
The IMF Adrift on a Sea of Liquidity

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On this day of mixed metaphors, forgive me for adding yet another to our already overlong list. Sitting through today's discussions—or, one might more appropriately say, today's pronouncements—I was struck by the image of the IMF as a rudderless ship adrift on a sea of liquidity. On none of the key issues does the institution or its principal shareholders have a clear, or a clearly articulated, position.

The first such issue is the resolution of global imbalances. No doubt the IMF is painfully aware of its inability to influence significantly the large-country policies that are responsible for the current account imbalances posing a growing threat to systemic financial stability and global economic growth. In reality, the institution has few instruments other than the bully pulpit with which to influence the policies of countries that do not borrow from it. This means that the Fund has little influence over countries that borrow abroad in their own currencies because they are in a position to undertake lender-of-last-resort operations on their own.¹ It means that the Fund has little influence over countries with ample reserves because they self-insure against capital account shocks. It means that the Fund has little influence over countries in current account surplus

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1. See Mishkin (forthcoming) for an analysis that emphasizes this point.

because they are relatively well insulated from sudden stops. (It is easier, after all, to respond to a crisis by lending less abroad than by continuing to borrow when there is no borrowing to be had.)

When we add up all the countries falling under one or another of these headings, it is clear that we have eliminated essentially all of the countries whose policies are contributing to the global-imbalances problem. It is well and good to argue, as Morris Goldstein does in chapter 5 of this volume, that the Fund should be more forceful in its criticism of exchange rate policies with implications for global stability. And it is fine to argue, along the lines of the Managing Director's Report on the Fund's Medium-Term Strategy (IMF 2005), that the Fund should reflect on why its advice to such countries is not more frequently accepted and that the Fund should publish a new report on the macroeconomics of globalization that will focus on such issues. But more reflection, another glossy publication, and even more attention to exchange rate policies will not solve this problem. The only solution is for management to be more forceful and direct. I want to be clear; I am not criticizing the IMF's dedicated staff. We cannot expect staff to go out on this limb alone, without a political safety net. Management has to be blunter. It has to be prepared to use its political capital—and even to bite the hand that feeds it—if this is the price to be paid for protecting the world economy from threats to global stability.

The second key issue is how and when to lend into crises. Should the IMF lend more or less frequently? Should it lend in larger or smaller amounts? Should it prequalify members for assistance or decide their eligibility on the spot? The managing director's report tells us only that more study of these complex questions is required. I agree that these questions are complex. I would also acknowledge that we academics have been unhelpful, given our own inability to agree. And it is understandably difficult for a large bureaucracy to reach a focused conclusion on such a divisive issue. But the Bank of England is a large bureaucracy, and it has a position on this issue (see chapter 15 by Gregor Irwin and Chris Salmon in this volume). Although I happen to think that the bank's position is wrong, I applaud it for its efforts. In my view, although moral hazard is a problem, as the bank emphasizes, meltdown risk can, at times, be an even more serious problem.

There will continue to be a need for the IMF to lend—and sometimes in our age of financial globalization for it to lend uncomfortably large amounts—to countries experiencing capital account crises. I am a campaigner for collective action clauses (CACs), standing committees of bondholders, and other restructuring-friendly reforms, but I do not believe that they will ever obviate the need for crisis lending. I do not believe that the Fund will be able to credibly divide its members, *ex ante*, into those eligible and ineligible for such assistance. I do not believe that prequalification

is feasible (Eichengreen 2002).² For all these reasons, I do not believe that more discussion of a successor to the late, lamented Contingent Credit Line would be productive. Inevitably, the Fund needs to acknowledge that we live in a world where the crisis lender must exercise discretion and where the rest of us rely on the Fund to exercise that discretion prudently. The IMF needs to be trusted to make appropriate lending decisions as the need arises. And, to gain our trust, the institution needs to specify the basis on which it will decide.

In this connection I wish to express my support, in principle if not in all its particulars, for one innovative lending proposal advanced at this conference: Kristin Forbes's shock-smoothing facility (chapter 18 of this volume). In recent years we have devoted considerable time to efforts to write more complete contracts for private-sector lending (I refer of course not just to CACs but also to GDP-linked bonds and other such instruments). That we have not yet extended this initiative to official loans is peculiar. After all, the standard objection to CACs and GDP-indexed securities—that of a first-mover problem due to the lack of market liquidity and the consequent reluctance of investors to take up new instruments—does not carry over to IMF loans. Thus, I have considerable sympathy for the general idea behind Forbes's shock-absorber proposal, namely that the interest rate on IMF loans might be indexed to the severity of the disturbance to which a country is subjected.³ To be sure, there may be a problem with finding an appropriate exogenous variable to which the loan might be indexed; for example, not every country has a well-defined analogue to Chile's copper prices. But if the implicit marginal rate of taxation is modest, it is hard to imagine that countries would forgo faster growth in order to reduce net repayments to the Fund. A modest initiative along these lines—indexing repayments to the growth of output—would not address the fundamental questions about the role of IMF lending, but it would be another modest step in the direction of more efficient contracts.

2. The fundamental problem with all schemes for prequalification is the fact that there exists no clear *ex ante* cutoff between countries with sustainable and unsustainable debts. In the gray area in which problem countries reside, debt sustainability is in the eye of the beholder, a fact that raises both economic and political problems. In addition, prequalification assumes an ability to disqualify a country subsequently if its economic policies and debt situation deteriorate. How this can be done without precipitating a crisis is not exactly clear. These considerations render me skeptical of insurance schemes involving prequalification such as that suggested by Cordella and Levy Yeyati (chapter 17 of this volume).

3. It can be objected that differential treatment of members and, specifically, the application of different interest rates on IMF loans extended through the same window are incompatible with the nondiscrimination provisions of the Articles of Agreement. I suspect there are ways of introducing this degree of variation into IMF charges if there existed a consensus that this was desirable.

The IMF appears to be equally at sea on the question of postcrisis debt restructuring. In Argentina, the Fund essentially disengaged itself, leaving it to the debtor and creditors to strike a deal. The creditors are predictably unhappy because their compensation is considerably less than was the case of typical debt settlements in the past.⁴ Will this outcome slow the development of international financial intermediation and increase the difficulty that poor countries face in accessing international capital markets? We don't know because we don't know whether the Argentine case is a precedent and whether the Fund intends to similarly recuse itself from future renegotiations. Simply saying that the Fund should "review the effectiveness of [its] instruments," including its lending into arrears policy, does not suggest that it has a coherent approach. The sovereign debt restructuring mechanism debate taught us that the IMF cannot act as a bankruptcy judge. In my view, however, the Fund, as spokesperson for the international policy community, possesses a legitimacy that it should use to advance the interests of the global community. In other words, it is not appropriate for the Fund to abrogate this responsibility.

No one, not even the members of this concluding panel, can resolve all the issues raised at this conference. Doing so will require an ongoing process—one that is efficient (in the sense of leaving no surplus on the table), effective (in terms of being able to reach decisions quickly), equitable, and legitimate. This is where reform of Executive Board representation and quota shares comes in.

To be sure, all of the proposals on the table have problems. Among other things, there is a greater reluctance on the part of the Europeans to consolidate their representation following the French and Dutch referenda on the EU constitution. Moreover, it is difficult to think of a reasonable quota formula, even one that would base quota shares on national incomes valued at purchasing power parity, that would not end up further increasing the weight of the United States in the institution, something that would not be seen as enhancing the Fund's legitimacy in the countries that are the subject of its programs. Still, I would propose Ted Truman's phased approaches to constituency and quota reform as the obvious place to start. Here IMF management can exercise leadership because no one can speak more authoritatively than Fund managers about how to enhance the efficiency, effectiveness, equity, and legitimacy of decision making within the institution.

Not a few academics and op-ed columnists have based their careers on criticizing the IMF. The institution is a convenient whipping boy. It is the international equivalent of the Federal Emergency Management Agency: Some will always blame the first-responding abilities of the emergency management agency more than the hurricane. All these are reasons why readers may want to discount some of the more extreme rhetoric. It does

4. For one of the more dispassionate assessments, see Porzecanski (2005).

seem to me, though, that the institution is adrift on the fundamental international financial issues of the day: global imbalances, crisis lending, debt restructuring, and its own internal governance. On these issues it needs to stake out a position that does more than simply mimic the preferences of its principal shareholders.

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