

A new IMF MD and the capital account

Since formation, while the World Bank has always had an American nominee as the head, the IMF managing director has been from Europe. Within Europe, if French Finance Minister Christine Lagarde becomes the next Managing Director, as seems likely at the moment, this would be the fourth time that a French citizen would occupy the position. The only other candidate is the Mexican Central Bank head, and erstwhile deputy Managing Director of the IMF, Agustin Carstens. He too is from an OECD country, but one which has joined the rich men's club fairly recently. The emerging economies do not have any agreed candidate as of now. But, if the growth rate gap between the emerging Asian economies and the old European/American economies remains at the level it has been for the last few decades, Ms. Lagarde's appointment could well be the last gasp of the G8 – in many ways its global agenda setting role has already been taken over by the G20.

The far bigger question is to what extent he or she would be able to change IMF's policies, and particularly the market fundamentalist ideology that has been prevalent in Washington over the last three decades. In many ways, this influence of the U.S. on a European CEO headed multilateral institution is strange. For one thing, the Europeans in general and the French in particular have always been far more dirigisme than the Anglo-Saxons. (The last MD was actually the French Socialist Party's candidate for presidency, with every chance of being elected: to be sure, he was a "Champaign socialist", very comfortable with the super-rich and Porsche cars than the man or woman on the streets, particularly in the developing world.) But it seems ideology changes with location in Washington.

The only economist out of the Big Three (Adam Smith, Karl Marx and John Menard Keynes) to emerge with his reputation enhanced after the first decade of the 21st century, is Keynes – after the financial crisis of 2008, the global economy was saved from the possibility of a depression only by Keynesian tools. Keynes was also one of the two principal authors of the IMF Articles of Agreement (the other was Harry Dexter White, the American). During the

conference Keynes argued strongly for location of the IMF outside Washington. To quote from Robert Skidelsky's monumental biography of the great man, "*Keynes's main purpose was to protect the Fund from preponderant US political control.*" He failed.

What Keynes feared has come to pass over the last three decades, in particular on the advocacy of unrestricted cross-border capital flows, and its corollary, market-determined exchange rates. Jagdish Bhagwati once described capital account convertibility as a "*conspiracy of Wall Street abetted by the US Treasury and IMF!*" (He later clarified that, "*Wall Street, like any other business, likes expanded markets. So they were pressuring for more and more markets, more and more financial opening.*") East Asian economies were accused of crony capitalism after the crisis of 1997-98 – the prime example of crony capitalism is the nexus and revolving door between U.S. Treasury and the Wall Street. By the 1980s, with the arrival of President Reagan, market fundamentalism had become the ruling ideology in Washington. The question is whether the IMF should have bought it and propagated a liberal capital account in its developing country members – with no empirical evidence to suggest that a liberal capital account helps growth. (Most fast growing Asian economies have capital controls.) One wonders to what extent IMF economists, many of them trained in U.S. Universities and under the influence of the Chicago School, contributed to the change in stance on the capital account. At one stage, the IMF proposed to amend its Articles of Association to prescribe full convertibility, also on the capital account, as an objective for all member countries. Only the series of crises in the developing world in the 1990s led to an abandoning of the proposal. The IMF continues, however, to believe in the virtues of a liberal capital account -- its reported change of heart is highly exaggerated.

Of the impossible trinity -- independent monetary policy, a managed exchange rate and a liberal capital account –, until the Second World War the accepted wisdom was to give up the first, allowing money supply to be determined by the reserves of gold; in the last three decades the IMF has advocated discarding the second, despite a series of crises from Mexico in 1994-95 to Iceland more recently, originating in it; it is high time it seriously looks at giving up the third – and looks at the real economy of growth and jobs a little more seriously. To end with the words of one of its founder economists, namely Keynes, "in future, the external value of (a

currency) shall conform to its internal value,... Secondly, we intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our own purposes, without interference from the ebb and flow of the international capital movements, or flights of hot money.”

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