



FINANCIAL TIMES



Kenneth Rogoff

November 4, 2011

Print Email Share Clip this

20

17

22

EUROPE • FINANCE

The eurozone does not need IMF help

With leaders of the Group of 20 leading nations now focusing on the International Monetary Fund as their preferred conduit for any bail-out in the eurozone, it is imperative they ask what concrete purpose the fund's capital will serve. Unless the IMF is granted considerable power to enforce conditionality at the eurozone level, it is hard to see much benefit in its involvement, aside from providing a fig leaf for large-scale European Central Bank purchases of euro sovereign junk bonds.

All eyes are on the Greek drama, but of course the problem is far deeper and more pervasive. There are at least five key flaws in the eurozone's present interim design.

First, the Maastricht treaty debt limits were not nearly strict enough, in size or enforcement.

Second, there is no mechanism for large, automatic fiscal transfers that would allow risk to be shared as in a single-country currency. If Europe's national governments are to have their borrowing sharply restricted, then there must be another mechanism to smooth consumption during recessions. (In theory, financial markets could be used to hedge macroeconomic risk across countries, but in practice there are many obstacles.)

Third, there is no clear lender of last resort for private financial institutions in the fiscally-weaker countries. Even if the Italian central government is still marginally solvent, it lacks the wherewithal to provide a convincing backstop

to the country's banks. If Italy still had the lira, it could simply print money if it ran out of other options. But it cannot unilaterally force the ECB to do so.

Fourth, Europe needs a powerful centralised financial regulator, for no other reason than to limit national explosions in privately-held debt. The Maastricht treaty limits only apply to public debt. Yet, in practice, private debts often become public debts in a crisis, as Carmen Reinhart and I have shown in our research.

Finally, too many eurozone decisions require unanimity, which adds a layer of dysfunction on top of national governments that sometimes already struggle with this.

Even with constitutional reform to address these structural flaws, a political agreement is needed to deal with the acute debt imbalances that have already accumulated. Any solution is going to have to involve large one-way transfers from north to south. In return for aid, the southern countries will almost surely have to subordinate macroeconomic policy to their richer neighbours. Neither prospect seems politically viable on a sustained basis. It is hard to see how even copious liquidity from the IMF can alleviate this intranet-family problem of European governance, unless of course the fund is allowed to enforce heavy conditionality.

Perhaps the situation where outside money might be most useful is in preventing bank runs on solvent countries. Unfortunately, however, the distinction between liquidity and solvency is in practice very difficult to make. In spite of its tough reputation, the IMF far more often misjudged solvency problems for liquidity problems than vice versa. Of course, the fund could be used as an enforcement vehicle for imposing conditionality on the south, but the limits of how much austerity can be prescribed are already being tested throughout the periphery.

The risk of contagion from a Greek default is a palpable one. But G20 leaders need to articulate exactly what the IMF can bring to the table that is not already sitting there in front of a very wealthy, but politically dysfunctional, eurozone system.

The writer is a professor of economics and public policy at Harvard University and former chief economist at the IMF

[Back to top](#)

