

Beyond the IMF

2006

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The drift away from the Bretton Woods paradigm, of a world where financial markets are coordinated and disciplined by a central multilateral institution, continues. Industrialized countries long since removed themselves from IMF tutoring. When it lost its essential purpose, the Fund survived as a developmental institution, dedicated to the financial stability of developing countries, more concerned with domestic than with international policies, and even joining the poverty alleviation crusade. During the last few years, however, emerging market countries are also drifting away from the Fund, prepaying debts to the institution, rejecting the Fund's role as a debt arbiter, building up international reserves, and above all, reforming domestic policies to lessen the risk of financial crisis and dependence on the IMF. At the same time, the Fund has been losing its financial capacity to provide emergency funding, and its human capital comparative advantage as an adviser. The principal reaction to this erosion of the Fund's role has been to call for IMF reform. A succession of ingenious proposals have been put forward, designed to seduce the Fund's main shareholders into an acceptance of the key steps required for reform — a surrender of voting power and the creation of new funding for the institution.

We argue that the focus on reform - which may or may not happen - should be complemented by greater attention to the reasons for the exodus from the Fund. Starting with a checklist of core IMF functions, one would find examples of both market mechanisms and government interventions that in some measure are acting as substitutes for the IMF, including functions such as crisis resolution, exchange rate management, financial policy coordination and surveillance. At the same time, exit from the Fund is also being driven by high borrowing costs for Fund resources, as market rates decline relative to Fund charges. Behind that trend is a cost crunch in the institution. A shrinking customer base means falling revenues, yet the institution has refused to adjust by cutting its administrative expenses. One reason for a closer look at the factors that are reducing demand for IMF services is to assess the significance of a diminished IMF. How effective are those alternative mechanisms? To what extent does the absence of an IMF mean a more dangerous world? Another reason for the examination proposed here is to identify opportunities for intervention that would reduce financial vulnerability, not through the Fund, but by strengthening the market and governmental substitutes for the IMF. The paper focuses in particular on the insurance role of the Fund and argues that developing countries are adopting alternative insurance mechanisms, from a higher level of reserves to regional co-insurance facilities to remittances as a counter-cyclical source of foreign exchange.

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