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Europe should give up its hold on the Fund

By Sebastian Edwards

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The resignation of Horst Köhler as managing director of the International Monetary Fund offers a unique opportunity to improve the governance of the embattled institution.

The IMF needs a new leader with solid technical training, a broad vision and first-hand experience in dealing with the macroeconomic risks faced by the emerging and transition economies. Mr Köhler, who is leaving to become Germany's next president, did not have any of these characteristics. A mediocre economist and a grey bureaucrat, Mr Köhler was not even Germany's first choice to succeed the urbane Michel Camdessus at the helm of the Fund. It was only after the US vetoed Europe's preferred candidate that Mr Köhler's name surfaced as a compromise. His tenure at the Fund left much to be desired.

Unfortunately, when it comes to the succession, politics as usual is likely to prevail. Instead of getting the best man or woman for the job, the position will go to a European politician.

At this point Rodrigo Rato, Spain's finance minister, appears to be the frontrunner. Mr Rato is an able politician and under his stewardship Spain's finances have done well. Yet it would be a stretch to argue that he is the best candidate for the IMF position. Mr Rato is a lawyer by training and in the early 1970s got an MBA in the US. He has no experience of crisis management, big economic reforms or crisis prevention.

It is hard to understand why, as has traditionally been the case, the head of the IMF should continue to come from Europe. After all, European politicians should be interested in defending their national interests and that goal is best served if the best man or woman available leads the Fund.

Consider the Argentine default, which has hit thousands of small European investors hard. There is no doubt that, had the IMF handled the Argentine situation - especially during late 2000 and 2001 - more competently, these citizens would be much better off today. Yes, Europe obtained a political triumph by appointing Mr Köhler in 2000. But the cost has been huge.

As Martin Wolf has recently argued on these pages, the IMF has become too small to handle modern financial and macroeconomic crises. Just three countries - Argentina, Brazil and Turkey - are currently using more than 70 per cent of the Fund's general resources.

It is for this reason that the Fund should increasingly emphasise crisis prevention and policy advice aimed at reducing macroeconomic vulnerability. The best person to lead the institution would be someone who has dealt with these issues. It should be someone who has dealt, at the policy and analytical level, with questions related to the role of speculative capital flows, banking supervision, debt dynamics and exchange rate policy.

Not surprisingly, the most knowledgeable people on these issues are in the successful

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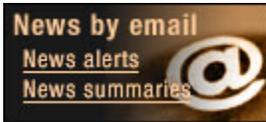
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Amity Shlaes



countries of Latin America. After decades of instability, a handful of countries there - in particular Chile and Mexico - have become examples of prudence, austerity and macroeconomic stability.

The list of Chile's achievements includes the use of a clever fiscal rule, the adoption of exchange rate flexibility, a novel pension reform, export growth success, the halving of poverty in less than a decade and the skilful management of speculative capital inflows.

Chile's economic policies have been praised by people as different as Joseph Stiglitz, one of the IMF's most ferocious critics, and Robert Rubin, the former US Treasury secretary.

Alejandro Foxley, Chile's first finance minister following the return of democracy in 1990 and one of the architects of the country's remarkable economic success, is the ideal candidate to lead the IMF. With a doctorate in economics from the University of Wisconsin, he is a widely published economist, a respected researcher, a successful manager and an able left-of-centre politician who was elected to the senate five years ago. Mr Foxley understands the plight of emerging and transition countries and at the same time he knows at first hand that policies aimed at macroeconomic stability have a tremendous pay-off.

There is no doubt that policies endorsed by Mr Foxley would immediately become credible. Under his leadership, the Fund would become more relevant and useful and suspicion about its objectives would disappear. This would be a tremendous improvement over the current situation. One can only hope that, for once, European politicians do the right thing.

The writer is a professor of economics at UCLA's Anderson Graduate School of Management. During 1993-96 he was the World Bank's chief economist for Latin America



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