

# The IMF and global exchange rates: dissensus in Washington

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**I**n many scholarly and activist circles, the International Monetary Fund (IMF, or 'the Fund') has a reputation as a global bully. The phrase 'Washington consensus' has come to invoke a rigid orthodoxy of austerity and liberalization which the Fund, along with its cousins the World Bank and the US Treasury, imposes on developing countries. As an organization, the IMF is seemingly monolithic, drawing comparison to the Vatican even amongst its own staff.

Close observers of the global economy recognize that matters are considerably more complex, but even so there has been relatively little study of internal debates at this highly disciplined organization. For this reason, I was drawn to a curious area of *dissensus* and ambivalence on a critical issue of global financial governance. The area in question is the Fund's policy regarding exchange rate regimes in developing countries. While seemingly obscure, exchange rates are critically important to the global economy. During the 1990s, a series of developing and post-Communist countries experienced financial crises that began with a collapse of their exchange rate regime. The IMF played a central role, prescribing policy solutions that drew substantial criticism. But while the Fund had clear prescriptions on issues like trade openness, privatization, financial liberalization, and budget balance, they didn't have a policy to speak of on the exchange rate question. This is particularly perplexing because overseeing the international monetary system was precisely what the Fund was created to do.

A key question facing many developing countries is whether to 'float' their currencies (allow them to adjust to market forces) or 'fix' them to a major currency, such as the U.S. dollar. Examining recently declassified IMF documents, I found that this question had begun to cause substantial internal friction within the Fund by the early 1990s. In particular, while the United States government favored a policy of promoting currency flexibility, several European countries (most notably France) opposed this preference. In an effort to avoid antagonizing these constituencies, the Fund's staff economists formulated an ambivalent and ad hoc policy that came perilously close to 'anything goes.'

This ambivalence proved to be a liability in the latter part of the decade, as countries repeatedly fell to currency crises. In many of these cases, countries had adopted a 'peg' to the dollar (that is, the local currency remained roughly constant vis-à-vis the dollar as a matter of policy.) Many economists knew that these policies were inherently vulnerable, but the Fund did little to raise concerns. For example, less than a year before the collapse of the Mexican peso in 1994, the Fund's Executive Board voiced support for the policy (at a time when prominent international economists were already raising concerns.)



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After a wave of crises in 1997 and 1998, IMF leaders realized they had a problem. The response was, finally, something that looked like a clear policy. Fund officials now promoted something called the 'bipolar view'; according to this policy, most developing countries faced a stark choice between a fully 'floating' currency and so-called 'hard pegs.' The latter meant 'locking in' a fixed exchange rate, as Argentina did when it adopted a law that fixed its currency to the dollar, by law, at a one-to-one rate. The problem? Argentina's financial system imploded in 2001, in large part because of this peculiar system. The IMF had gone from deep skepticism towards this kind of policy, to endorsing and even advocating these 'hard pegs'. In both Russia and Brazil, Fund officials pushed national policy-makers to adopt this approach, something which (with the benefit of hindsight) would have been catastrophic.

In short, the IMF switched from an ambivalent and hands-off posture to the ill-fated 'bipolar view', which was clear but hardly sound advice. While this 'bipolar' policy had the support of senior Fund managers, it was eventually vetoed by the IMF's senior body, the Executive Board. [What is the explanation for this 'Washington dissensus'?](http://www.oxfordjournals.org/page/6725/3) (<http://www.oxfordjournals.org/page/6725/3>)

I found two interrelated explanations. The first was that the economics profession, the source of the Fund's legitimacy and expertise, was itself deeply divided. While some economists are ardent advocates of currency flexibility (such as free-market guru and Nobel Prize winner Milton Friedman), others (most notably the also Nobel Laureate Robert Mundell, sometimes referred to as 'father of the Euro') said the opposite. As a result, the Fund's staff had very little ability to present the policies they advocated as backed by credible expertise. Second, the wealthy and powerful countries that ultimately control the Fund were themselves divided. European countries which make up a substantial percentage of the Fund's Executive Board were in the midst of their own monetary experiment (the creation of the Euro), and tended to interpret the challenges facing developing countries in light of their own experience. Several countries, such as France, were strongly opposed to establishing a blanket preference in favor of currency flexibility, as the United States favored. This was a bit of international monetary rivalry that goes back decades to de Gaulle's famous complaint that the international role of the dollar was an 'exorbitant privilege.'

In short, in this critical area of governing the international monetary system, the IMF was in a stalemate: European countries could block the organization from taking the US-favored line (which was also closest to that of the Fund's staff economists), but they couldn't provide an alternative. When the Fund's leaders attempted to forge a compromise, the result was a Jerry-rigged improvisation that pleased no one. The result was ambiguity, ambivalence, and inconsistency in an organization famed for its rigor and discipline.

So what's the lesson in all this? Governing the international economy is a problem of coordinating individuals, organizations, and countries with diverse interests and ideas. Often crises result not from the actions of any particular group doing the 'wrong thing', but because everyone's actions add up to a mutually inconsistent, contradictory whole. This is an important lesson to bear in mind as policy-makers around the world attempt to prepare for the next financial crisis – which is sure to come.

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