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Introduction and Summary

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The world needs a strong and effective International Monetary Fund (IMF) as the principal multilateral institution responsible for international economic and financial stability. A consensus on the role of the Fund and the scope of its activities in the 21st century is needed to achieve this objective. However, such a consensus does not exist today in official circles or among private observers. In the view of many observers, the Fund has failed to exercise effectively its intended role as steward of the international monetary system. Consequently the IMF, once the preeminent institution of multilateral international financial cooperation, faces an identity crisis.

No single change by itself can restore the IMF to its prior position as a highly respected international monetary institution. Effective reform of the IMF must encompass many aspects of the IMF's activities—where it should become less as well as more involved. During the past decade, a large number of changes in the international financial architecture and in the IMF's operations have been put in place. Those reforms have not been sufficient to restore the IMF's luster at the center of today's international monetary and international financial system.

Successful reform of the IMF must engage the full spectrum of its members. The IMF should not focus primarily on its low-income members and the challenges of global poverty. It should not focus exclusively on international financial crises affecting a small group of vulnerable emerging-market economies. Instead, it must be engaged with each of its members on the full range of their economic and financial policies. However, the Fund should give priority attention to the policies of the 20 to 30 system-

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Box 1.1 Managing Director's Report on the Fund's Medium-Term Strategy

On September 15, 2005, the IMF released Managing Director Rodrigo de Rato's Report on the Fund's Medium-Term Strategy (IMF 2005b). The report draws on preliminary discussions held at the time of the meeting of the International Monetary and Financial Committee (IMFC) in April 2005, the work of an internal committee, as well as inputs from the IMF's Executive Board. Its self-description is a strategy paper, not a five-year plan and not a reform agenda although that term has been used to describe the document. The report views IMF reform as requiring an evolution, not a revolution, at the Fund.

The report proposes globalization as its organizing principle: "Viewing the challenges through the lens of globalization holds the potential to prioritize the elements of the Fund's well defined mandate in the macroeconomic area and to address the criticisms of limited effectiveness, focus, and preparedness to face the future." It argues that 21st century globalization involving large cross-border capital movements and abrupt shifts in comparative advantage have exposed gaps in the work of the Fund with respect to surveillance, lending facilities, and governance.

The report lays out five key tasks responding to these new global conditions:

- make surveillance more effective,
- adapt to new challenges and needs in different member countries,
- help build institutions and capacity,

(box continues next page)

ically important countries that impact the functioning of the global economy, including the policies of its wealthiest members that remain the principal drivers of the world economy and, therefore, are the source of the greatest risk to global economic and financial stability.[1]

Managing Director Rodrigo de Rato in his remarks (chapter 3) to participants in the Institute for International Economics conference on IMF reform states that the IMF is the "central institution of global monetary cooperation." He suggests that the Fund can rest on its 60-year history of accomplishments, but he also acknowledges the need for changes. In fact, a few days earlier the IMF released a report by de Rato on the Fund's medium-term strategy (IMF 2005b and box 1.1). In the report, he argues

1. The systemically important countries include primarily the Group of Twenty (G-20) countries: the United States, the European Union as a group, Japan, Canada, and possibly one or two other industrial countries, but also Argentina, Brazil, China, Egypt, India, Indonesia, Korea, Mexico, Nigeria, Russia, Saudi Arabia, South Africa, Turkey, and possibly a few other large emerging-market countries. See also footnote 2.

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Box 1.1 *(continued)*

- prioritize and reorganize IMF work within a prudent medium-term budget, and
- address the governance issue of fair quotas and voice (representation) in the Fund.

Against this background, the report discusses nine issues and proposes 31 actions or "deliverables" as next steps in the strategic review of the Fund by IMF management, the Executive Board, and member countries. Most proposed actions are process oriented, a few involve reoriented research efforts, and a larger number concern internal organization and management.

The report highlights four new proposals: intensified analysis of globalization, including a possible new report on the macroeconomics of globalization; a redesigned "contextually savvy" program of communication; a work program on issues surrounding capital account liberalization; and the assessment of the achievability of the Millennium Development Goals with available financing.

In keeping with the theme of a strategic review, the managing director's report suggests that these initiatives might be financed by scaling back the Fund's activities in five areas: a sharper delineation of the Fund's role in low-income countries; less time spent, in particular by the management and Executive Board, on procedures and documentation; less work on standards and codes; less research in other (unspecified) areas; and less spending on overhead and support activities, including the possibility of more offshoring of information technology services.

that the Fund is being pulled in too many directions and is accumulating new mandates: "The question [is] whether the Fund is fully prepared to meet the great macroeconomic challenges that lie ahead." On the other hand, he argues that the IMF's principal power in meeting the challenges of the 21st century is the soft power of persuasion. He implicitly dismisses proposals that the Fund should use or develop other instruments to carry out its mission, and one detects little sense of urgency in his remarks.

US Treasury Under Secretary for International Affairs Timothy Adams's remarks (chapter 4) convey a greater sense of potential institutional crisis than those of the IMF managing director. Adams declares he is a "believer in the IMF . . . as a facilitator of international monetary cooperation" but notes "the IMF now faces fresh, tough questions about its relevance" to the industrialized countries and to emerging-market economies. The risk is that the IMF is becoming a development institution focused primarily on its low-income members. To strengthen the Fund's relevance, Adams argues that it should concentrate on its core mission, "international financial stability and balance of payments adjustment." The IMF needs to be

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"far more ambitious in its surveillance of exchange rates" and by implication other macroeconomic policies. Noting that exchange rate surveillance is politically difficult, he states, "Nevertheless, the perception that the IMF is asleep at the wheel on its most fundamental responsibility—exchange rate surveillance—is very unhealthy for the institution and for the international monetary system." Adams concludes that the medium-term strategy paper of the managing director represents activity but adds that what the Fund needs is achievement and, "To achieve, the IMF needs to refocus and deliver."

Four international experts on the wrap-up panel at the conference expressed even greater urgency to address IMF reform. Barry Eichengreen (chapter 25) describes the Fund as "a rudderless ship adrift on a sea of liquidity. On none of the key issues does the institution or its principal shareholders have a clear, or a clearly articulated, position." Mohamed El-Erian (chapter 26) chooses different words but comes out in the same place: The IMF is losing relevance, there is no simple solution, and what it needs is a critical mass of reforms. Tommaso Padoa-Schioppa (chapter 27) argues that the Fund has drifted from its core mission of ensuring stability and has lost leverage because for many countries international liquidity is no longer scarce. Finally, Yu Yongding (chapter 28), while more reserved than the others, nevertheless agrees with C. Fred Bergsten (chapter 13) that the Fund has become weak and ineffective.

On the content of IMF reform, the managing director's strategy document (IMF 2005b) is frequently eloquent in its diagnosis of the issues. In arguing for more effective surveillance, the managing director calls for improvements in focus and context, "less cover-the-waterfront reporting on economies, more incisive analysis of specific weaknesses and distortions that risk crises and contagion or hinder adjustment to globalization, and more active Fund engagement in policy debates that shape public opinion and policy choices," including a revitalization of the IMF's International Monetary and Financial Committee (IMFC), which meets twice a year at the ministerial level and provides nonbinding guidance on IMF policies and activities.

On capital account liberalization, the managing director's report perceptively observes, "Financial globalization has both caused and been caused by the liberalization of the capital account." With respect to the Fund's role in addressing the many problems and challenges faced by low-income countries, he acknowledges "a consensus that the Fund should remain engaged in these areas" but asks "how best to do so, and to what degree?" Finally, with respect to governance and IMF quotas and voice in the institution, he notes that "[t]he current allocation puts this legitimacy [of the Fund as a universal institution] at risk in many regions. . . . In the view of too many, governance and ownership imbalances in the Fund now rival global current account imbalances. Neither imbalance is sustainable." However, on none of these issues does Managing Director de Rato put forward, or

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promise to put forward, concrete proposals. This lack of leadership is most notable in the area of IMF governance, where there is widespread agreement that actions are needed but no consensus about their content.

The communiqués of the IMFC, the Group of Seven (G-7), the Group of Ten (G-10), and the Group of Twenty-Four (G-24) issued at the time of the September 2005 IMF–World Bank annual meetings, as well as the communiqué of the Group of Twenty (G-20) issued in mid-October, all welcome the managing director's report and look forward to specific proposals.[2]

Of the individual pronouncements in September 2005 by IMF governors and members of the IMFC, almost all emphasize the salience of the governance issues without suggesting any degree of consensus on appropriate solutions. There is a similar lack of consensus on IMF policies with respect to emerging-market economies. In addition, the managing director's report calls for a sharper delineation of the IMF's involvement with the Fund's low-income members, implying a substantial reorientation and scaling back of the financial and organizational resources devoted to the Fund's activities in this area, but the statements by finance ministers and central bank governors suggest less than full comprehension of his objective. In support of a more expansive vision of the IMF's role in low-income countries is the report's advocacy of intensified IMF involvement in the building of institutions and capacity in low-income countries. Such an increased emphasis would be likely to move the Fund into activities beyond its traditional core competencies on fiscal, monetary, exchange rate, and financial-sector policies; and IMF members may also underappreciate the implications of this suggestion.

The managing director's strategy document barely mentions exchange rates and omits entirely any discussion of the IMF's responsibilities in this area; officials noted this omission in a number of statements at the time of the IMF–World Bank annual meetings. With respect to reports on "surveillance-only cases" of advanced and/or systemically important countries, the strategy document advocates discussing reasons why the Fund's advice is not accepted and what adaptations might deal with such concerns. A number of official commentators note that this approach might usefully be applied to all members. A few also note the omission of a broad treatment in the report of the IMF's lending activities aside from the mention of a few proposals that are under discussion and the contro-

2. The G-7 comprises Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. The G-10 grouping comprises the G-7 countries and also Belgium, the Netherlands, Sweden, and Switzerland. The G-24—formally the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development—comprises representatives of 24 Asian, African, Latin American, and Middle Eastern countries plus observers. The industrial-country members of the G-20 are the G-7 countries, Australia, and the country holding the EU presidency when not a European G-7 country; the nonindustrial-country members are Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, and Turkey.

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versial issue of the IMF's role in crisis resolution. Finally, although most of the statements by officials to date welcome and praise the managing director's report, a few comment that it lacks ambition or fails to recognize what one finance minister identifies as a need for organizational and cultural change in the institution.

Michel Camdessus (2005) evoked several noteworthy contrasts when he delivered the Per Jacobsson Foundation lecture two days after the Institute conference on IMF reform. Perhaps because he was liberated from the constraints of his former position as managing director, Camdessus presented a more comprehensive and provocative reform agenda covering the IMF's mission, its human and financial resources, and its governance; see box 1.2. He went beyond de Rato's strategy paper in arguing that the Fund should propose a bold initiative in the area of global imbalances such as organizing a new Plaza or Louvre agreement although, of course, the IMF was on the sidelines at those events. He says the IMF is and should be equipped to be an international lender of last resort and should expand its provision of financing to low-income members. Camdessus also advocated the introduction of population into the formula used to guide negotiations on the distribution of IMF quotas, and he called for a consolidated European chair in a smaller Executive Board. In an area not addressed by de Rato at all, Camdessus argued that the Fund should have significant periodic increases in its quota resources and should positively consider the resumption of allocations of special drawing rights (SDR).

The balance of this chapter provides a summary of the papers and discussion at the Institute conference on IMF reform. Papers covered four areas: (1) the IMF and the international monetary system (chapters 5 through 8), (2) governance of the IMF (chapters 9 through 13), (3) the Fund's lending facilities, including engagement with its low-income members (chapters 14 through 21), and (4) IMF financial resources (chapters 22 through 24). Chapter 2 provides my overview of IMF reform issues that was prepared as background for the IIE conference. Chapters 3 and 4 are the remarks delivered at the conference by IMF Managing Director de Rato and by US Under Secretary of the Treasury Timothy Adams, respectively. Chapters 25 through 28 are overall assessments presented at the close of the conference by Barry Eichengreen, Mohamed El-Erian, Tommaso Padoa-Schioppa, and Yu Yongding. Chapter 29 outlines my proposed package of IMF reforms.

The IMF and the International Monetary System

If the IMF is to restore its position as the principal multilateral institution responsible for international economic and financial stability, the Fund must play a central role in responding to changes in policies, or the absence of policy changes, affecting the system as a whole. The Fund should provide more of the grist for, if not manage the process of, international

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Box 1.2 Michel Camdessus's reform agenda

Michel Camdessus (2005) gave the Per Jacobsson Lecture on September 25, 2005. He identified two key challenges for the IMF, on which he focused most of his attention, and for the other international financial institutions (IFIs) over the next 15 years: helping emerging-market countries advance more rapidly and helping the poorest countries reduce poverty. To meet these challenges, he laid out a three-part reform agenda for the IFIs: mission, human and financial resources, and governance. In the course of his remarks he put forward 20 separate proposals for IMF reform.

Under the heading of the IMF's mission, Camdessus called for strengthening surveillance and proposed reinforcing the IMF's message, in particular for the major countries, by submitting the preliminary conclusions of staff missions to a broader public debate within countries before the Executive Board reviews them. He argued for paying more attention to structural rigidities (including those in labor markets), demographic developments, and large accumulations of international reserves. He advocated a "bold initiative" by the IMF to deal with payments imbalances by structuring a cooperative effort along the lines of the Plaza (1985) and Louvre (1987) agreements, but this time with the IMF—not the G-7 or the G-20—at the center of the process.

With respect to mission, Camdessus also proposed revisiting the issue of orderly capital account liberalization to learn the lessons of previous experience. Acknowledging that this process would take time, he argued that, in order to promote the process of capital account liberalization, the IMF should have the same kind of jurisdiction over the capital account transactions that it has over current account transactions. He belittled the Asian countries' experience with capital controls during the Asian financial crisis and warned against using controls to buy time as a substitute for the right policies. He argued that controls promote distortions and corruption and tend to favor the rich over the poor.

In the area of debt workouts, Camdessus proposed renewing the debate about a sovereign debt restructuring mechanism or its equivalent, with the essential feature that the IMF should be in the center of its design and operation. He argued that the globalized financial system needs a lender of last resort and said the IMF is equipped to play this role. He proposed confirming the Fund in this role. He also advocated equipping the IMF with the authority to create special drawing rights (SDR) on a contingency basis to deal with global liquidity squeezes; countries not caught up in the squeeze would advance their allocations of SDR to the Fund for its use in conditional lending programs.

Finally, under the heading of mission, he proposed fighting corruption by introducing ethical requirements into the education of future business and official

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Box 1.2 Michel Camdessus's reform agenda *(continued)*

leaders. He also argued it is essential for the IMF to support its poorest members by increasing their access to concessional financing from the IMF, improving the provision of financing to countries in postconflict situations or after economic shocks, and focusing the attention of the IMF and other IFIs on the scale of the annual transfer of real resources to the poorest countries.[1]

Under the heading of human and financial resources, Camdessus proposed expanding staff resources to equip the Fund properly to carry out new responsibilities for global financial stability and the oversight of financial markets and to reduce the "cloning syndrome" in IMF recruiting efforts by seeking staff with broader skills (outside of economics) and experience (inside of national governments). He strongly rejected the view that IMF quota resources are taxpayers' money and proposed significant periodic increases in quotas and a less doctrinaire attitude against allocations of SDR.

Under the heading of governance, Camdessus argued that "the legitimacy of the Bretton Woods Institutions is increasingly questioned" and advocated the creation of the decision-making council provided for in the IMF Articles of Agreement to give political guidance to the Fund alongside the technical guidance provided by the Executive Board. He would replace not only the consultative International Monetary and Financial Committee but also the "G-10, G-20, and other Gs," thus implying the G-7. With respect to voting shares and the Executive Board itself, he proposed introducing population into the quota formula, a single European chair with multiple alternates in the Executive Board, and a parallel consolidation of other chairs to produce a smaller and higher-caliber board. He noted that these steps would take time and argued that the Europeans should take the lead to put them in motion. With respect to the choice of management, he supported renouncing the special US and European roles in the selection processes for the heads of the Fund and the World Bank: The processes should be open and competitive.

Finally, he proposed that the annual G-8 leaders' meetings should be coupled each year with an extended meeting with leaders of the countries on the new council and presumably in the meantime with the leaders of the countries that are members of the IMFC, which would create a global governance group with more legitimacy than today's G-8 or G-20. He added one proviso: The meetings should be prepared by the IFIs and also should be attended by the UN secretary-general and the heads of other relevant multilateral organizations.

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1. The transfer of real resources to a country is conventionally defined as net long-term capital inflows plus net foreign direct and portfolio equity investment inflows plus grants minus associated net interest or income payments deflated by a relevant price index such as the country's export price index.

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economic policy coordination. Many observers feel that in recent years the Fund has hung back and failed to assert leadership in the international monetary system of the 21st century in the face of increasing imbalances and the prospect that benign economic and financial conditions will inevitably deteriorate.

The Papers

Four experts prepared papers on the subject of the IMF and the international monetary system for the conference: Morris Goldstein on Currency Manipulation and Enforcing the Rules of the International Monetary System (chapter 5), John Williamson on Revamping the International Monetary System (chapter 6), C. Randall Henning on Regional Arrangements and the International Monetary Fund (chapter 7), and Rawi Abdelal on the IMF and the Capital Account (chapter 8).

Goldstein. The Goldstein paper addresses a central, but often neglected, issue of the IMF's role in surveillance, in particular over members' exchange rate policies. Goldstein notes that the Bretton Woods conference elaborated a post–World War II international monetary system based on fixed exchange rates that sought to avoid the beggar-thy-neighbor policies that had undermined the interwar global economy. With the move to generalized floating exchange rates in the mid-1970s, the Fund's responsibility was transformed. The IMF was obligated under the new Article IV of its revised charter to exercise firm surveillance over members' exchange rate policies, in particular each member's obligation to avoid manipulating exchange rates to secure unfair competitive advantage or to prevent effective balance of payments adjustment.

Goldstein argues the Fund has fallen down on its job assignment as umpire for the exchange rate system. He makes the presumptive case that a number of Asian countries, China in particular, have been manipulating their exchange rates to prevent global balance of payments adjustment. He lays out his case by debunking several fallacies about exchange rate manipulation: If a country's rate is fixed against another country's currency, the country cannot be manipulating that rate; passive intervention in defense of a fixed rate is not manipulation even if it is heavy; a country may be justified in maintaining an undervalued rate for domestic economic reasons; and it is the real exchange rate that matters and in due course inflation will take care of any nominal undervaluation.

To restore the IMF to its proper role in this area, Goldstein advances three proposals: (1) The Fund should begin issuing its own semiannual report on exchange rate policies, including the identification of cases of potential currency manipulation practices; (2) The Fund should make more frequent use of its powers to conduct special or ad hoc consultations on

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members' exchange rate policies; (3) The Fund should review promptly its guidelines for surveillance over members' exchange rate policies to see whether clarifications and improvements can be made, although Goldstein himself thinks the guidelines are reasonable.

Williamson. The Williamson paper picks up where the Goldstein paper leaves off. The central purpose of the Fund is to promote the achievement of maximum growth consistent with minimizing imbalances that threaten to provoke economic or financial crises. The institution should use its surveillance powers to achieve this objective. The problem, in Williamson's view, is that the IMF lacks a framework within which to do so. Williamson proposes, as he and others have before, the use of reference exchange rates as an appropriate framework. The framework would be based upon an assessment of what real effective exchange rates would be consistent with maximum noninflationary domestic growth and equilibrium in the external accounts of each member of the IMF.

Williamson provides a useful summary of various approaches to estimating reference exchange rates. He also outlines a process whereby the IMF staff would produce quarterly or semiannual estimates of reference rates that would be reviewed by the IMF Executive Board, with possible revision in light of that review. Once established, the reference rates would become the basis for IMF surveillance over policies affecting those rates, including intervention policies, until the rates were revised. He concludes that this framework for surveillance, especially if it were embraced by the major members but even it were not, could strengthen the Fund in promoting international economic policy cooperation and as the umpire for the international monetary system.

In a final section, Williamson identifies another potential role for the IMF in improving the functioning of the international monetary system. He advocates that the IMF actively encourage the adoption of growth-linked bonds by a critical mass of its emerging-market members. The motivation behind his proposal is similar to that of Kristin Forbes when she proposes a shock-smoothing facility under the heading of IMF lending facilities (chapter 18).

Henning. The Henning paper addresses an emerging challenge facing the IMF: the Fund's relations with regional monetary arrangements. Henning points out that this topic is not new; the Fund had to deal with the G-10 network of swap arrangements in the 1960s and 1970s and more recently with the emergence of the European Monetary Union (EMU).[3] How-

3. EMU stands for both Economic and Monetary Union and European Monetary Union. While the former is a formal term (per the Maastricht Treaty of 1991), the latter is descriptive of the process of harmonizing the economic and monetary policies of the EU member states with respect to a single currency, the euro.

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ever, the Chiang Mai Initiative (CMI) for monetary cooperation in East Asia gives this topic a new urgency coming on top of Japan's failed proposal in 1997 to create an Asian monetary fund (AMF) and, more important, the widespread discontent in Asia with the IMF's management of its financial crises and many Asian countries' subsequent self-insurance through the buildup of large foreign exchange reserves. Henning also notes that Venezuelan President Hugo Chavez has proposed a Latin American monetary fund.

Henning proposes that the Fund extend IMF membership to regional monetary arrangements such as the EMU and at least upgrade its regional surveillance in recognition of increased regional economic and financial integration, downgrading its surveillance of the policies of individual members of monetary unions. More provocatively, he recommends that the IMF adopt a set of criteria differentiating acceptable from unacceptable regional financial arrangements. These could be adopted in a soft form as a code of conduct or in a hard form as an amendment to the IMF Articles of Agreement. On the basis of his suggested principles aimed at minimizing conflicts with countries' existing IMF obligations, ensuring sound adjustment and financial policies, and promoting transparency, Henning opines that the CMI in its current form would largely pass his tests as long as the transparency of the implementing bilateral arrangements were increased. In contrast, the AMF would not have passed.

Abdelal. The Abdelal paper deals with the IMF and capital account liberalization. This topic has been contentious in the past, remains controversial today, and lies at the core of the challenges of financial globalization in the 21st century. Abdelal provides a short, comprehensive review of the IMF's approach to capital account liberalization culminating in the management's deserved failure, in his view, to convince IMF members in the late 1990s to amend the IMF Articles to make capital account liberalization an objective of the Fund and to provide the institution with more comprehensive jurisdiction over members' capital account regimes. He notes that the IMF carries a heavy burden with many of its members because of members' perception of the IMF's proliberalization posture in the past. He argues the Fund in its own interest should continue its current cautious posture. In his view, the status quo in this area is absolutely correct.

Turning to the future, Abdelal recommends that any proposal to amend the Articles be shelved until there is a fuller professional consensus about all aspects of capital account liberalization as well as a policy consensus. In the meantime, Fund management and staff should remain neutral in their advice to members and take care not to be seen as stealth advocates of premature capital account liberalization. At the same time, the Fund's staff should become known as the world's experts in all aspects of this issue and pay increased attention to the supply-side aspects of international capital flows.

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Discussion and Commentary

The IMF is behind the curve on the central issue of the day: the role of the IMF in promoting exchange rate and other global macroeconomic adjustments. Managing Director de Rato (chapter 3 and IMF 2005b) advocates friendly persuasion and an enhanced communications strategy as remedies. This is a prescription for continued irrelevance. Most agree with former managing director Camdessus (2005) that a "bold initiative" is needed that would address the level of certain countries' exchange rates as well as longer-term issues of the flexibility of their exchange rate regimes; Camdessus cited the Plaza and Louvre agreements of 1985 and 1987 as examples although the IMF played a spectator role in them.

Adams (chapter 4) calls for more IMF ambition in this area. He decries the perception that the IMF had been "asleep at the wheel on its most fundamental responsibility" of exchange rate surveillance. US Treasury Secretary John Snow (2005) includes "related macroeconomic policies as well" in his advocacy of strengthening IMF surveillance.

Eichengreen (chapter 25) acknowledges that the IMF has few instruments in the area of surveillance other than the bully pulpit, but Fund management must invest its political capital and be forceful and direct in its communications. El-Erian (chapter 26) characterizes the current global macroeconomic situation as a "stable disequilibrium." Padoa-Schioppa (chapter 27) argues that the IMF's central issue is stability and notes that the IMF has been absent from the scene when it comes to exchange rate aspects of this topic. Many official statements at the IMFC meeting and the annual meetings about de Rato's medium-term strategy commented on the absence of any mention of exchange rates or exchange rate regimes!

Most agree that this is not an area where it is easy for the IMF to operate. It was noted that the current "rules" of the IMF give the overwhelming benefit of the doubt to the member that it is not manipulating its currency with the intent to prevent global adjustment. However, that reality does not mean that the IMF should not raise questions and use its existing procedures to pursue answers.

There is also room to be skeptical about whether reference rates as proposed by Williamson are a way forward toward a standard for "naming and shaming" countries and their policies. They, in fact, may be "archaic" as one commentator suggested. Nevertheless, a high-profile effort in this important area to articulate a set of such rates would be a bold initiative by the Fund management and staff.

On a more cautious note, Yu (chapter 28), while advocating depegging the renminbi and arguing that the Chinese economy is distorted with its twin current account and capital account surpluses, challenges the proposition that doing so is the key to the global adjustment process, which he sees as closing the US saving-investment gap. He also asks why China should lead the way in Asia when China has trade and current account deficits with its Asian neighbors. Why should China give them the gift of increased compet-

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itiveness? This comment points to a deep flaw in the US, G-7, and IMF strategy in focusing too much attention on China and its exchange rate regime and not sufficient attention on its neighbors Malaysia, Hong Kong, Singapore, Korea, and India. Finally, Yu challenges Goldstein's technical reading of the situation today. He questions whether the IMF has rules on exchange rates, whether the guidance in the IMF's principles for surveillance over exchange rates is operationally clear, and whether a country with a "fixed" exchange rate can be a "manipulator" since the choice of a fixed rate itself is unconnected with the intellectual notion of an equilibrium. Finally, he notes that external pressure on China is counterproductive, reinforcing the case for a multilateral approach to Asian exchange rates more generally.

On regional arrangements, El-Erian (chapter 26) agrees that this is an issue for the Fund, and Yu (chapter 28) echoes Henning in warning that the CMI and AMF are threats to the IMF. He asserts that a tripartite world economic structure is inevitable. One should conclude that Henning is onto something important.

On the issue of capital account liberalization, the emerging consensus is encouraging. Padoa-Schioppa (chapter 27) asserts that jurisdiction over these issues belongs in the World Trade Organization (WTO), not the IMF; but that does not appear to be the issue for today or tomorrow. De Rato (chapter 3) argues that the IMF must have a view in this challenging area for macroeconomic policy as well as financial-sector policy and should deepen its knowledge of the issues surrounding capital account liberalization. Adams (chapter 4) is silent on the issue, suggesting that the United States agrees with de Rato's agenda for the IMF in this area.[4] Camdessus (2005) favored orderly capital account liberalization and, not surprisingly, revisiting the possibility of an amendment to the IMF Articles in this area. El-Erian (chapter 26) argues that financial-sector issues and by implication capital account policies are central to the IMF's responsibilities in the 21st century. The Fund must become a center of excellence in this area as it already is on the real side of the global economy.

Governance of the IMF

The IMF is an institution of global governance. As a consequence the quality and legitimacy of its own governance is central to its success in carrying out its mission to promote maximum global growth and international

4. Adams's remarks (chapter 4) on the US agenda for IMF reform comprise five areas: quotas and representation, exchange rate surveillance, public debt sustainability, crisis resolution, and low-income countries. Snow (2005) adds "the interplay of financial flows, macroeconomic policies, and financial sector health," consistent with de Rato's emphasis, and Snow endorses "enhanced monitoring of financial stability," including through the assessment of compliance with standards and codes with special emphasis on anti–money laundering and countering terrorist financing. Snow's position on standards and codes appears to be at odds with de Rato's view that the IMF's efforts in this area should be scaled back.

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financial stability. During the past decade, an increasing number of questions have been raised about IMF governance. The prevailing view is that, unless these issues are promptly addressed, the Fund's effectiveness will be permanently undermined.

The Papers

Five experts prepared papers on various aspects of IMF governance: My paper on Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform (chapter 9), Lorenzo Bini Smaghi on IMF Governance and the Political Economy of a Consolidated European Seat (chapter 10), Miles Kahler on Internal Governance and IMF Performance (chapter 11), Governor of the Central Bank of Argentina Martín Redrado on a Latin American View of IMF Governance (chapter 12), and C. Fred Bergsten on a New Steering Committee for the World Economy? (chapter 13).

Truman. My paper lays out approaches to addressing the interrelated issues of representation on the IMF Executive Board (chairs) and voting power in the IMF (shares). With respect to chairs, I outline a sequence of steps for consolidating EU representation, starting with consolidating EU representation into 7 seats exclusively containing EU or potential EU members compared with the existing 10 seats and culminating in a single EU seat.

With respect to shares, I propose a revised, simplified quota formula composed of GDP on a purchasing power parity basis and the variability of current payments and capital flows as a basis for quota negotiations, which I emphasize are necessarily political. I argue that the US position favoring a reallocation of existing quotas from Europe to a group of emerging-market economies primarily in Asia is unrealistic because no country has ever agreed to a voluntary reduction in the absolute size of its quota. To do so, a sovereign country, in effect, must accept that its absolute importance in the world has declined.

Consequently, I propose a one-step or two-step process of increasing the overall size of the Fund (total IMF quotas) in which the ultimate objective is to provide parity in the voting shares of the EU and the United States at hypothetical quota shares of 18 percent. I argue that such a reallocation of voting power by 13 percentage points relative to the current distribution should not weaken the financial strength of the IMF and would greatly enhance the Fund's legitimacy. Finally, I advocate the use of the G-20 as a forum to negotiate the basic political deal.

Bini Smaghi. The Bini Smaghi paper applies statistical coalition analysis to the issue of the EU voting share in the Fund and the associated issue of a single EU chair. This analysis distinguishes between voting share and

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voting power, which is the ability to influence other members to form coalitions and may be larger or smaller than a member's voting share.[5] According to this approach, today the US voting power in the IMF on issues requiring a simple weighted majority is 21.48 percent compared with its voting share of 17.08 percent; the voting power of all other members (constituencies) is less than their voting shares. If the 25 members of the European Union were to vote as a bloc, their voting share of 31.89 percent would increase to a voting power of 47.98 percent. This fact explains in part why the European Union is considered by non-EU members of the Fund as being overrepresented in the institution.

On the basis of these calculations, Bini Smaghi examines the impact of a reduction of the EU voting share to 22 percent (implying a voting power of 21.41 percent) while the US voting share is increased to 19.56 percent (implying a voting power of 16.36 percent and requiring an increase in the US quota or overall quotas). The resulting 7.47 percent of votes is redistributed proportionately to other members, and their voting power would be higher than their voting shares. He concludes that if this EU consolidation were accompanied by unified representation—that is, a single EU seat—the European influence in the IMF would be maintained or even increased.

Kahler. The Kahler paper examines a number of IMF structural and procedural issues through the lens of corporate governance. Kahler concludes that the IMF most closely resembles the model of blockholder power in which the views of a few large shareholders dominate the institution. To address this problem of legitimacy and influence he proposes a number of changes beyond an endorsement of a realignment of chairs and shares.

With respect to the Executive Board, Kahler favors steps to create a smaller board of more senior national representatives. He recommends as well clearer guidelines to ensure that the Executive Board remains the central locus of decision making at the IMF. He urges clearer indicators for IMF performance to enhance accountability. He would split the surveillance and lending functions of the IMF.[6] He favors an open and transparent process of choosing the managing director and dropping the convention that the person should be a European and the principal deputy should be a US citizen. He advocates a staff with a broader skill set, including more expertise in political economy and country experience. Finally, he makes a number of suggestions about increased transparency: requiring that all Article IV documents be published, authorizing the Independent Evaluation Office to assess the performance of the governments of the major shareholders in addition to the IMF itself, and advocating greater IMF interaction with legislatures and nongovernmental organizations.

5. A similar analysis can be found in Leech and Leech (2005).

6. This proposal was first advanced and continues to be supported by the UK government.

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Redrado. The Redrado paper considers, from the viewpoint of an emerging-market economy, the role of the IMF today and necessary reforms of the IMF that would make its work more relevant to emerging-market countries. Redrado argues that today a country cannot rely on the IMF for the international liquidity necessary to run countercyclical macroeconomic policies and must accumulate its own international reserves or build up its own stabilization fund. The IMF's role should be limited to (1) the promotion of financial stability through addressing collective action problems at times of crisis, possibly including revisiting the proposal for a sovereign debt restructuring mechanism first put forward in 2001, and (2) the provision and full disclosure of timely information about economies, but without including the staff's opinions on a member's policies.

If the IMF were reformed, first in its outdated representation and voting structures, Redrado could envision a more active IMF providing immediate access to financial resources under "clear and nondiscretionary rules . . . based on explicit macroeconomic indicators that reflect the medium-term dynamics of the economy." He also favors splitting the reformed IMF into two parts: (1) a global coordinator on the basis of rules governing monetary and financial issues on the WTO model and (2) a revamped IMF focused on financing, the adjustment process, and preventing and managing crises but also operating under nondiscretionary rules.

Bergsten. The Bergsten paper examines the pros and cons of various arrangements to help guide the world economy as well as the Fund. Bergsten argues that the IMF and its internal bodies including the IMFC to date have proved ineffective in managing today's big challenges of international economic policy—global imbalances, exchange rates, energy, and debt issues. He notes that the IMF has always been directed by an outside group, most recently the G-7 finance ministers and central bank governors. However, the G-7 itself lacks credibility, legitimacy, and effectiveness because of its failure to police members' own policies and because of changing global needs and the changing importance of countries.

Thus, Bergsten answers his own question: The world economy needs a new steering committee. As candidates, first he rejects a Group of Four (G-4) of the United States, the European Union, Japan, and China as being too restricted for the broad set of policy issues a steering committee should cover. He rejects expanding the G-7 or G-8 by four or five other countries—Brazil, China, India, and South Africa as well as Russia—because that would still leave the G-7 in control and without legitimacy.

He advocates using the existing G-20 as the appropriate steering committee for the world economy because of its broad and balanced representation of, for example, different parts of the world, countries at various stages of development, and energy producers and consumers. However, he would consolidate European representation and transform the group into an F-16 at the finance minister level. Perhaps it would be comple-

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mented by an L-16 at the leader level at a later date, after the issue of China's political orientation is resolved. (He notes that, in any case, at the leader level there recently has been a regrettable lack of attention to economic and financial issues.) The F-16 solution, in Bergsten's view, would produce a more effective steering committee for the world economy and, in the process, enhance the legitimacy of the Fund as a global organization when the steering committee deals with major issues affecting the Fund.

Discussion and Commentary

No one disputes that IMF governance is a central issue in IMF reform. De Rato (chapter 3 and IMF 2005b) is at his most eloquent both in describing the problem and in describing its resolution as not a zero-sum game. His predecessor Camdessus (2005, 10) asserts that because of governance issues "[t]he legitimacy of the Bretton Woods Institutions is increasingly questioned."[7] Adams (chapter 4) lists quotas and representation reform as the first of five US priorities for IMF reform, and for many his mention of the representation component of the issue—chairs on the Executive Board—was a first.

Yu (chapter 28) comments negatively on the lack of balance in IMF representation and the US ability to block (veto) some decisions. He also says that China should and could contribute more resources to the Fund. Padoa-Schioppa (chapter 27) criticizes both US and European leadership in the IMF and says flatly that there should be a single European representative. Eichengreen (chapter 25) argues that the ongoing process of IMF reform must be efficient, effective, and legitimate. He links the last requirement to progress on chairs and shares and suggests that my phased approaches have some merit. Ariel Buira (2005) argues that the unrepresentative nature of IMF governance aggravates the gap between industrial countries and developing countries in the Fund: The former group makes the rules under which the latter group may be allowed to borrow from the institution.

Issues of IMF chairs and shares are not easy to resolve. Skepticism about their early resolution was heard at the conference. On representation in the Executive Board, even a small first step by consolidating the EU countries into seven chairs would require major political decisions by Ireland, Poland, and in particular Spain to leave their non-EU majority constituencies and potentially lose the opportunity for one of their nationals to be assured of being the executive director, the alternate executive director, or in line for one or the other position. Similarly, positions

7. Camdessus (2005) advocates not only a consolidation into one European seat on the Executive Board but also a consolidation of other seats to produce a much smaller board. Groups of countries would be led by the United States, China, Japan, and so forth. Thus, he would hope to upgrade the caliber of the executive directors.

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are dug in with respect to revising the quota formula; recent calculations with the existing formulas imply larger, not smaller, quota shares for most members of the EU. Many representatives of industrial countries question whether a measure of the need to borrow from the IMF should figure at all in quota calculations even though it has done so historically.

Optimists can take some comfort in the fact that the G-20 meeting in mid-October 2005 covered these issues. Its communiqué noted the need for "concrete progress" on quota reform by the 2006 annual meetings and suggested that the G-20 itself would seek to identify principles that could be used in the 13th general review of quotas to be completed by January 2008.

It would appear from the comments at the conference that the process of choosing the leadership of the IMF is not on the radar screen today despite the fact that such decisions are made best when the choice actually has to be made. Although the Kahler suggestions on this and other internal performance and governance issues did not attract comment, a number of them are implicit in the budgetary and organizational components of de Rato's medium-term strategy (IMF 2005b).

In contrast, the case for and against Bergsten's new steering committee for the world economy attracts a great deal of attention. Both de Rato (chapter 3 and IMF 2005b) and Camdessus (2005), rejecting both the G-7 and the G-20, come out strongly in favor of the IMFC as the appropriate body.[8] Yu (chapter 28) sees no immediate need for China to join the G-7, implicitly endorsing an expanded role for the G-20 if not Bergsten's F-16. One speaker agreed that the IMFC is discredited but stated that the F-16 is a nonstarter and the only answer to many of the global economic and financial issues of the day is to raise them to the level of an L-20. Many noted that the issue of the steering committee for the world economy is intimately linked to the topic of the first part of the conference—the role of the IMF in the international financial system and performance of the global economy.

IMF Lending Facilities

The IMF's lending is at the core of its operations. In lending to members with external financing needs, the Fund seeks to provide sufficient assistance to permit the borrowing country to adopt adjustment measures that minimize adverse effects on national or international prosperity. In return, the borrowing country endeavors to make changes in its policies sufficient to allow it to repay the IMF as well as to reduce the risk that it will face similar problems in the immediate future. It is not surprising that

8. One of de Rato's few action items involves the hardy perennial of improvements in the format and communiqués of the IMFC. Camdessus expresses support for the traditional French position in favor of the creation of a decision-making council replacing the IMFC, which technically can only offer guidance to IMF management and the Executive Board.

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much of the controversy during the past decade about the role of the IMF swirls around this core activity. Has the IMF been too generous in its large lending programs? Are new facilities needed to enable the Fund to meet its members' potential requirements in the 21st century? Should the IMF scale back, increase, or otherwise modify its lending and policy engagement with low-income members?

The Papers

To provide answers to questions about IMF lending facilities, eight experts prepared papers for the conference: William R. Cline on the Case for a Lender-of-Last-Resort Role for the IMF (chapter 14), Gregor Irwin and Chris Salmon on the Case Against the IMF as a Lender of Final Resort (chapter 15), Kemal Derviş and Nancy Birdsall on a Stability and Social Investment Facility for High-Debt Countries (chapter 16), Tito Cordella and Eduardo Levy Yeyati on the Case for an IMF Insurance Facility (chapter 17), Kristin Forbes on a Shock-Smoothing Facility for the IMF (chapter 18), John B. Taylor on the Policy Support Instrument: A Key Component of the Recent IMF Reform Movement (chapter 19), Steven Radelet on IMF Facilities for Poststabilization Low-Income Countries (chapter 20), and Michael Mussa on Reflections on the Function and Facilities for IMF Lending (chapter 21).

Cline. The Cline paper argues that cases of large-scale IMF lending on the whole have been successful: The IMF has been repaid, spreads have returned to precrisis levels, and there has been no impairment of the Fund's preferred-creditor status. In Cline's view, concerns about moral hazard associated with IMF lending have been seriously overstated; external private-sector creditors have absorbed large losses in a number of cases and do not invest in anticipation of IMF rescues if things go bad.

Addressing the case of Argentina, Cline believes that the case does not offer support for curtailing large-scale IMF lending. He also bemoans what he estimates to be the punitive terms imposed by the Argentine government on external bondholders; in his view, Argentina's willingness to pay fell well short of its ability to pay. He suggests that the Fund needs to apply a higher threshold of confidence in the ability of governments to meet their fiscal-policy commitments, suggesting that this element might be added to the IMF's framework for exceptional access to its resources. Cline sees the Argentine case as suggesting that rogue debtors are a bigger problem than rogue creditors. The size of Argentina's debt to the IMF was not a problem in the negotiations. He does suggest that the IMF should use a higher bar in approving programs in cases where the Fund is providing net new money rather than in cases where it is rolling over debt coming due after a default.

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Cline argues that going forward the IMF should continue to make large-scale loans as necessary. He advocates limited IMF involvement in debt default and workout situations where the IMF would specify sets of high, central, and low repayment scenarios as background for the negotiations. The country's compliance would be judged on that basis, including by implication its continued access to IMF credit and rollovers—IMF lending into arrears. Regarding codes of conduct, he considers as commonsense many of the elements in the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets developed by the private sector under the leadership of the Institute of International Finance and representatives of a group of emerging-market countries. In agreement with the stated intent of those principles, Cline writes there is no substitute for continued case-by-case treatment of countries' debt crises. Finally, he identifies as unfinished business strengthening the scope for legal recourse of creditors in situations of debt repudiation, including, perhaps, a proscription on the Bank for International Settlements from shielding the reserves of a country in default that demonstrably failed to conduct good-faith negotiations with its external creditors.

Irwin and Salmon. The Irwin and Salmon paper, contrary to Cline's, argues that the balance of much of the same evidence supports those who have urged caution about the benefits of large-scale IMF programs. In support of this proposition, Irwin and Salmon argue that in most cases countries did not regain market access as quickly as had been anticipated and that repayment of IMF borrowing was protracted. They argue that there has been an overreliance on IMF financing to resolve external financing crises, contributing to moral hazard and an underreliance on private-sector involvement in financing arrangements for countries facing external financial crises.

Irwin and Salmon propose four solutions going forward. First, IMF large-scale lending should be more sharply limited. Second, the IMF's exceptional access framework should be strengthened via the introduction of quantitative measures (rules) in place of the present subjective elements (discretion). They also suggest the possibility of delinking access rights from quotas in light of the fact that the sizes of members' quotas tend to lag behind countries' economic sizes. Third, IMF governance should be strengthened by the introduction of quantitative risk measures into IMF lending decisions inter alia to limit an excessive concentration of lending to a few borrowers and the increased application of ex post assessments by the Fund's Independent Evaluation Office. Finally, greater reliance should be placed on standstills, market-based mechanisms such as aggregation clauses, and understandings such as the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets.

Derviş and Birdsall. The Derviş and Birdsall paper was the first in this session on new facilities, and theirs is the most ambitious proposal. They

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observe that in 2002 many emerging-market economies had total public-sector debt relative to GDP much greater than the benchmark (IMF 2003) of 25 percent with a median ratio of 60 percent and a median ratio of interest payments to GDP of 4.3 percent. Market interest spreads for these countries are high. They also have high poverty rates and weak human development indicators. Consequently, a "debt event" involves large setbacks to policy programs designed to reduce debt ratios and promote development and poverty reduction efforts. But even without a crisis, the constant fear of a crisis reduces investment, constrains social programs, and worsens the distribution of income. To overcome this chronic insecurity, countries have a choice among sustained programs of fiscal austerity, comprehensive negotiated debt reduction programs, at present, possible only in crisis circumstances, or the new stability and growth facility that Derviş and Birdsall propose.

The facility would be available to countries that qualify on the basis of programs to reduce gradually their debt ratios and of policy commitments in the areas of development and poverty reduction. Drawings on the facility would be phased over time and interest rates would be low relative to market rates, in other words without the special premium over regular IMF lending that applies in borrowing from the Supplemental Reserve Facility, and preferably on slightly concessional terms. Countries would reduce their debt ratios through their fiscal programs and at the same time replace part of their public-sector debt with obligations to the facility as they reduce their average interest costs on their outstanding debt. Derviş and Birdsall estimate that for a target group of 18 countries the facility would require financing of $10 billion to $20 billion annually for 10 years—$100 billion to $200 billion in total over a decade. They suggest that the facility could be lodged in the IMF, the World Bank, or a combination, in cooperation with the United Nations development agencies. If it were entirely in the Bank, the Fund would have to be involved in the qualification, the setting of macroeconomic policy conditions, and the monitoring of continued eligibility.

Cordella and Levy Yeyati. The Cordella and Levy Yeyati paper presents a more modest proposal in the class of insurance facilities. The authors also start by noting the economic and social costs of episodes of external financial distress. However, they focus on cases of "avoidable liquidity runs" linked to perceived liquidity risk. They note that self-insurance through reserve accumulation is costly and external insurance tends to be self-defeating.

Their answer is a country insurance facility in the IMF for which a country would prequalify and receive automatic access as well as an adequate amount of finance to deal with a crisis without requiring major changes in its fiscal stance. They suggest the requirements could include a public-sector debt ratio of less than 60 percent of GDP and a fiscal deficit

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of less than 3 percent of GDP for the previous three years, external debt would receive a multiplier of more than 1.0, a sublimit would be placed on short-term debt, and indicators might be cyclically adjusted. The borrowing would be for six months, renewable at a larger spread after six months. If it could not then be repaid, the country would enter into a program with standard economic belt-tightening conditions. Their calculations suggest that if such a facility had been available in the late 1990s Korea and Thailand might have used it and Chile might have found it useful because the country might have avoided the adoption of a procyclical monetary policy. They provide an analogy between today's IMF air bag approach after a crash (crisis) and an antilock brake system in advance of a crisis under their proposal.

Forbes. The starting point for the Forbes paper is the observation that the recent benign global economic environment will not last forever and emerging-market countries will again face the constraint of being unable to implement countercyclical policies in the face of external shocks. Forbes suggests that the IMF could establish an insurance type of facility as a supplement to its normal ex post lending facilities. It would aid countries in hedging against external shocks while requiring, she estimates, minimal additional IMF resources.

The shock-smoothing facility Forbes envisages would permit a country to borrow from the IMF in good times with an initially flat presumptive repayment schedule for principal and interest. The actual repayment schedule would vary according to a country-relevant index designed to provide the amount and type of insurance that would benefit the country the most. For example, the index could be linked to the price of an important commodity or the growth rate of an important external market. (She raises the possibility of a subsidized variant for low-income members as well.) The country would benefit from the shock-smoothing feature and as a result might not need access to regular IMF lending programs in the future; the IMF would benefit by responding to a perceived need for this type of insurance. However, the IMF would take on additional risk in connection with specific shocks because the sum of actual payments might fall short of the initial contractual amount. Therefore, the IMF would have an incentive to work with the private market to develop risk-sharing instruments such as the GDP-linked bonds suggested by Williamson (chapter 6).

Taylor. The Taylor paper provides the background and rationale for the establishment in the IMF of a Policy Support Instrument (PSI) that was agreed in principle in April 2005 and adopted by the IMF Executive Board on October 5 following the annual meeting and the IIE conference on IMF reform. The instrument is voluntarily available to low-income members that have successfully stabilized their macroeconomic situations and have

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no need for balance of payments financing but wish to continue a policy relationship with the Fund.[9]

The advantages of the instrument articulated by Taylor are that the country does not increase its debt; it has more ownership of its policies; it maintains a link to IMF policy advice; the IMF provides a signal that its policies are sound; it restores the IMF relationship with these countries to one focused primarily on their balance of payments needs; and it reinforces a division of labor between the Fund (for balance of payments lending) and the World Bank (for development lending). Taylor noted that this proposal should be viewed in the context of other IMF-related reforms: the widespread adoption of collective action clauses in external sovereign bonds, clarification of limits on the availability of IMF financing, streamlining of IMF conditionality, and a refocusing of the IMF on its core responsibilities.

Radelet. The Radelet paper covers some of the same ground as the Taylor paper but from a perspective of economic development, it is somewhat critical of the IMF's involvement with low-income countries. On a continuum of IMF involvement with low-income countries, Radelet sees the PSI as a mechanism for poststabilization countries whose priorities should shift decisively toward the achievement of development goals; in effect, the country is released from the perception and sometimes the reality of IMF-recommended policies that are antigrowth. Moreover, this shift encourages countries to build domestic economic policy institutions instead of relying on Fund policy requirements as a substitute for such institutions. Countries should consider a PSI after low-access lending from the Poverty Reduction and Growth Facility (PRGF) and possible precautionary PRGF arrangements, where the intention is not to borrow. The next step after a PSI in the Radelet view might be a program of intensive surveillance with the IMF.

Radelet adds three additional points about the IMF's relationship with its low-income members. First, he suggests an indirect or direct IMF involvement in the World Bank's Country Policy and Institutional Assessment system in which the IMF's views in whole or in part would be incorporated in the assessments of macroeconomic policies in general, fiscal policy, debt policy, financial-sector policy, and possibly trade. In addition to demonstrating a capacity to cooperate across 19th Street in Washington, this approach could benefit both institutions by stressing a division of labor. Second, he advocates consideration of greater flexibility in normal PRGF programs, for example, in response to external shocks. Finally, he comes out strongly against grants from the IMF; it should remain a bal-

9. The first country to have a PSI is Nigeria, which received approval on October 17 and a Paris Club agreement the next day. The Nigerian case differs from the basic model in that Nigeria did not have a prior stabilization program with IMF financial support.

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ance of payments lending organization on penalty terms, compared with the terms of grants.

Mussa. The Mussa paper has two elements. The first is an analysis of the IMF as a lender of final resort and the rationale for the basic instruments that it uses. The second is a commentary on the papers of the other authors in this session of the Institute conference.

Mussa argues forcefully that the IMF should be viewed by countries facing balance of payments difficulties as a lender of final resort, not as a general supplier of global liquidity. The Fund solves a collective action problem by pre-positioning substantial financial resources for lending at low rates with a very high assurance of repayment. This is an important public purpose that is not "adequately reflected in the profit and loss calculus of relevant private-sector actors" and some government officials. However, it is an institution of public trust, and its lending should be temporary with appropriate safeguards to ensure that the loans are used for the "fundamental purpose of helping to resolve balance of payments difficulties in a manner consistent with the interests of the international community, including the obligation of repayment." Standby arrangements financed by the general resources account of the Fund have proved to be a very flexible mechanism for achieving this purpose. From time to time, special facilities such as that in connection with the conversion of computers at the turn of the 21st century may be appropriate, and one should keep a "somewhat open mind" about new facilities, but no more.

With respect to Argentina, Mussa argues that mistakes were made by the IMF and its members in continuing to lend in 2001, by the private sector in encouraging the IMF not to engage with Argentina in 2002, by the IMF in its rollover lending in 2004 in a "tortured stretch of the meaning" of its policy on lending into arrears, and by the IMF and the United States when they claimed that the IMF's noninvolvement in Argentina's negotiations with its external bondholders was a success. He proposes the creation of a mechanism by which in extreme cases of this type it would be possible to roll over IMF claims on a country under special economic circumstances such as severe negative impact on economic activity; he suggests that the new facility be clearly labeled the "deadbeats refinancing facility."

With respect to lending to low-income countries, Mussa argues that it is essential to keep the financing of that lending separate from the general, principally quota-based, resources of the Fund. It would be preferable for the Fund to discontinue lending to low-income countries except in cases of clear, short-term balance of payments need. In his view, the IMF should stop all PRGF lending not related to balance of payments needs and certainly stop lending to countries to which it has granted 100 percent debt relief.

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Discussion and Commentary

It is doubtful that unanimity will be achieved on the issue of the IMF as a lender of last (or final) resort. Camdessus (2005, 6) is emphatic on the subject: "A globalized financial system needs a lender of last resort, and the IMF is the only institution equipped and prepared to play such a role in extreme circumstances. . . . It is a function that it [IMF] has been performing and adapting to, for over 50 years, and it would be timely to confirm the Fund in the role of providing the international community with this vital guarantee with enough scope for judgment to avoid any risk of moral hazard." Camdessus's successor, Rodrigo de Rato (chapter 3 and IMF 2005b), is more cautious. He argues that the Fund should review its instruments, including its policy on lending to members that have arrears to private-sector creditors, and states, "We need to have a Fund that can say no."

Eichengreen (chapter 25) notes that the IMF "appears to be at sea" with respect to postcrisis debt restructuring; he cites disapprovingly its disengagement in Argentina.[10] It is not enough for the Fund just to review its policy on lending into arrears. As a spokesperson for the international policy community it has broader responsibilities.

Adams (chapter 4) identifies crisis resolution as one of the five items on the US agenda for IMF reform; he implies a criticism of the Fund in the case of Argentina by suggesting that the Fund should set the "resource envelope" for debt restructuring through the primary fiscal surplus in an IMF program, which would be consistent with the Cline proposal that the Fund define high, central, and low scenarios.[11]

Eichengreen (chapter 25) cites the lack of consensus on many aspects of crisis lending, noting that academics have been unhelpful because of their lack of agreement. He refers to the firm position of the Bank of England but says it is wrong: "Although moral hazard is a problem, as the Bank emphasizes, meltdown risk can, at times, be an even more serious problem." For Mussa, there is no significant moral hazard in IMF lending because there is no permanent shift of the burden of financing to the IMF and its financial supporters; there is only temporary relief and the IMF is repaid. It was noted at the conference (Irwin and Salmon, chapter 15) that the IMF

10. Some have observed that the IMF's involvement in some other cases, in particular those of the Dominican Republic and Grenada, has been more active and constructive (IMF 2005a). These are small cases, however, and they involved restructurings without prior defaults to private-sector creditors.

11. My view is that such a resource envelope involves more than the primary fiscal surplus, normally expressed as a percent of GDP, in the case of repaying external debt; it involves the growth rate of GDP and an exchange rate. Moreover, if the country has a sustainable public debt position, the resource envelope involves the country's capacity to access international capital markets going forward.

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must think that there is some risk that it will not be repaid: It has arrears and reserves. Thus, there must be some expected losses. However, one can ask whether this point involves excessive counting of very small beans.

The issue of new IMF lending facilities, ranging from the Derviş-Birdsall stability and growth facility to the Forbes shock-smoothing facility, primarily involves elements of insurance and advance commitment. Those who advocate such initiatives are motivated in part by the perception, in the words of El-Erian (chapter 26), that the Fund needs to be perceived as a trusted adviser and supporter. The remarks of Redrado (chapter 12) underscore the current disaffection; countries cannot trust the IMF as a provider of liquidity because "the IMF has not been technically, financially, or even politically up for acting in that capacity." The issue for the Fund is whether further work in this area is justified. De Rato (chapter 3 and IMF 2005b) has a discussion of this topic on his modest list of deliverables.

Each of the proposals for new IMF lending facilities advanced at the conference was criticized. The Derviş-Birdsall proposal was criticized because of its size and, if it were located in the IMF, because of the potential impairment of members' claims on the IMF, which are their international reserves. On the Cordella–Levy Yeyati insurance proposal, it was observed that all runs are rooted in some flaw, albeit small, in a country's economic and financial fundamentals. Mussa points out the challenge, the impossible challenge in his view, of identifying a set of sound policies as well as the problems involved in disqualifying countries after they earlier have qualified for an insurance facility or the Derviş-Birdsall facility. The search for new facilities of this type, he observes, is a "search for the holy grail" and can at best make a marginal contribution. Eichengreen (chapter 25) fundamentally agrees that it is impossible to sort countries ahead of time; there is no substitute for judgment. However, he expresses some sympathy for Forbes's proposal.

What about the IMF's involvement with its low-income members? Here, there may be the hint of an emerging consensus. De Rato (chapter 3) wants to "deepen" the IMF's work with low-income countries. However, his proposals (IMF 2005b) generally involve a refocusing and refinement of that relationship. Camdessus (2005), on the other hand, would like to see a stepped-up involvement in this area by the Fund along with the World Bank. Many critics, on the other hand, do not trust the Bank to support the right policies, be they macroeconomic policies, financial-sector policies, or other economic policies.

Adams (chapter 4) includes IMF engagement with low-income countries on his agenda for IMF reform, but the US vision implies a lower level of IMF engagement as evidenced by US advocacy of the PSI. Snow (2005) emphasized differentiation in the roles of the Fund and the Bank. However, differentiation does not define the parameters of cooperation between the Bretton Woods institutions. De Rato (IMF 2005b) promises yet another effort to do so. Padoa-Schioppa (chapter 27) favors moving the

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PRGF to the Bank. Taylor and Radelet do not. Cutting through the nuances, what appears to be evolving is a scaled-back IMF involvement in the details of the process of preparing Poverty Reduction Strategy Papers and IMF lending to PRGF-eligible countries.

IMF Financial Resources

The IMF is an international lending institution. As such it needs to have resources to lend. It also needs to cover its operating expenses. The issues posed for the authors of the papers for this session of the Institute's conference focused primarily on the first aspect although the commentary touched on the second.

The Papers

Three experts prepared conference papers on different aspects of the IMF's financial resources: Ariel Buira (chapter 22) on Does the IMF Need More Financial Resources?, Desmond Lachman (chapter 23) on How Should IMF Resources Be Expanded?, and Karin Lissakers on Is the SDR a Monetary Dodo? This Bird May Still Fly (chapter 24).

Buira. The Buira paper makes the case for increasing the financial resources of the IMF. He advocates at least a doubling, preferably a tripling, of IMF quotas. He notes that, according to the IMF's own calculations, it has ample resources of more than $130 billion in one-year forward commitment capacity.[12] In his view, however, this comfortable position reflects, in part, a progressive shift in IMF lending policy during the past 30 years.

Buira starts from the fact that the IMF is a cooperative international monetary organization designed to promote high employment and growth through its lending activities that give confidence to its members to run the right policies to achieve those objectives. This activity involves striking an appropriate balance between financing and adjustment in IMF lending programs. Over time, according to Buira, the virulence of economic and financial shocks (declines in commodity prices or sudden stops in external financing) has not diminished; it may even have increased. Meanwhile, the policy requirements for access to IMF financing have changed: The IMF has shifted the balance from financing toward adjustment through a hardening of conditionality. The number and complexity of IMF conditions have increased, and countries have increasingly failed to meet them. One result has

12. This is a measure of IMF resources available for new commitments in the coming year. It equals uncommitted usable resources (primarily from the quotas of members that are able to lend through the IMF) plus projected repayments one year forward minus a generous prudential balance.

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been programs that have not been completed, leaving financing that has gone untapped; another is that even successful programs receive less financing. Moreover, Buira argues, the policy conditions have not permitted countries to have countercyclical macroeconomic policies. As a consequence, the Fund has not really helped member countries to cope with their balance of payments problems in a manner that is consistent with international or, in particular, national prosperity. This combination of developments, he says, is driving countries to self-finance their potential international adjustment needs by building up their holdings of foreign exchange reserves and by establishing devices such as the Chiang Mai Initiative in East Asia to share reserves through a nascent Asian monetary fund. The Latin American countries, in his view, are likely to try to follow the Asian initiative.

Finally, Buira notes that the total of actual quotas in the IMF has declined relative to the total of calculated quotas (unadjusted for the actual size of total quotas) based on the variables in the traditional quota formulas. As of 2003, the ratio of actual to calculated quotas has declined by 50 percent since the early 1980s and by almost two-thirds since the mid-1970s largely because current payments, the variability of current receipts, and in particular international reserves have risen more rapidly than IMF quotas.[13]

Lachman. The starting point of Lachman's paper is that the IMF has adequate financial resources today and should limit the availability of its resources because of the risk of moral hazard. However, Lachman notes that the Fund's reliance on quota resources involves potential problems, including delays in putting them in place once a consensus has emerged that they are needed. Political approval is needed, and issues arise of equity and burden sharing in financing the IMF's lending programs and operations.

Lachman considers three alternatives. First, he looks at gold sales that could generate approximately $36 billion in resources from realizing the capital gains on the IMF's holding of more than 100 million ounces of gold, but he argues that it would be politically difficult to reach agreement to alter the IMF's portfolio by selling gold. Second, he looks at a proposal by Jacques Polak (1999) to convert the IMF to an SDR basis for all its operations. Doing so could add approximately $45 billion dollars to IMF resources, in effect by making all members' quotas usable. This proposal is technically complicated, however, and would require amendment of the IMF Articles of Agreement. Finally, he considers IMF borrowing in the private market that he estimates could produce an additional $100 billion in IMF lending capacity. It would not require amending the IMF articles, and

13. Those three variables along with GDP are used in a complex set of standard formulas to derive calculated quotas. (The ratio of actual quotas to GDP has also declined over time.) As noted earlier in this chapter, some argue that the formulas should be simplified and updated to a single formula.

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might face fewer political obstacles to implement. His conclusion is that the third option is most promising and is preferable to increasing IMF quota resources should the IMF need to expand its lending capacity at some point in the future.

Lissakers. The Lissakers paper examines the issue of whether there is a role for the SDR in the international monetary system of the 21st century. She notes that the SDR mechanism was established in 1969 in the closing days of the Bretton Woods international monetary system as part of a failed effort to sustain the fixed exchange rate regime that was the cornerstone of that system. A total of approximately SDR 20 billion (about $30 billion) was allocated in the early and late 1970s. Since then proposals have been made to allocate more SDR, and an amendment to the IMF Articles was proposed after the mid-1990s for a one-time special allocation of an additional SDR 20 billion, largely for the benefit of members that had joined the IMF since the first or second allocations. The amendment was advocated and supported by the Clinton administration. However, neither the Clinton administration nor the Bush administration pushed the amendment through the Congress, and it cannot become effective without US ratification.

Thus, the SDR languishes, but the instrument is not yet in the category of the dodo bird because there has been no movement to make it extinct—to cancel the existing SDR or eliminate the SDR provisions in the IMF Articles. Should the SDR be put out if its misery? Lissakers suggests no; it might yet become useful. Harkening back to the first session of the IIE conference on the IMF and the international monetary system, she notes the risk of a looming dollar crisis and a global economic and financial meltdown as simulated in the September 2005 *World Economic Outlook* (IMF 2005c). She suggests that the IMF and its members might just want to keep around the potential to use an allocation of SDR to boost economic confidence and global liquidity if the meltdown becomes extreme.

Discussion and Commentary

Camdessus (2005) favors significant periodic increases in IMF quotas, and he is sympathetic to regular allocations of SDR, consistent with Lissakers's report on his view on the SDR when he was managing director. The current managing director, Rodrigo de Rato, is silent on both issues except to note that the 13th review of quotas ends in January 2008. Adams (chapter 4), in the context of his discussion of governance of the IMF, stated the US view that IMF liquidity is at a record high (in nominal terms) and there is no need to increase IMF resources through a general increase or ad hoc increases in IMF quotas. Quota shares should be adjusted via reallocation. On the other hand, Redrado (chapter 12) cites the decline in IMF resources

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relative to the global total of trade and finance as one reason why countries cannot turn to the IMF for help in financing countercyclical economic policies. He suggests that, once the IMF becomes more legitimate as the result of changes in its governance, increased financing might be available.

On the issue of IMF borrowing from the market, one comment was that a lender of last resort should not rely on the market for its financing; the cost of borrowing may rise with its need for funds unless the financing has been drawn down in advance of the need. The comment also could have been made that it is good to force the IMF and its members to obtain political support for any increase in the scale of its activity. On the other hand, market discipline on the IMF may be useful.

At the conference, no comments were made on the SDR issue, one way or another, except to suggest that in a dollar crisis the SDR might again come into play as part of a mechanism to facilitate the funding of excess official dollar balances in a substitution account in the IMF.

El-Erian (chapter 26), however, placed substantial emphasis on a point that was touched upon by Lachman: The IMF has to find a modern and stable way to fund its budget without relying exclusively on earnings from its lending activities. In particular, he argues that the IMF has lost much of its monopoly power in providing international financing, and it may be doing much less total lending in the future than it has in the past, other than to low-income countries, which generates limited net income. De Rato's medium-term strategy (IMF 2005b) mentions this issue in its reference to the revenue side of the Fund's medium-term budget. He promises a review of the Fund's finances and of ways to broaden its income base.

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