Europeans and Americans don't run the world any more, and shouldn't automatically run the IMF

(Article by Saul Eslake, Director of the Productivity Growth Program at the Grattan Institute, published in the business pages of the Melbourne Age *newspaper, and in the online edition of the* Sydney Morning Herald*, on Tuesday 24th May 2011)*

There's a vacancy at the top of the International Monetary Fund, following the resignation of Dominique Strauss-Kahn in the wake of his being charged with sexual assault offences which are now the subject of criminal proceedings in New York.

Since the position of Managing Director of the IMF was created almost exactly 65 years ago, it has always been held by a European, as part of an 'understanding' with the United States, which has also ensured that the Deputy Managing Director of the IMF and the Managing Director of the other 'Bretton Woods twin', the World Bank, have always been American citizens. And although the first Managing Director of the IMF was a Belgian, and the next two were Swedes, for all but 12 years since 1963, the post has been held by a Frenchman.

Since Mr Strauss-Kahn's resignation last week, Europeans have been moving swiftly to ensure that this position remains their property. German Chancellor Angela Merkel has argued that 'with serious problems with the euro, and the IMF strongly involved [in efforts to resolve Europe's on-going sovereign debt crisis], there is a lot in favour of a European candidate being put forward'.

With all due respect to Madame Christine Lagarde, the French Finance Minister, who seems to be emerging as the Europeans' preferred candidate, this argument is bogus. It's not as if Europeans have been doing such a stellar job of managing their sovereign debt crisis that being a European would constitute incontrovertible evidence of the skills required to carry out that task. The mire into which Greece has sunk is partly the result of the persistent failure of European institutions to discern the true state of Greek finances, and to insist sooner that previous Greek governments put them in order. Even today, there are deep disagreements between the European Central Bank and European governments, including Germany's, as to whether Greece should be permitted to 'reschedule' or 'reprofile' (that is, to default on part of) its outstanding debts.

And given that much of the debt owed by Greece, Ireland and Portugal is owed to European (and especially to German, French and British) banks, which might in turn need to be bailed out by their respective governments in the event of a default by Greece, Ireland or Portugal, there might even be grounds for concern that a European with political aspirations beyond his or her term as Managing Director of the IMF might be tempted to offer greater financial support to a European government in difficulty than a non-European would do.

I certainly don't recall any suggestions that it would have been a Good Thing to have had an Asian heading the IMF during the Asian financial crisis of 1997-98, or that it would have been an advantage to have had a Latin American in charge of the IMF during any of the myriad financial crises that have afflicted Latin American countries during the last thirty years.

The selection criteria outlined by the IMF's Executive Board stipulate that the successful candidate will have 'a distinguished record in economic policymaking at senior levels', an 'outstanding professional background', 'demonstrated the managerial and diplomatic skills needed to lead a global institution', 'capable of providing strategic vision for the work of a high quality, diverse and dedicated staff', 'a proven understanding … of the challenges facing the Fund's diverse membership', 'a firm commitment to, and appreciation of, multilateral co-operation and … a demonstrated capacity to be objective and impartial', and 'will also be an effective communicator'.

Someone who meets all of these criteria – but not the unofficial one of being a European – is the immediate past Governor of the Reserve Bank of Australia, Ian Macfarlane. He was in that position for a decade – longer than anyone else except 'Nugget' Coombs – after a career which included six years at the OECD (a 'global institution') in Paris.

He certainly has 'a distinguished record in economic policymaking at senior levels'. During his decade at the top of the Reserve Bank, there was only one quarter in which the annual rate of 'underlying' inflation exceeded the top end of the 2-3% target agreed between the Bank and the Government at the beginning of his term. Yet this was not achieved by sacrificing economic growth: there was only one quarter of negative growth on his watch; and the unemployment rate fell from 8.4% when he took up the position of Governor to 4.7% by the time he left it. And while that record was obviously in part shaped by circumstances beyond his control or influence, his preparedness to raise interest rates when necessary (in the fact of covert political pressure to refrain from doing so), and willingness to avoid doing so at other times (such as when the A$ fell sharply during the Asian crisis and again during and after the 'tech bubble' certainly contributed to those outcomes.

More importantly, from the standpoint of fulfilling the criteria for Managing Director of the IMF, he has had 'hands on' experience of dealing with a banking crisis, having been Deputy Governor of the RBA in the early 1990s when two State-owned banks failed, and two of the four major private banks came perilously close to a similar fate. Under his leadership the Reserve Bank was one of very few in the industrialized world (and the only one among the 'advanced' members of the G20) not to have made the mistake of leaving interest rates too low for too long in the aftermath of the 2000 'tech wreck' and the terrorist attacks of September 11, 2001. And unlike most of his peers, Ian Macfarlane knew a 'bubble' when he saw one, in the Australian housing market of 2003-04; and unlike any of them, actually did something about it – by raising interest rates (at a time when most other central banks were still lowering them), and giving a series of explicit warnings about the dangers of excessively leveraged investment in residential property.

Ian Macfarlane, together with his then Deputy Stephen Grenville, was among the first to recognize that the IMF was taking the wrong approach to dealing with the Asian crisis, that raising interest rates aggressively and tightening fiscal policy sharply (the course which the IMF, under its French Managing Director Michel Camdessus, urged Thailand, Korea and Indonesia to do) would worsen the crisis rather than bring it to an end. The very different approach that the IMF under Dominique Strauss-Kahn has taken to the European sovereign debt crisis has vindicated Ian Macfarlane's judgement.

Indeed, when former US Federal Reserve Chairman Alan Greenspan was given an honorary knighthood by the Queen in September 2002, the Chicago-based economist David Hale suggested that Ian Macfarlane was a worthier candidate. Again, history would have vindicated that judgement.

For all that, I suspect that Ian Macfarlane doesn't want the job. But in these pages last week, William Pesek suggested four highly qualified candidates from Asia – Haruhiko Koroda, who has been head of the Asian Development Bank since 2004; Sri Mulyani Indrawati, the highly effective Indonesian Finance Minister from 2005 through 2010; Malaysian central bank governor Zeti Akhtar Aziz; and current deputy head of India's Planning Commission Montek Singh Ahluwalia (who has also previously worked at the IMF). Another highly credible suggestion has been Singapore's Finance Minister, Tharman Shanmugaratnam.

It's surely high time that the Europeans, and the Americans, came to terms with the fact that they don't run the world economy any more, that global institutions like the IMF and the World Bank are no longer 'their' playthings – and that appointments to their upper echelons should be made on the basis of merit, not nationality.

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