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Finance Leaders Call for IMF Role in Averting Protectionist `Currency War'

By Sandrine Rastello and Iuri Dantas - Oct 10, 2010

Global governments tasked the International Monetary Fund with calming the recent outbreak of tensions over currencies amid signs they are already triggering a protectionist backlash.

Officials including U.S. Treasury Secretary Timothy F. Geithner and Egyptian Finance Minister Youssef Boutros-Ghali said the lender should outline how countries can expand their economies without damaging those of other nations. China is accused of keeping the yuan undervalued to boost exports, while low interest rates in the U.S. and other industrial nations are blamed for propelling capital flows into emerging markets.

“The IMF has an important role to play to help ensure that progress toward rebalancing strengthens,” Geithner said in a speech at the IMF’s annual meeting yesterday in Washington. “It is ultimately the responsibility of countries to act, but the IMF must speak out effectively about challenges and marshal support for action.”

Currency intervention has returned to the fore as countries from China to Brazil and Japan try to restrain their exchange rates to secure a trading edge. That has roiled currency markets as has the prospect of easier monetary policy from the Federal Reserve. The dollar fell last week to its lowest in 15 years against the yen.

The ‘Right Place’

IMF Managing Director Dominique Strauss-Kahn accepted the role of currency cop and said the fund would publish reports highlighting linkages between economies as part of a “systemic stability initiative.” The IMF’s steering committee also said it should “deepen its work” on capital flows, exchange rate movements and the accumulation of reserves.

“The need to have this kind of spillover report has been discussed for months and now it’s part of our toolbox,” Strauss-Kahn said.

It may already be too late to stop a shift toward protectionism. Ukraine’s Deputy Premier Serhiy Tigipko said in a Washington interview that his country may become the latest emerging market to consider capital controls to prevent short- term investments from fueling volatility in its currency, the hryvnia. India may also intervene “to prevent volatility and prevent the disruption of the macroeconomic situation,” Reserve Bank of India Governor Duvvuri Subbarao told reporters in Washington.

The IMF studies will focus on the U.S., China, the U.K., Japan and the euro area. They will show, for instance, how U.S. monetary policy affects capital flows to other countries.

Canadian Finance Minister Jim Flaherty said there is broad support for Strauss-Kahn’s enhanced role and warned the restraining of some currencies risks fanning protectionism. China, the world’s fastest growing major economy, has limited gains in the yuan to about 2 percent against the dollar since June.

‘Role to Play’

“There’s general agreement that the IMF has an important role to play,” Flaherty told reporters. “There have been discussions here with respect to developing rules of the road or guidelines with respect to how countries deal with their currencies.”

The IMF nevertheless has a weak record in recent years on pushing governments to change their policies toward trade and exchange rates. A 2006 effort to oversee the rebalancing of the world economy petered out and China has repeatedly rejected the fund’s analysis.

“For lack of a better alternative, the IMF has to play an active role in trying to mitigate currency competition,” said Eswar Prasad, a senior fellow at the Brookings Institution and a former IMF official. “But the IMF power is really limited to persuasion because it has few good instruments to promote cooperation among member countries who are unwilling to modify their policies.”

Currencies Vulnerable

A U.K. official questioned the new approach, telling reporters it sounded like the IMF would now just carry out its regular reviews of economies at the same time. By contrast, Boutros-Ghali said “the IMF is the place to deal with these issues.”

Developing economies that compose the Group of 24 this week said low interest rates in the advanced world have left them vulnerable to exchange rate appreciation and overheating. Brazil has already stepped up intervention in the currency market in a bid to prevent its currency, the real, from rallying. Polish central bank governor Marek Belka said capital inflows have the potential to “derail monetary policy.”

Chinese officials said they will stick to a gradual rise in the yuan’s value to avoid social turmoil.

“We are committed to a more flexible exchange regime,” People’s Bank of China Deputy Governor Yi Gang told reporters in Washington yesterday. “A more flexible, market-based, managed floating regime is better for China and is better for the rest of the world. But the approach is probably a gradual one.”

“It’s very unlikely that China will come on board because they already feel they’re unfairly singled out,” said Prasad, who used to head of the China division at the IMF.

The currency spat came as talks aimed at increasing the power of emerging markets within the IMF stalled. The U.S. rejected a proposal by European governments to reduce the number of seats they hold on the 24-strong board as insufficient, according to two European officials, who spoke on condition of anonymity.

China would become the IMF’s third-largest member after a planned increase in voting rights. Strauss-Kahn said with greater influence comes more responsibility.

“You cannot be in the center and be a free rider,” he said. “The more you are at the center, the more you need to take your part in stabilizing the whole system.”

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