The IMF Debate

The tug-of-war over who should succeed Michel Camdessus as the Managing Director of the IMF has been resolved. Behind the wrangling over positions and personalities, there are evidently differing views about the IMF's role and, thus, about the nature and extent of proposed reforms. They range right across the spectrum. On the one hand, there is Michel Camdessus' view that the IMF requires additional funds to meet the challenges of accelerating globalisation, especially in financial markets, of the transition of numerous countries to a free market system and of the longstanding needs of the poorer countries. At the other extreme, Jeffrey Sachs, Paul Krugman, Joseph Stiglitz and Milton Friedman have suggested that the IMF should simply self-destruct. They argued that the Fund can contribute little or nothing to relieving crises in international financial markets; that, on the contrary, the Fund's readiness in the event of crisis to make large-scale funds rapidly available to afflicted nations, thus securing the investments of such countries' private creditors and creating moral hazard for both the state and the creditors, was in itself a root cause of crisis. This socialising of private losses, they said, a priori tempts international banks and investors to undertake excessively risky financial transactions.

Development politicians take this critique a step further. Through its approach to overcoming crises the IMF all too often adds the element of political instability to situations of economic uncertainty. In the name of orthodox free market theory, the Fund usually seeks to correct at one stroke all the weaknesses in the economic system of a crisis-hit country. This approach, the critics say, frequently weakens the political structure, thus jeopardising the basic preconditions for sustainable reform.

Criticism of the IMF's stabilisation programmes is hardly new. And indeed one can debate long and hard whether the standard programmes in any given case were sufficiently adapted to the peculiar circumstances of the individual country in crisis. However, one should resist the temptation of making the IMF a scapegoat for political instability in these countries. It can be shown empirically that such countries do not call in the IMF at a time when a relatively smooth adjustment process appears possible, but rather as a last resort only when far-reaching and painful intervention can no longer be avoided. The IMF is usually called in too late because the respective governments believe they are not politically in a position to introduce the adjustment process on the basis of – presumably – well-conceived stablisation programmes.

One radical conclusion that could be drawn from all this is that the IMF should not be available a priori to finance adjustment problems arising from the economic policy failures of individual countries. Indeed, a key recommendation of the report of the Meltzer Commission published on March 8th was that the IMF should "restrict its lending to the provision of short-term liquidity, ending the existing practice of extending long-term loans for poverty reduction and other purposes". This suggestion caused a major stir. But what was forgotten at the time was that a Group of Independent Experts commissioned by the IMF itself – the John Crow Group – had come to a similar conclusion in a report published last autumn. The Group recommended that the IMF should restrict itself to its core activities, which it defined as surveillance of foreign exchange regimes and associated macroeconomic indicators and, most important, the international implications of these policies.

That would take the IMF back to its original brief. When it was founded, it was set up as a purely monetary policy institution designed to finance the balance of payments deficits of its members where these deficits could be viewed as temporary either by their nature or after the implementation of adjustment measures. The aim of such funding was to avoid individual governments' resorting to restrictive foreign trade measures or massive devaluation rather than making the appropriate adjustment to their domestic economic policy regime. The thinking was that external restrictions would negatively impact the aims of the IMF: the spread of prosperity through free trade and capital movement.

In the view of the Meltzer Commission, the IMF should continue to make available short-term liquidity, but restrict itself to illiquid, but essentially solvent, emerging economies. It recommended that such liquidity should be provided only at a penal interest rate higher than the market rate last paid by the debtor country and only against the lodging of securities. In return, the IMF should in normal circumstances dispense with the imposition of detailed economic policy requirements which in the past have led time and again to conflict and controversy. At the same time, the increased cost of IMF credits and the requirement of security should remove the temptation to use the IMF as a lender of first resort rather than of last resort. This would make it possible to stop or even reverse the explosive growth of Fund liquidity through quota increases and the creation of ever new financing facilities, which has been a characteristic of the Camdessus era.

This recommendation appears fundamentally sound. It gives rise to the further recommendation that the IMF should withdraw from the provision of medium- to long-term development and transformation funds. This, too, appears to make sense in the interests of drawing clear lines of responsibility and competence between the IMF and the World Bank. Naturally, the question then arises whether this withdrawal should apply to "strategically important" countries such as Russia. It was above all the USA which pushed through constant new financial assistance despite the series of broken economic policy promises of the Russian government – thus leading other countries into moral hazard.

But a move to restrict the IMF's "clients" to emerging economies at the exclusion of other developing countries cannot be justified. It is not the case that the problems faced by even the poorer developing countries are solely structural in nature and thus in the area of responsibility of the World Bank. They, too, can be affected by temporary, external shocks. The bottom line is that the IMF should not be required to act only if the world financial system is at risk.

A third recommendation of the Meltzer Commission was that all countries in receipt of IMF credits (but why should this apply only to them?) be required to publish, regularly and up-to-date, all important financial data. The John Crow Group proposed, for example, that the policies of the largest industrialised countries in particular should be more closely monitored to examine their international implications. The Group recommended that above all regional and multilateral spillover effects should be included in IMF surveillance and this should be done in a clear and transparent fashion without regard to the political sensitivities of larger countries.

Fourthly, the Commission recommended that the IMF – in collaboration with the Bank for International Settlements – draw up new standard rules for the capitalisation and liquidity management of financial institutions. These should be applied to the emerging economies to diminish the frequency of crises which often arise from the sudden withdrawal of short-term funds. This proposal, too, is to be supported. If it is true that at a time of greater international economic integration there is also an ever greater need for basic operating rules to be generally accepted, then an institution is required to take on the function of a catalyst in resolving such issues. At an international level, some progress is being made in the field of bank supervision. But what is lacking is the national implementation of these rules. Which institution, if not the IMF, is better suited to take on the role of catalyst and to provide the technical assistance needed in implementation? But how would it enforce compliance without financial leverage? Should the World Bank, in agreement with the IMF, impose such conditions in the credits it grants? The new IMF boss will face the difficult task of steering a course of reform through the labyrinth of differing opinions and interests and then of gaining international approval for them.

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