Financial

**Small Nations, Big Test for IMF; Fund's Role May Be to Contain the Crisis as It Hits Places Like Iceland**

Anthony Faiola
Washington Post Staff Writer
1106 words
14 October 2008
The Washington Post
FINAL
D01
English


Even as the United States and Europe move to smother their financial conflagrations, smaller economies are now facing the threat of currency collapses and banking crises. Their vulnerability is posing a critical new test for the International Monetary Fund and other multilateral lenders.

The fund said yesterday that it is in talks to throw a financial lifeline to Hungary, where the banking system has been critically strained since flows of international credit dried up. The IMF is already involved in talks in Iceland, where a meltdown in the banking sector -- and the tanking of the local currency -- prompted it to dispatch a team last week to hash out a possible loan. Analysts say a series of other nations, including Lativa, Romania and Bulgaria, may ultimately need to seek IMF assistance.

The proliferation of fresh hot spots is raising new questions about how, and when, the IMF will act as a financial firefighter. During the 1990s and early 2000s, the fund's mission largely centered on the stabilization of developing countries in fiscal crisis. But in recent years, as much of the world prospered, the IMF increasingly shifted from banker to financial adviser, dramatically reducing its lending. As the U.S. financial crisis spread to Europe recently, the fund was largely sidelined by developed nations with whom its advice holds little weight.

With global turbulence now threatening to cause smaller economies at various stages of development to implode, analysts said, the fund may now be charged with containing the crisis on the margins through targeted lending. The fund's managing director, Dominique Strauss-Kahn, speaking ahead of the annual IMF meeting in Washington yesterday, has already acknowledged a surge in requests for assistance in recent weeks. He said the fund, armed with about $200 billion for loans, would streamline the often-lengthy approval process to as little as two weeks. He suggested that it would also be more flexible on the notoriously tough conditions it attaches to such loans.

The crisis "has hit a lot of emerging countries or low-income countries, and so we need to be ready to answer, and we are already answering to many countries asking for support," Strauss-Kahn said over the weekend. "To do that, we have a lot of resources which are available, and the world must know that we are ready to help the countries which need some support."

Yet some critics argue that the fund needs to be even more flexible and that it should prepare to turn on a dime to help countries in need. "Unfortunately, they do not react with the speed that we would like," Guido Mantega, Brazil's finance minister, said in an interview yesterday. "I have talked for two years about establishing rapid lines of credit that do not have even the kind of conditions they are now talking about. They need to understand that at this point, we cannot afford to let even one country fail."

The fund may not have a choice but to relax loan conditions. The IMF in the past solicited promises from borrowing governments to not interfere heavily in their financial sectors and to control spending. Yet those arguments are now far harder to make given the massive bailouts and government interventions being orchestrated by the fund's largest members in Europe and the United States.

"How is the IMF going to go to Iceland and try to extract strict conditions when they can just point to the United States and Europe and say: 'Look, they are not following your advice. Why should we?' " said William Easterly, professor of economics at New York University and a longtime World Bank economist.

While IMF loans or promises of assistance can calm investors' nerves, they also carry a powerful stigma. Recipients are sometimes seen as economic basket cases, and that stigma can dissuade some from seeking help. In fact, an IMF spokesman said yesterday that while a fact-finding mission is in Iceland, the fund has not yet received an official request for financing from the government there.

Strauss-Kahn said yesterday that the fund is in "close dialogue" with Hungary, a nation that saw a rush of cash as it joined the European Union in 2004 and is now suffering as investors pull back. Banks there have become increasingly dependent on foreign capital, making them particularly vulnerable now. Like the United States, Hungary has also been living beyond its means, importing more than it exports and, in 2007, running the largest budget deficit in the 27-nation E.U.

"Hungary is not going to be the only one," said Simon Johnson, senior fellow at the Peterson Institute for International Economics and former chief economist at the IMF. "You see other countries in Eastern and Central Europe with similar problems. If capital does not start coming into some of those countries soon, you're going to see bigger problems."

Other multilateral financial institutions are stepping up responses, too. The World Bank last weekend said it planned to launch a $3 billion fund to help banks hit by the financial crisis in cash-strapped developing countries.

Concern is also growing over vulnerabilities in Latin America, home to no less than 31 financial crises over the past 25 years. While the region's giant, Brazil, remains flush with cash reserves, Latin America overall is sharply slowing after years of stellar growth, challenging the ability of smaller, heavily indebted nations to sustain their debt, currency and financial systems.

In response, the Inter-American Development Bank said yesterday that it plans to approve a record volume of loans in 2009 and is topping off a $12 billion pool of loans with an extra $6 billion. That amount is nowhere near enough to bail out one of the region's large economies if it gets into deep trouble. But the loans could assist smaller countries in Central and South America, where some are under severe stress as global lending between banks had almost evaporated. Other regional lenders are putting up an additional $3.3 billion.

"Latin America has been pretty resilient up until three weeks ago, but now we see signs of strain," said Luis Alberto Moreno, IDB president. "This money is going to be used so that governments can support their commercial banks and extend credit as needed to export agencies for trade finance. We need to do whatever we can to preserve the gains that have been made in recent years."

-