

Europe's stranglehold over the IMF has become a curse



AMBROSE EVANS-PRITCHARD

19 DECEMBER 2016 • 8:49PM



The IMF's Christine Lagarde insists that she acted purely in the general interest, but the French courts ruled otherwise

The International Monetary Fund seems cursed. One managing-director embroiled in scandal is perhaps unlucky: to suffer three in a row starts to look serious.

First it was the Spaniard Rodrigo Rato, now awaiting trial for embezzlement for allegedly running a "corrupt system" at the helm of Bankia.

Then it was France's Dominique Strauss-Kahn, accused of louche conduct in a New York hotel room.

Now it is the turn of Christine Lagarde, inheritor of the French fief and today convicted of criminal negligence by a top French court in a case that has strange whiffs of political chicanery.

The guilty verdict certainly calls into question her full fitness to lead a financial superpower with resources of \$668bn, and vice-regal dominion over whole countries and societies.

All three are European, the only race able to compete for the post under the Bretton Woods carve-up that has prevailed since the end of the Second World War. The fact that this has led to trouble is not accidental.

“European politics has become very corrupt. It is almost inevitable that the European system will throw up people who have done something that will later be construed as having crossed the line, and who are therefore tainted,” said Ashoka Mody, the IMF’s former deputy-director for Europe.

“My reading is that Europe is in very long-term decline from political and economic pre-eminence, and there is a great temptation to cut corners as they try to face these challenges,” he said.

This European stranglehold over the Fund is now over. It is inconceivable that the next IMF chief will be chosen in the old cosy way.

The Asian powers will not tolerate it any longer. If nothing is done they will walk away from the Fund entirely and create their own financial structures, probably revolving around China.

The Fund mishandled the East Asia crisis in 1998, imposing fiscal retrenchment that went far beyond the therapeutic dose, and dished out the same medicine to countries as starkly different as Korea and Indonesia.



Dominique Strauss-Kahn's tenure at the IMF ended with a disastrous sexual scandal

It was bad economic science. Asia’s rising powers concluded that the IMF system was stacked against them. The Class of 1998 turned instead to “self-insurance” by building up such vast foreign reserves that they would never again be at the mercy of the Fund.

This accumulation of excess savings led to the pre-Lehman capital glut and is a key reason why the world economy has been so far out of kilter for the last fifteen years, ending in a global liquidity trap.

When the European crisis blew up, the Fund was suddenly all too willing to bail out countries - and on terms that were not available for the Asians, or the Latin Americans before them. The IMF was in effect hijacked by its European masters for a series of rescues that used up 80pc of its total lending between 2011 and 2014.

The terms violated cardinal rules. Greece, Ireland, and Portugal were each allowed to borrow 3,000pc of their quotas, triple the normal limit. In the case of Greece, the Fund's management violated their charter by lending to a state known to be insolvent rather than demanding a debt restructuring. An internal probe has since shown that they pulled the wool over the eyes of the IMF board.

Some shortcuts can perhaps be justified given the real danger of contagion to Italy and Spain at that moment, and given fears of a global financial melt-down. Yet what emerges from the board's probe is that the eurozone political class treated the Fund as their tool. The US went along with this in tacit collusion, but that is surely about to end under the Trump White House.

The IMF remains vital to the global financial system but it is clearly an organisation that has lost its way. Cleansing must begin from the top down. This could start with the appointment of former Indian central bank governor, Raghuram Rajan, or the Korean chief economist of the Bank for International Settlements, Hyun Song Shin. George Osborne's moment has passed.



Korea's Hyun Song Shin is touted by some as a rising star who could give Asia a shot at the IMF CREDIT: BIS

To be fair to Mrs Lagarde, the case against her is bizarre. There was no allegation of personal gain. It would not be a criminal matter in the US or the UK. The controversy dates back 2008 when she was French finance minister, and it has nothing to do with the IMF. The prosecutors themselves described the charges as "weak".

The Cour de Justice de la République is mostly made up of parliamentarians from the Senate and Assembly. It is a special tribunal for political cases, a legislative Star Chamber. The court ruled that she should not face prison or a criminal record - given the delicacy of her global position - yet the judges condemned her for going along with a €403m arbitration award from the French state to the tycoon Bernard Tapie in 2008 rather than launching an appeal.

The Left alleges that Mr Tapie backed the presidential election bid of Nicolas Sarkozy in 2007 on the understanding that his government would later settle claims from long-standing litigation with the state-owned bank Credit Lyonnais.

Evidence has since emerged that the panel ruling itself was unsound. The €403m award has been struck down. Mr Tapie has been ordered to repay the money. Mrs Lagarde's former chef de cabinet at the treasury is now being investigated for alleged fraud and "diversion of state funds" in a parallel case linked to the Tapie Affair.

Mrs Lagarde told the court last week that "the risk of fraud totally escaped me", insisting that she had acted with "a clear conscience with sole aim of defending the public interest."

The court clearly concluded otherwise. It appears a harsh ruling. There is no evidence - at least so far - that she bowed to pressure from Mr Sarkozy's political machine.

In a larger sense the details of the case hardly matter. Her travails crystallize a feeling that the IMF has been in the wrong political hands for a long time. It needs exactly the sort of reform that it demands so clinically from the hapless countries that fall under its tutelage.