Captain Rato and the *Titanic*

The growing irrelevance of the International Monetary Fund.

BY DESMOND LACHMAN

On evaluating the International Monetary Fund's management of today's highly imbalanced global economy, one cannot help but be reminded of the apocryphal story about the inquest into the sinking of the *Titanic*. When asked why he did not steer the ship away from the iceberg to avoid a collision, the captain supposedly asked, "What iceberg?" Reading today's soothing speeches on the state of the global economy by Mr. Rato, the IMF's managing director, one has to wonder whether he will fare any better than did the *Titanic*'s captain when some future inquest looks into how today's global imbalances unwound.

The current passivity of the IMF in providing any real leadership to solve today's unprecedented global payment imbalances has prompted Barry Eichengreen, the renowned economic historian, to extend the maritime metaphor as it applies to the IMF. He aptly describes today's IMF as a rudderless ship floating on a sea of global liquidity. For that reason, he correctly chastises the IMF for failing to discharge its stewardship of the international monetary system and he raises the most pertinent of questions when he asks what will happen to the global payment system when today's conditions of excess liquidity come to their inevitable end.

Questions about the relevance of the IMF are hardly new. Indeed, the total lack of involvement of the IMF in the ERM exchange rate crisis of the early 1990s has long since prompted the question as to whether we really do need an IMF for the industrialized countries. After all, the industrialized countries have not borrowed from the IMF since the early 1980s. Further, they are highly unlikely to do so in

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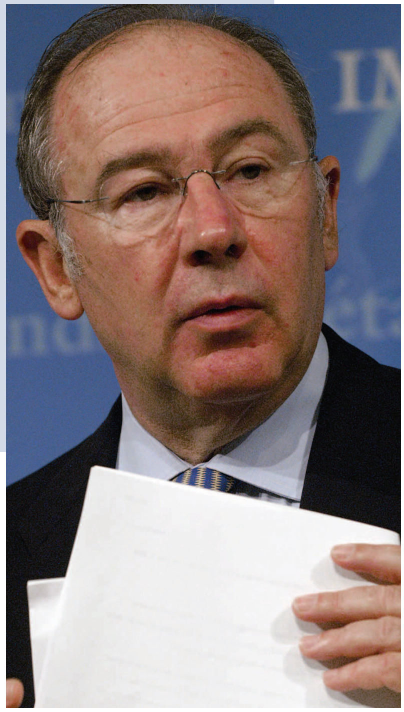
IMF

the future since they almost universally regard the IMF as a lending agency exclusively for the troubled emerging market economies with which they would hardly want to be compared.

More surprising, perhaps, is that in the emerging market economies themselves serious questions are now being asked about the IMF's relevance. In reaction to their bitter experience with IMF borrowing during the 1997 Asian crisis as well as to their under-representation on the IMF's governing board, most Asian countries are determined never to have to go back to the IMF to borrow money. To that end, they have built up an enormous cushion of international reserves and they are even toying with the idea of setting up their own Asian Monetary Fund to handle any future balance of payments crises that they might experience.

Even in Latin America, the traditional bread and butter for IMF lending, questions are now surfacing as to whether the IMF still has any relevance for the region. Following the recent prepayment by Argentina and Brazil of the entire US$25 billion of their outstanding IMF loans, one must now expect this question to be asked even more frequently. Indeed, on making those prepayments, both the Argentine and the Brazilian governments made a great deal of political hay out of the supposed fact that they were forever weaning themselves from IMF borrowing and from IMF meddling in their internal economic affairs.

That serious questions should be asked today about the relevance of the IMF, at a time of enormous global economic imbalances, suggests how long forgotten are the distant lessons of the inter-war period that were the very reasons for the IMF's original establishment. Was not the IMF set up in 1944 with the explicit mandate to prevent the beggar-thy-neighbor and protectionist policies of the 1930s? Was it not supposed to be the primary guardian of the smooth functioning of the international exchange rate system?

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And do today's unprecedented large and growing global payment imbalances not carry with them the risk of a disorderly unwinding of those imbalances, which might intensify the protectionist policies that are all too much in evidence? If one needed any reminding of those protectionist risks, one only need look to the strong support Chuck Schumer (D-NY) receives in the U.S. Senate for his proposed bill to impose a 27 percent across-the-board tariff on Chinese imports should China not meaningfully adjust its exchange rate in a sufficiently timely manner.

Doubts about the IMF's relevance at the very time when the organization could be most useful to the global economy also reflect the IMF's less-than-stellar execution of its basic mandate of promoting international monetary co-operation. Timothy Adams, the U.S. Undersecretary for International Affairs, recently put the matter well when he suggested that the IMF has been asleep at the wheel in the exercise of its surveillance role over the world's exchange rate system. In particular, he singled out that over the past twenty-five years there have been as few as two occasions (Korea and Sweden) upon which the IMF exercised its special consultation

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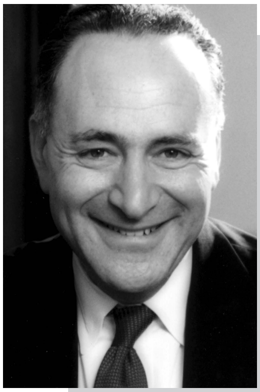

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procedures for countries suspected of manipulating their currencies. This despite the fact that there have been all too many instances of such currency manipulation over the past twenty-five years.

Timothy Adams clearly had in mind the IMF's passivity in dealing with China's very large and growing external current account surpluses. By artificially keeping the Chinese currency cheap through exchange market manipulation, China's external current account surplus is now set to become the largest in the world at a time when it is enjoying very strong long-term capital account inflows. As a result, its international reserves have already ballooned to over US$800 billion and they keep growing by around US$250 billion per year.

Yet the IMF maintains a virtual silence on the Chinese exchange rate issue and it certainly shrinks from making any statements that could be suggestive of China manipulating its currency. It does so despite the overwhelming evidence to the contrary. It also does so notwithstanding the fact that a meaningful reduction in China's large current account surplus must be part of the solution to a reduction in the very large U.S. current account deficit, and a movement in the Chinese currency is needed to unlock parallel exchange rate movements in the rest of Asia.

Should the IMF not be coming up with serious ideas as to how to deal with today's global payment imbalances?

More serious still than the IMF's passivity on the China exchange rate question is the IMF's virtual silence on today's unprecedented global payment imbalances. And this despite the fact that the U.S. current account deficit has now ballooned to an all-time high of $750 billion, or some 6 percent of GDP, and shows every sign of further widening in the years ahead.

If the IMF had any relevance in exercising its supposed role as guardian of the international financial system, should the IMF not be coming up with serious ideas as to how to deal with today's global payment imbalances? Or should it not be providing the leadership so sorely needed to ensure that these problems are dealt with in a co-operative manner that might provide the greatest chance of their successful resolution?

The IMF has no new clients of any size knocking at its door.

Instead, the IMF now seems to be fretting that its loans to the middle-income emerging market countries are being prepaid and that it has no new clients of any size knocking at its door. It does so despite the fact that history would suggest that today's unusually favorable economic conditions for the emerging market economies are unlikely to persist. It also does so despite the fact that these countries have not grasped the opportunity afforded to them by the good times to adequately fortify themselves against the bad times that will surely follow.

If ever over the past sixty years the global economy needed an IMF to effectively discharge its original mandate of helping to safeguard the international exchange system, it has to be now at a time of such large and disturbing global economic imbalances. However, on examining the IMF's woeful record of late, it is far from clear that we have in place the type of IMF that might be up to the task. ◆