

Seventy years of the IMF

As the International Monetary Fund completes seventy years, it is interesting to see how it has changed since its birth in Bretton Woods in the US in 1944. The two principal midwives were John Maynard Keynes of the UK and Harry Dexter White of the US. The former had much less weight in the deliberations than the latter given UK's weak economic and financial position. For one thing, Keynes wanted the headquarters to be away from Washington, to reduce the possibility of undue ideological influence of the US. He had also proposed the creation of a *Bancor*, an artificial currency to be issued by the IMF. He failed on both counts. (Incidentally, India though still a colony, was one of the founding members.)

In the first quarter century of its life, the institution's principal role was as the administrator of the fixed exchange rate system agreed to in the Bretton Woods conference. The system worked very well, and restored war-ravaged economies in Europe, Japan and elsewhere, to economic health. Capital controls was the norm in that era. In his speech in the House of Lords explaining the benefits of the new international monetary system, Keynes stated that, *"We are determined that, in future, the external value of sterling shall conform to its internal value as set by our own domestic policies, and not the other way round. Secondly, we intend to retain control on 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 international capital movements or flights of hot money. Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside. In other words, we abjure the instruments of Bank rate and credit contraction operating through the increase of unemployment as a means of forcing our domestic economy into line with external factors."* China has done exactly this, and achieved unparalleled growth over the last 35 years.

One foundation of the fixed rate system was the US dollar's convertibility into gold at a fixed price, a legacy of the gold standard era. With the war in Vietnam in the 1960s, the US started incurring deficits on its current account, and the dollar holdings of other central banks grew rapidly. The pledge to convert dollars into gold at a fixed price

came under question: in a unilateral move, the US ended the convertibility. There was an attempt to maintain fixed exchange rates despite this (the Smithsonian Agreement), but it did not work as other developed countries also started liberalizing their capital accounts. We are effectively in an era of floating, market determined exchange rates since then, China the major exception.

From an arbiter of the fixed exchange rate system, the IMF converted itself into a propagator of liberal capital account and floating exchange rates. To what extent the new faith conforms to Article I of its Articles of Agreement is debatable: it requires the IMF to ***“facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.”*** (I will come back to this issue in a later article.)

The 21st century has not gone too well for the Washington institution. For one thing, the present Managing Director is under investigation for a political scandal dating back to her days as Finance Minister of France; her predecessor had to leave because of a sex scandal, and the investment company which he founded after leaving the IMF, has recently declared itself insolvent; *his* predecessor Rodrigo De Rato has been convicted of accounting irregularities in Bankia, a Spanish bank of which he was the Chief Executive. (The 2011 reported profit of € 300 mn, was actually a loss of € 3 bn!) He was also found guilty of charging personal expenses to his corporate credit card. Personal peccadilloes apart, it is amazing that individuals who could not manage an investment company or a commercial bank, have headed IMF, the arbiter of global macroeconomic policies!

The IMF's professional record in recent years has also not been very reassuring. It had estimated the fiscal compression ratio (ratio of a drop in fiscal deficit to the resultant fall in nominal GDP) at 0.5%. It turned out to be altogether different! Nor could its surveillance foresee the 2008 crisis in the mortgage market, or the later crisis in the euro zone. To quote from a 2011 report of the *IMF's Independent Evaluation Office (IEO)*, *“Research at the IMF: Relevance and Utilisation”*, ***“there is a widely held***

perception that IMF research is message driven. About half of the authorities held this view, and more than half of the staff indicated that they felt pressure to align their conclusions with IMF policies and positions. Policy recommendations provided in some research publications did not follow from the research results ... number of country authorities and researchers noted that IMF research tended to follow a pre-set view with predictable conclusions that did not allow for alternative perspectives.” Its staff boasts of 150 nationalities but “*they went to the same graduate school, studied with the same professors*” in the US (Brett House in a book review, Finance and Development, September 2014).

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