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What Exactly Does the IMF Do?

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Published May 17, 2011 | FOXBusiness

The arrest of Dominique Strauss-Kahn, the managing director of the International Monetary Fund, has thrown the spotlight onto an organization that despite its growing influence remains relatively unknown to many Americans.

While shocking, the charges of criminal sexual acts and attempted rape against Strauss-Kahn may have created fewer shockwaves in the U.S. had it not been for the growing role of the IMF since the global financial crisis. After all, the 62-year-old Frenchman was the guy negotiating the controversial bailouts of Greece and Ireland and his absence creates serious uncertainty in Europe.

"It's got all the key elements of power, money and sex," said Bill Bartmann, CEO of Bartmann Enterprises and author of *Bailout Riches*. "The magnifying glass will stay on the IMF. That's a good thing. Transparency and full disclosure usually leads to better activity."

So what exactly does the IMF do? The IMF strives to be the world's financial firefighter. It deploys emergency loans in an effort to put out economic fires around the world, everywhere from emerging countries in Asia and Latin America to developed ones in Europe. The IMF also monitors economic and financial developments and provides technical assistance and training.

IMF Influence Ebbs and Flows

The IMF receives funding from its 187 member countries, but the bulk of the cash comes from the richest countries: 17.4% from the U.S., 6.5% from Japan, 5.6% from Germany, 4.2% from France and 4.2% from the U.K. Smaller economies like New Zealand and Peru contribute less than 0.3% each.

The IMF's mission is to work to "foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world."

In reality, the IMF is countercyclical: it is truly in demand during bad economic times or when countries run into trouble.

Originally formed in July 1944 as an organization to help nations adjust to a world of fixed exchange rates, the IMF searched for direction after President Richard Nixon took the U.S. off the gold standard in 1971 and the fixed exchange rate system vanished.

"It is an institution that has waxed and waned in its importance," said Douglas Holtz-Eakin, former director of the nonpartisan Congressional Budget Office.

But the IMF was right in the middle of the East Asian financial crisis in the late 1990s when South Korea, Malaysia and Thailand all faced troubles.

As the global economy boomed in the middle of last decade, the IMF again took a back seat and even had to make serious cutbacks to adapt to the changed environment. Its purchases and loans to member nations shrank in 2007 to $1.29 billion, down from $26.58 billion in 2002, according to IMF data.

The global financial crisis and especially the European debt mess changed all of that, putting a fresh premium on capital and the expertise of the IMF. Creditor countries agreed to triple the IMF's lending capacity to $750 billion and its annual disbursements to member nations shot up to $22.04 billion in 2009 and $21.18 billion last year.

"It was struggling for a role. Lo and behold, up pops Greece and Portugal and Ireland," said Holtz-Eakin, noting the fixed exchange rate euro-zone countries have. "It was right back in its sweet spot."

Despite some calling for the European Union to solve its own problems, the IMF has been heavily involved in the debt mess there, becoming the bailout source for Greece and Ireland. Leaders have found it more politically palatable to use the IMF as an intermediary, instead of giving cash directly to struggling neighbors.

Of course, the IMF doesn't just loan out money -- it demands strict conditions aimed at changing the fiscal conditions of troubled countries.

"The IMF is not just an ATM," said Cam Harvey, a finance professor at Duke. "Many countries don't like this because it infringes on their sovereignty, but they don't have any choice."

Power Struggle Ahead?

The likely departure of Strauss-Kahn has created new uncertainty in the European debt crisis because he played a pivotal role, supporting the bailout of Greece and recently pushing for even more money for Athens. The IMF also signed off on another $2.24 billion to Ireland on Monday.

Most observers doubt the absence of Strauss-Kahn will significantly impact the IMF's current stance in talks to rescue troubled European countries.

"We would like to stress again that the change in leadership at the IMF is expected to have no impact on IMF policies regarding the euro zone periphery," Win Thin, global head of emerging markets strategy at Brown Brothers Harriman, wrote in a note.

Some believe the incident may create an opening for Europe to attempt to solve the crisis on its own. On Tuesday a European Union official for the first time acknowledged Greece may need to restructure its debts.

"It's not like [Strauss-Kahn] was going to wave a magic wand," said Harvey. "It has to come from within Europe. He would have been an asset at the table. Him not being there is not going to throw anything into disarray."

Still, it is unclear who would replace Strauss-Kahn assuming he is forced to resign or is ousted.

After Strauss-Kahn's arrest Sunday night, the IMF tapped American and former JPMorgan Chase (NYSE:JPM) exec John Lipsky to become its managing director. Yet Lipsky, who was previously first deputy managing director, had already announced his intent to leave the IMF at the end of August.

The power vacuum at the IMF may create a struggle between emerging market nations that have sought a greater voice and traditional powers in Europe and North America.

A number of individuals have been mentioned as possible replacements, including French Finance Minister Christine Lagarde, former Turkish finance minister Kemal Dervis, former South African finance minister Trevor Manuel and others.

In any case, the IMF is likely to continue working to put out financial fires.

Thin said, "The IMF is likely thrilled to be back in business and relevant again, and it will continue to play a big part in current and future rescue programs in both [developed markets] and [emerging markets], regardless of who heads it."