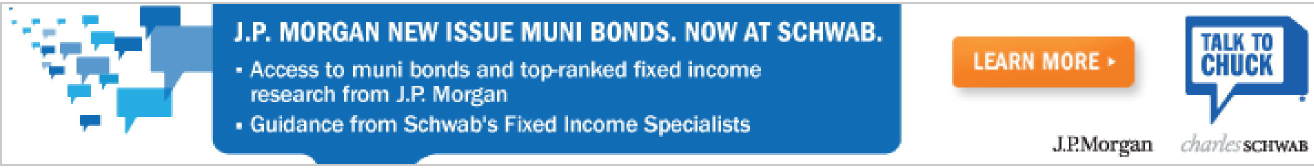

Commentary

Greek Loan Would Violate IMF Charter

Swaminathan S. Anklesaria Aiyar, 04.23.10, 3:11 PM ET

The proposed International Monetary Fund loan of $15 billion to Greece is wrong on two grounds. First, it violates the IMF's charter. Second, it is an unwarranted favor to Europe that developing countries will perceive as being at their expense.

The IMF suffers from mission creep. Although created for balance of payments rescues, it now wants to stage fiscal rescues too--that means bigger budgets and more staff, the two unwritten goals of any bureaucracy.

The articles of association of the IMF state clearly its aim to provide loans for balance of payments support. Greece has a huge fiscal need but no balance of payments need. Greek importers can get all the euros they wants from Greek banks, which get euros from the European Central Bank. The IMF is by definition a monetary authority, and Greece has no monetary issues--it surrendered its monetary powers to the ECB Bank on joining the eurozone. Some eurozone countries have fiscal crises, but these are Europe's problem, not the IMF's.

The IMF's funds proved wholly inadequate to meet balance of payments needs during the Great Recession of 2007-09. So member countries tripled its lending resources to meet future balance of payments crises, which presumably did not include fiscal crises.

If Greece gets an IMF lifeline, bond speculators will logically attack the other eurozone countries with large deficits--Portugal, Spain and maybe Italy. Rescuing them would empty the coffers of the IMF. Yet it would be politically difficult to say no to Spain or Italy after saying yes to Greece.

Historically, there was a clear division of work between the World Bank and IMF. The Bank provided fiscal support for development, so its loans entered the budgets of borrowers. The IMF provided hard currency for balance of payments support. This hard currency was purchased by the central bank of the borrower, and went into the borrower's foreign exchange reserves, not its budget. Indeed, loans from the IMF were technically called "purchases" of hard currency, and repayments were called "repurchases."

This Bank-IMF division of labor has blurred since 1991. Ex-communist countries needed massive support, and it was politically expedient to use the full resources of the Bank and IMF. The blurring was rationalized by arguing that the IMF always sought fiscal stringency when lending. Further, even when such loans went to central banks, they enabled central banks to give more budget support to their governments. This blurring also facilitated emergency loans during the Asian Financial crisis. IMF loans to Russia and Argentina were formally allowed to enter the budgets of the borrowers.

By the same logic, say Europeans, the IMF should give fiscal support to Greece. They are wrong. Argentina, Russia and all the other IMF borrowers had serious balance of payments problems. The IMF gave loans to tackle these balance of payments problems--in accordance with its charter--and the fiscal support was just a supplementary benefit.

Greece, however, has no balance of payments problem. Any IMF rescue would be straightforward fiscal support, violating the IMF's charter. Why would it do this? To bestow a special favor on Europeans, its dominant shareholders.

Developing countries should be expected to protest. They are the main candidates for future IMF loans, and so feel they have the most to lose through fund diversion. The poorer members do not have the political or economic strength to stand up to Europe, but the BRICs (Brazil, Russia, India, China) do. The BRICs have contributed to the IMF's expanded coffers and need to worry about the husbanding of those resources.

The IMF is supposed to be lender of last resort. Europeans want it to be among the lenders of first resort in this crisis. Greece can, after all, borrow from the markets, but it will have to pay 7% interest. Instead of relying on market discipline, the Europeans seek to use IMF to organize a rescue package with an interest rate averaging maybe 5%. This implicit interest subsidy is justified by saying Greece will default if it has to pay 7 % interest. Maybe, but many analyses suggest that Greece is fundamentally insolvent and will likely default anyway.

It is easy for the IMF to jump into this mess, but will be hard to extricate itself if things go wrong. Developing countries should protest that limited IMF funds are being put at risk just to spare Europe from taking care of its own.

Swaminathan S. Anklesaria Aiyar is a research fellow at the Cato Institute's Center for Global Liberty and Prosperity in Washington, D.C.

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