minister Guido Mantega said voting had to be proportional to a country's economic output. "The calculated quota share of Luxembourg is now larger than the one of Argentina or South Africa," he commented, adding that Belgium had a bigger share than Indonesia and Spain's quota was larger than the sum total of all the 44 sub-Saharan African countries.

In another criticism of the fund's operations, Argentine Economy Minister Hernan Lorenzino said many of the IMF's rules had been changed to "accommodate support" to the most needy countries in Europe "in a way that was not seen at the time of the Asian crisis in 1997 or the Latin American crisis in the 2000s."

Lagarde said Brazil, India, China and Russia, which have been part of the push for changes in quota rights, had all made pledges to the fund, but did not want to disclose the extent of their contributions.

While raising additional funds to bail out the banks, the IMF made clear that the global austerity program aimed at impoverishing the working class had to be intensified.

Singapore Finance Minister Tharman Shanmugaratnam, the chairman of the IMF's policy-steering committee, said "everything we do should be supportive of medium-term fiscal consolidation, particularly in advanced economies." It was "critical" that as many as possible of the advanced countries return to normal growth levels within two to three years and that this included a focus on "structural reforms in order to bring confidence and investment levels back."

In other words, government must slash social programs, in line with the demands of the banks and financial markets, and step up labour market "reforms," aimed at cutting wages and working conditions, in order to boost profits and investment opportunities.

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