American Enterprise Institute for Public Policy Research

April 2004

On the Issues

Go Back to Basics at the IMF

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The Europeans who will nominate a new managing director for the International Monetary Fund should view their task as an opportunity to return the Fund's focus to exchange-rate issues and assistance of countries in fiscal crisis.

Horst Koehler's hasty departure as the IMF's managing director has already started the horse-trading amongst the European nations to whom tradition has assigned the task of nominating a successor. It would be the greatest of pities if in that horse-trading the Europeans lost sight of the fact that perhaps never before has the IMF been in need of more basic reform. For the IMF now has practically nothing to say about the key global exchange-rate issues of the day. Moreover, in recent years, the IMF's bread and butter business of lending to crisis-stricken countries has run amok.

Set up in the shadow of the Great Depression by the 1944 Bretton Woods agreement, the IMF's basic mission was supposed to have been that of "promoting exchange rate stability, maintaining orderly exchange-rate arrangements, and avoiding competitive exchange depreciations." In particular, the IMF was to have been the bulwark against a repetition of the destructive competitive depreciations of the 1930s that were thought to have been a major factor in the length of the Great Depression.

Yet today, the IMF offers little leadership in addressing the burning currency issues of the day, which have eerily come to resemble those of the 1930s. What, if anything, has the IMF been saying about the fact that the three major global economies—Europe, Japan, and the United States—simultaneously want weaker currencies? Does the IMF even raise an eyebrow when Japan engages in massive purchases of U.S. dollars, to the tune of $100 billion in the first two months of 2004, with the explicit objective of weakening the yen? Or could the IMF be more conspicuously silent about the fact that a host of Asian countries, led by China and India, maintain currencies that are grossly undervalued by any reasonable measure?

One would hope that in their deliberations, the European nations seek a new IMF chief who might provide the intellectual leadership so sorely needed to deal with today's difficult global exchange-rate issues. For only then can one expect the IMF to get back into the game of promoting orderly exchange rates, so necessary for enhancing global prosperity.

Lending to "Emerging Market" Economies

The Europeans also might wish to nominate a new IMF chief who would restore order to the chaos in IMF lending to "emerging market" countries. Since the 1995 Mexican peso crisis, the IMF has abandoned the normal limits that used to apply to the amount of money it would lend to a country in distress. Instead, it has lent tens of billions of dollars to countries on the grounds that "exceptional circumstances" prevail. The net result of this approach has been

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huge bailouts that provide incentives for investors and governments alike to behave in an irresponsible fashion, since they assume that they will be saved from the consequences of their mistakes by the IMF's largesse. It has also eliminated any semblance of transparency in the IMF's lending operations, and it has undermined the IMF's balance sheet. This latter point is epitomized by the fact that Argentina, Brazil, Indonesia, and Turkey now account for three-quarters of the IMF's outstanding loan portfolio.

The fact that the IMF is now forced to lend Argentina very sizeable amounts of money in order to ensure that Argentina does not default on its past IMF loans should raise basic questions about the wisdom of the IMF's current lending policy. In particular, it should raise the question as to whether the IMF should not revert to its pre-1995 type of access limit policy, whereby there were strict ceilings upon the amount that the IMF could lend to any individual country. Such a change in policy would effectively restrict the IMF to its original role of a catalytic lender for the emerging markets.

Given the IMF's highly hierarchical structure and the very long tenure of its managing director's appointment, it is not often that one has the opportunity to change the IMF's basic direction. In today's increasingly complicated financial market world, it would be a crying shame if Europe's leaders did not grasp this opportunity to effect real change at the IMF.