RESHAPING THE GLOBAL FINANCIAL ARCHITECTURE: A COMMENT

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My contribution to this panel is that of an outsider, one who may not perceive a fine veil of arguments before concluding that the king has no clothes. The primary issue before this panel is how the International Monetary Fund might best be reformed to serve as the central institution of a new global financial architecture.

In May, I testified on this issue to the Joint Economic Committee on a panel with George Shultz, Paul Volcker, and Lawrence Lindsey. My own testimony developed on the conclusion of an important paper by Prof. Charles Calomiris that, "The principal lesson of the recent bailout programs managed by the IMF and the U.S. government ... is the vital need for all parties ... to find a credible way to commit *not* to sponsor such counterproductive bailouts." I observed that,

> The characteristic IMF response to this type of criticism, of course, is that the conditions for receiving IMF credit induce the type of reforms that are necessary to avoid a future crisis. In a few cases, this has been successful. The larger record, however does not provide a basis for optimism. Most developing country governments, once the recipient of IMF's subsidized credit, have become loan addicts. As noted earlier, most of these governments have relied on IMF loans for more than two decades, despite the conditions for receiving these loans and the usual two-to-five year maturity of these loans.

And I concluded that,

> Maybe we don't need the IMF--that is now the judgement of former Treasury secretaries George Shultz and William Simon and the former chairman of Citicorp Walter Wriston. I am willing to defer judgement on this issue. In the meantime, Congress should not approve any *additional* funds for the IMF, at least until some of the broader questions are addressed.

At that hearing, there was broad agreement that additional funding should be conditional on a major reform of the IMF without much agreement on the details. Paul Volcker provoked the most controversy by asserting that the IMF would be more receptive to reform if Congress first approved the additional funding. As is often the case, the recent resolution of this issue was a compromise of those two positions: Congress approved additional U.S. funding of $18 billion in exchange for a promise by the administration and the other major IMF member governments to seek specific reforms.

Since that hearing, my views on this issue have evolved from no more funding without IMF reform--to no more funding, period--to no more IMF. For I have concluded that *the IMF cannot perform the role that the member governments expect of it.* As they sing over at the Birchemere, "Walk through this world with me."

First, the IMF is institutionally incapable of being an effective lender of last resort. The IMF cannot create high-powered money or act quickly enough to prevent a liquidity crisis. And the IMF cannot have sufficient information to distinguish between an illiquid bank and an insolvent bank. As summarized in an article by UCLA economist Deepak Lal, the IMF "... can lend only after lengthy negotiations with a country's government and with the approval of its board. (And) it has no way of sorting out the ‘good’ from ‘bad’ loans, for instance made by foreign banks to residents in the country, and to liquidate the latter. The lender of last resort function for the money centre banks involved in foreign lending must therefore continue to be provided by their parent central banks."

And second, the IMF has not proved to be generally effective in promoting the type of economic policies that are necessary to avoid a financial crisis.

References

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