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Super-Sizing the IMF is Wrong

by Kenneth Rogoff

CAMBRIDGE – As the global financial crisis radiates out from the developed economies into emerging markets, it is ravaging not only governance-challenged economies such as Venezuela, Russia, and Argentina. The crisis is also striking countries like Brazil, Korea, and South Africa, which appeared to have made substantial and lasting progress towards macroeconomic stability. For this reason, the future shape of the International Monetary Fund is rapidly moving to the top of the agenda for world leaders as they prepare to meet in Washington in mid-November to discuss the future of the global financial system.

Just a short time ago, the IMF seemed relegated to a sustained period of irrelevance as it failed to modernize either its euro-centric political representation or its arcane government-to-government lending facilities. Suddenly, the Fund has moved to center stage as the only agency seemingly capable of stemming the vicious downward spiral that is currently seizing emerging-market stocks and bonds.

World leaders should be happy that the IMF stands ready to take the lead in the next phase of the global financial crisis, even if its lending resources of approximately $250 billion are inadequate to stem the current run on emerging markets. Emerging-market companies alone have hundreds of billions coming due in the next twelve months, far more than their governments' reserves can cover if credit markets do not normalize.

Unlike United States Federal Reserve chairman Ben Bernanke, most emerging-market central bankers are in no position to extend blank checks across their economies without a boomerang effect on interest rates and exchange rates. (We will see how investors judge the dollar once the smoke clears and the huge expansion of US money and debt becomes evident.)

But it would be a terrible mistake simply to super-size the IMF in its current guise by greatly scaling up its lending facilities, as many propose. Rather, the Fund's role, even in the current crisis, should be sharpened as an interlocutor between lenders and developing country borrowers, rather than simply as a replacement for all other loan sources.

The key reforms for the IMF remain (1) improving governance by reducing European representation while increasing that of Asia, and (2) focusing the Fund's mission on monitoring and surveillance rather than as a direct provider of bailout loans. Contrary to popular opinion, now is exactly the right time to make these changes. Rich country governments, led by central banks, should provide the large scale funding needed to stem the run on developing country finances. The Fund's main role should be in monitoring.

Without its own currency, the IMF is poorly positioned to intervene with the overwhelming force needed for lender-of-last-resort operations. In principle, the IMF could be allowed to print money (it already has its own accounting unit, the so-called Special Drawing Rights). But this is not realistic, given the lack of an adequate system for global governance. Even the euro area, which is far more cohesive than the world as a whole, has not quite figured out how to use its central bank as lender of last resort.

The IMF's lending resources have shrunk dramatically relative to world trade and income compared over the past 50 years. But increasing its resources to a trillion dollars or more is not a realistic option, either. The IMF does not have an adequate framework for handling the massive defaults that could easily attend a huge surge in lending, much less the political will to distinguish between countries that are facing genuine short-term liquidity problems and countries that are actually facing insolvency problems.

So what should world leaders do with the IMF? In the short run, the IMF could help coordinate additional loans from countries such as the US, Japan, and China, to help maintain economic and political stability in the developing world. Without directly acknowledging America's central role in causing the financial crisis, the US Federal Reserve has already offered to exchange up to $30 billion each with the central banks of Korea, Brazil, Mexico and Singapore.

The IMF can also play a useful role in helping surplus countries manage their foreign exchange reserves, much as the Bank for International Settlements already does. World leaders can allow the IMF to sell some of its gold stock to endow the agency with enough cash to fund its monitoring and surveillance functions. Then in the future, it will not need to make crisis loans just to keep the lights on in the building.

As tempting as it may be to ramp up IMF lending on a long-term basis, this would be a strategic mistake for both the world and the Fund. The rich countries, together with China and the Middle East oil exporters do indeed need to take bold steps to help out emerging markets, and the Fund has a useful role to play. But super-sizing the Fund, without sufficient governance improvements and lending constraints, would give the world too much of a good thing.

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