

CORE MISSION

Adam S. Posen

The IMF must use its unique focus to assert its independence as geopolitical divisions intensify

As the IMF turns 80, its core macroeconomic mission still deserves to be pursued and prioritized. The ongoing corrosion of globalization—reinforcing and being reinforced by geopolitical fragmentation—increases the vulnerability of all but the largest economies to foreign economic shocks, arbitrary swings in current account balances, interruptions in access to dollar liquidity, and accumulation of unsustainable debt. The increasing politicization of international finance and commerce by China, the European Union, and the United States has, however, put at risk the IMF's ability to assist member countries and limit exploitative behavior by the governments of the three largest economies. For the sake of global economic stability, the IMF must get out in front of these dangers.



But stability will not be achieved by broadening the institution's remit in an effort to pander to the changing whims of the largest shareholders, though that response might be understandable as a short-term political approach. Instead, the IMF must emphasize its unique role as a multilateral conditional lender and a truth teller regarding international debt and monetary issues. This role justifies greater operational independence, along the lines of central banks.

First, the broader and more discretionary the core IMF agenda, the greater the vulnerability of member countries to the geopolitical machinations of large-economy governments and the market flows they influence—which is precisely the threat that is currently on the rise.

Second, broad consistency in both substance and process in dealings with member countries is critical to the legitimacy of the IMF's decision making, especially when members are most vulnerable. Technocratic evenhandedness is essential to successful buy-in by all members over the long run, even at the expense of some local support in short run. Inconsistencies of the sort imposed by the US on successive programs with Argentina or by the EU's "troika" role in the euro area crisis are likely to grow over time.

Third, although there are other international forums to address inequality, climate, and other global issues, only the IMF can be a quasi-lender of last resort and speaker of truth to economic power on debt and monetary issues. The IMF cannot put up substantial funds for longer-term development and global public goods—or mobilize private financing on an ongoing basis—as others can. It should be ready to trade its seat in these discussions for greater institutional (not just de facto) independence in its core mission.

We are likely at the early stage of a cycle of cross-border distrust among the big three economies feeding demands for self-reliance and then demanding that smaller economies choose sides. The IMF may have only a brief window to build its institutional strength before it is pressured recurrently to choose sides between major shareholders.

More central than ever

The IMF's core macroeconomic mission is to address member nations' vulnerabilities that arise through cross-border commerce and financial flows and manage the international monetary system that underlies those flows. In their recent assessment, *Floating Exchange Rates at Fifty*, Douglas Irwin and Maurice Obstfeld point out that many of the problems the IMF and the Bretton Woods agreements were designed to address are inherent to international finance. These problems remain, even though the postwar fixed exchange rate system was abandoned in favor of today's non-system:

- Exchange rate flexibility allows for monetary independence, yielding low inflation, but still does not prevent sudden stops and financial crises.
- Foreign economic shocks are still transmitted, often with substantial effects on smaller and lower-income countries.
- Capital flows often drive large rapid fluctuations in current account deficits.
- Interruptions in the availability of dollar liquidity to member economies have major repercussions, sometimes causing financial crises.
- Self-insurance efforts by large-surplus economies—whether through currency manipulation or replacement of imports with subsidies and tariffs—reduce global growth and impose adjustments during recessions on others.



“Given growing distrust among the US, the EU, and China, there should be mutual agreement to give the IMF that operational insulation.”

As a result, there is no getting away from crisis lending with conditionality when member economies lose access to financial markets or suffer capital flight. The IMF’s ability to provide credible conditional adjustment financing, cushion groups of economies from common economic shocks, and restore access to market liquidity while restructuring international debt obligations is therefore more, not less, central than ever.

Only the IMF can provide this support on a multilateral, nearly universal basis. Any other institution or bilateral intergovernmental arrangement offering emergency financing will give that lender prejudicial influence over the borrowing country.

Benefits of surveillance

Surveillance of spillovers from the misguidedly excessive self-insurance policies of the largest economies, if consistently pursued, has a good shot at benefiting the global economy. Small achievable changes in the policies of those economies can aid many significantly, boost IMF credibility, and reduce risk. Similarly, by seeking to coordinate on cross-border debt and monetary issues, the IMF can generate benefit by influencing small changes in (or offsetting) behavior by lenders and reserve currency issuers. The more independent the IMF, the greater its legitimacy in its interaction with members.

The IMF must also call China, the EU, and the US to account through surveillance of their increasingly political and bullying control of access to their markets and its spillovers to the rest of the world. When China or the US conditions access to its payment systems or fossil fuel exports on national security goals, uncertainty reverberates through the rest of the world. Emerging markets’ growth prospects rise and fall as the big three economies arbitrarily determine who gets to produce their imports and who does not.

Let the other international economic and financial institutions—the World Bank, the Organisation for Economic Co-operation and Development, the Group of 20 major economies, and so on—take their seats at every arguably relevant table and maximize their funding. The IMF is the only multilateral institution that deals directly with cross-border spillovers and macroeconomic volatility. The IMF is the only multilateral institution that can engage in macroeconomic conditionality with any hope of legitimacy and of changing borrower policies. The IMF is the only international entity that can force negotiation, albeit not necessarily rapid restructuring, by private sector investors. And the IMF is the only international organization that can chide the big three economies in precise terms with respect to their *policies* and not just ask for more contributions to public goods.

In surveillance, as in lending and other policy decisions, the EU, the US, and China have a common interest in making sure that each is criticized according to the same criteria, with the same frequency, and through the same public channels. The IMF should lock in on independent frankness rather than a mutual nonaggression pact over US fiscal deficits, Chinese exchange rates, and the EU’s ill-timed austerity, which served the world so poorly in the 2000s and 2010s.

Confronting new challenges

To better achieve its mandated goals and shore up its legitimacy, the IMF should aim for greater operational independence, akin to that of most central banks, while maintaining external evaluation of its competence by its members and having them set its overall goals. This is already taking place to some degree with respect to executive board approval of specific program decisions, for example. Continued progress will likely require narrowing down the IMF’s mandate to its core functions in exchange for more autonomy in specific policy decisions. Yielding some turf is what the Fund must do in terms of governance deals without compromising its even-handed treatment of members.

Given the growing distrust among the US, the EU, and China, there should be a way forward to a mutual agreement to give the IMF that operational insulation. Securing such an agreement, with clear limits on what the IMF can address, would assure each of the big three economies that the other two will not be able to exercise control in situations that really matter to them. All macroeconomic institutions depend upon such a mutual recognition that it is better to yield control to be confident that there will be no abuse of power in turn. The absence of adequate insulation of IMF operations will likely splinter the global financial

safety net, with divergent politicized conditionality; allocate access to funding unevenly, if not unfairly; and diminish stability of the international monetary system.

By focusing on its core mission, the IMF can adapt to the new global economic challenges arising from the fragmentation of geopolitics and the corrosion of globalization. Particularly worrisome is the largest economies' increasing tendency to link access to their markets to various political loyalty tests or side payments. All manner of access is affected—exports to those countries, employment and technical knowledge in high-tech and other industries deemed “critical,” financial services and liquidity, foreign direct investment into and from those countries, and cross-border aid and lending. Intentional or not, this is the kind of national-security-driven fragmentation that the creation of the Bretton Woods institutions 80 years ago was aimed to prevent.

There are of course other imminent global challenges: climate change first and foremost, but also pandemics, food security, technology competition, trade wars, real wars, and the mass migrations all these induce. For member countries other than the big three, these challenges are likely to be experienced as recurring, increasingly frequent macroeconomic shocks. To the extent that these are simultaneous shocks across many member countries, the IMF should provide special facilities or lending to those members on common terms and insist that the big three economies change their behavior or offset the shocks.

Exercising best practice

For the majority of its members, then, it is essential that the IMF's advice on macroeconomic policies to manage shocks and the vulnerabilities they expose follow best practice, and is consistent for all members, whatever the source of the shock. This is in the long-term best interest of the big three economies as well. But their governments are increasingly tempted either to insert their geopolitical preferences into IMF decisions or to shield their protectionist self-dealing from surveillance, despite the large impact on others.

The IMF can thus best serve its membership—including the big three—as a bulwark of technocratic multilateralism against politicized bullying in financial and other market access. A significant step in this direction would be greater IMF executive board ability to pass decisions by qualified majority voting—meaning restriction of the largest shareholder's ability to exercise a veto—except on long-term or quasi-constitutional issues. This exchange of narrowness for the

“The Bretton Woods institutions must be more reliable if the big three economies continue to retreat from rules-based globalization.”

sake of operational independence would be helpful because the IMF would not be putting more US taxpayer funds at perceived risk or using them to serve mission creep.

Another step forward would be to adopt stricter and more consistent rules limiting IMF lending to economies at war, for example, with respect to Israel, the West Bank and Gaza, and Ukraine today. There is, of course, a need for support and eventual reconstruction assistance, but if the IMF is seen as taking sides while conflict is ongoing, it may split the world economy even further. For the first time since the 1980s, military conflicts directly involving the major powers' allies on opposite sides are occurring and are likely to continue. The IMF should forestall falling into this trap.

Beyond China, the US, and overrepresented EU economies, the IMF's members, particularly low- and middle-income countries, should view these challenges as an opportunity to have more say on matters that affect them deeply. Enhanced operational independence would go hand in hand with continued IMF accountability to its board for evaluation of its policy execution and for goal setting. The Bretton Woods institutions must be more reliable in the coming years if the big three economies continue to retreat from rules-based globalization in favor of with-us-or-against-us exclusionary economics. For all the immediate pressure on the IMF, well intentioned or otherwise, to respond to its largest shareholders on any given issue, insulation from increasing geopolitical division would be more than prudent. Greater operational independence is the prerequisite for addressing any and all of the other global economic challenges as geopolitics corrodes globalization. **F&D**

ADAM S. POSEN is president of the Peterson Institute for International Economics.