ABOLISH THE IMF

By

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The White House and the Congress recently agreed on the $18 billion funding for the International Monetary Fund. That is the good news. The IMF needs additional resources now, to help countries such as Brazil and Argentina to withstand the current financial turmoil.

The bad news is that the reforms of the IMF being discussed – less secrecy, and loans with shorter maturity and at market rates – are clearly insufficient. They are nothing else than tinkering at the margin. And, as the current global financial crisis has strongly suggested, what the world needs is a major redesign of the international monetary system. A refurbished IMF will simply not do.

The problem is that the IMF’s mandate does not allow it to operate effectively in a modern world where investor’s confidence is key, and where the frank, uncensored and prompt dissemination of information is of paramount importance. Refitting the IMF for this new reality would take too much effort and would be too costly.

The G-3 should convene a major international conference, in the spirit of the Bretton Woods conference 54 years ago, to design a new global system. This conference should result in the abolishment of the IMF, and in the creation of three institutions with the mandate, and ability, to help prevent major, generalized and costly financial crises. The first of these institutions would be the Global Information Agency, and would
provide timely and uncensored information on countries’ financial health. It would do this early on, when countries still have time for implementing corrective action. It would rank countries’ financial systems, and would use modern risk management techniques to evaluate the degree of fragility of different economies. If there is no enough information – or if information is suspect – it would say so, alerting investors and forcing countries to implement real improvements. Faced with this independent rating body that would speak up freely, countries would have the incentive to implement modern accounting practices, put in place effective supervisory frameworks and avoid major fiscal imbalances.

The second institution would help prevent crises, by playing a pro-active – rather than reactive, as the IMF currently does -- role in the world financial system. This institution, call it the Contingent Global Financial Facility, would provide contingent credit lines to country’s that, although solvent, are facing temporary liquidity problems. That is, it would assist countries that in the medium run could meet their obligations, but are facing temporary liquidity squeezes. In order to be eligible for assistance from this facility, countries would have to meet some minimum standards in terms of information disclosure and transparency, as well as in terms of economic fundamentals. From a practical point of view, only countries that have been certified by the Global Information Agency discussed above, would qualify for these loans. These, in turn, should be for short maturities and carry relatively high interest rates. By acting before a crisis erupts – and not, as the IMF usually does, after the currency has collapsed --, this institution would help restore confidence before it is too late. This Contingent Global Financial Facility would provide the role of an international lender of last resort of sorts. However, by assisting only eligible countries, it would provide the right set of incentives and would
avoid serious moral hazard problems. With time it could even become a world central Bank.

The third institution – let’s call it *Global Restructuring Agency* – would be in charge of “clean up,” and would deal with those countries that, in spite of everything, run into a crisis. This institution would help countries restructure their debts and would provide funds under conditionality. In order to minimize the coordination problems associated with major crises this institution would be allowed to call for a “cooling-off” period – not too different from our “Chapter 11” for companies --, that would allow creditors and debtors to work out an orderly restructuring. This restructuring facility would work closely with regional development banks, which in the new system would have a significantly more important role than at present time. In this way, regional sensibilities and cultural perspectives would be taken into account when designing adjustment packages.

Of course, implementing a reform along these lines would not be easy. There are many political interests tied up to the current system. However, unless we are willing to think radically we will not be able to build a international system that would world to enjoy the benefits of globalization at the same time as avoiding its major drawbacks.