5

Lending Facilities

The traditional conception of IMF lending activities is that they should strike a balance between adjustment and financing. The borrowing country receives sufficient financing to allow it to take adjustment measures that minimize adverse effects on national or international prosperity. On its part, the country takes sufficient adjustment measures to ensure that it will be able to repay the Fund.[1]

As outlined in chapter 2, the IMF currently lends through five types of facilities: Stand-By Arrangements (SBA), an Extended Fund Facility (EFF), a Supplemental Reserve Facility (SRF), a Compensatory Financing Facility (CFF), and a Poverty Reduction and Growth Facility (PRGF).

In recent years there has been a trend toward streamlining the various facilities, revising them to reflect the changing realities of the international financial system—flexible exchange rates and more extensive private capital flows—and reducing their number in effect so that they can operate from one overall platform with multiple models or variations. For example, in the wake of the tsunami that hit Asian and African countries in December 2004, the Executive Board did not create a new facility; it approved an amendment to its "policy" on emergency lending to members in postconflict situations, which was adopted in 1995 and extended in 2001 to provide subsidized lending to countries that are PRGF eligible to include subsidized lending to countries hit by natural disasters. In March

1. This second half of the bargain is known as IMF "conditionality." It is frequently pointed out by critics of the IMF's operations today—for example, Bird (2003) and Babb and Buira (2005)—that the concept of conditionality is not to be found in the original IMF Articles of Agreement but was gradually insinuated into IMF policies, largely under the influence of the United States, which wanted to limit the size of IMF programs financed largely from its IMF quota. Conditionality was not codified until the 1969 amendment to the Articles of Agreement and was not supported by guidelines about how it was to be applied until the late 1970s.

2005, the Executive Board approved a Trade Integration Mechanism (TIM) as a policy associated with EFF or PRGF borrowing that permits countries to borrow to finance balance of payments shortfalls associated with multilateral trade liberalization.

Not all facilities involve actual lending. For example, the IMF long has had precautionary SBA or EFF lending arrangements under which the country has the right to borrow but states its intention not to do so. The underlying idea is that this type of program provides confidence to private-sector international lenders to the country by providing an IMF seal of approval of its policies. In the past, the Fund has also experimented with a variety of signaling devices and intensified monitoring mechanisms short of precautionary lending programs, and recent consideration has focused on a new type of nonborrowing program, a policy support instrument, that could be used by PRGF-eligible members; see the section on Support for Low-Income Countries.

Going the other way, from intentions not to borrow to promises to lend, in 1999 the IMF instituted a contingent credit line (CCL) feature into the SRF under which a specified amount of financing automatically became available to countries that had been preapproved to receive it. Despite tinkering with the feature, no one signed up for approval, and the CCL was not renewed in November 2003. However, as described below, variations on this general theme are under active discussion in the form of financial insurance for countries that have met preestablished conditions.

One fundamental issue is the question of which countries are likely to borrow from the IMF in the future. Data underlying tables 2.3, 2.4, and 2.5 reveal that 136 countries of the current 184 country members of the IMF have borrowed from the IMF during the past 30-plus years; see table 5.1.[2] Three additional countries, for a total of 139 members or 76 percent of the total membership, have had one or more programs under which they did not borrow. The countries include 38 percent of the industrial countries and 81 percent of all other IMF members, including 91 percent for the 77 PRGF-eligible countries (note that we have not classified India in the last category).

It is reasonable to assume that none of the industrial countries in the classification used in this paper will need to borrow again from the IMF, and the same may hold for a handful of other countries that we can

2. Most of the countries listed in table 5.1 had formal IMF programs; a few may have borrowed their first credit tranches, which do not require formal programs. The table does not include countries—for example, the United States—that only have borrowed all or part of their reserve tranche subscriptions to their IMF quota, in effect, borrowing back their reserves. Many of the borrowing countries have been "prolonged users" of IMF resources through successive borrowing programs. Sometimes such prolonged use may be appropriate, but it also raises questions about IMF program design, policies, and incentives. The IMF has acted in recent years to adopt new policies to take a closer look at and exert constraints on the phenomenon of prolonged use of IMF resources.

Table 5.1 Countries borrowing from the IMF, 1970–2005[a]

Category of countries	Borrowers (139)[b]	Nonborrowers (45)	Percent of borrowers (76)
Industrial countries (24)	Australia, Finland, Greece, Iceland, Italy, New Zealand, Portugal, Spain, United Kingdom (9)	Austria, Belgium, Canada, Denmark, France, Germany, Ireland, Japan, Luxembourg, Netherlands, Norway, San Marino, Sweden, Switzerland, United States (15)	38
Emerging-market countries (22)	Argentina, Brazil, Chile, China, Colombia, Czech Republic, Ecuador, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Philippines, Poland, Russian Federation, South Africa, Thailand, Turkey, Venezuela (21)	Singapore (1)	95
Other developing countries (61)	Algeria, Barbados, Belarus, Belize, Bosnia and Herzegovina, Bulgaria, Costa Rica, Croatia, Cyprus, Dominican Republic, El Salvador, Equatorial Guinea, Estonia, Fiji, Gabon, Guatemala, Iraq, Israel, Jamaica, Jordan, Kazakhstan, Latvia, Lithuania, Macedonia, Mauritius, Morocco, Panama, Paraguay, Peru, Romania, Serbia and Montenegro, Slovak Republic, Slovenia, St. Kitts and Nevis, Swaziland, Trinidad and Tobago, Tunisia, Ukraine, Uruguay (39)	Antigua and Barbuda, Bahamas, Kingdom of Bahrain, Brunei Darussalam, Botswana, Iran, Kuwait, Lebanon, Libya, Malta, Marshall Islands, Micronesia, Namibia, Oman, Palau, Qatar, Saudi Arabia, Seychelles, Suriname, Syrian Arab Republic, Turkmenistan, United Arab Emirates (22)	64
PRGF-eligible countries (77)	Afghanistan, Albania, Armenia, Azerbaijan, Bangladesh, Benin, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Dominica, Ethiopia, The Gambia, Georgia, Ghana, Grenada, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Kenya, Kyrgyz Republic, Laos, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Moldova, Mongolia, Mozambique, Myanmar, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Papua New Guinea, Rwanda, Samoa, São Tomé and Príncipe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sri Lanka, St. Lucia, St. Vincent and the Grenadines, Sudan, Tajikistan, Tanzania, Togo, Uganda, Uzbekistan, Vietnam, Yemen, Zambia, Zimbabwe (70)	Angola, Bhutan, Eritrea, Kiribati, Timor-Leste, Tonga, Vanuatu (7)	91

PRGF = Poverty Reduction and Growth Facility

a. The countries borrowing during 1970–75 are approximated on the basis of countries that had credit outstanding in 1975.
b. Colombia, Nigeria, and Paraguay have had IMF program(s) but have not borrowed.

Sources: IMF, *International Financial Statistics* (various years); IMF, annual reports (various years).

assume have continuous access to international capital markets or are so wealthy that they do not need it. Note that these countries, by assumption, face no international pressures to adjust, with the United States a leading example. However, approximately 75 percent of the IMF's membership, about 135 countries, are potential borrowers either because their access to international capital markets is subject to interruption or because they have little or no such access.

As noted in chapter 2, a number of potential borrowers from the IMF have taken steps in recent years to self-insure against the possible need to borrow external financial resources from the IMF by improving their macroeconomic policy frameworks, strengthening their financial systems, and building up their international reserves. However, the global economic environment has been remarkably benign over the past few years, with near record global growth, low inflation, strong commodity prices, and a sustained period of abnormally low nominal and real interest rates in the United States, the euro area, and Japan. These conditions will not persist. As Goldstein (2005b) details, the evidence is ample that a significant number of emerging-market countries could experience financial crises over the next five years because, in part, their self-insuring has been incomplete. For example, for many countries, sovereign and external debt levels remain unsustainable, and the benign global economic conditions could become less benign in a hurry.

The question is not only which countries will want to borrow from the IMF in the context of the next global economic downturn or period of adjustment of macroeconomic imbalances but also which countries should be eligible to borrow from the IMF. For some observers and critics, the answer to the second question is linked to the quality of IMF surveillance; effective surveillance in a crisis-prevention mode should lead to a reduced need to borrow. At the extreme, a smaller number of observers and critics would limit borrowing from the IMF to those countries that had previously received good report cards from the Fund. The report cards might contain a short list of subjects or a very long list of subjects.

The view that the scope of borrowing from the Fund should be and can be sharply reduced flies in the face of two realities. The IMF is an organization with a near universal global membership; those members are not going to leave other injured members, whether their injuries are self-inflicted or not, by the side of the road for the vultures to feed upon as carrion. Reinforcing this first reality is a second in the fact, persuasively argued by Daniel Tarullo (2005), that the IMF is a political institution established by governments that must respond to political forces, including forces of financial need. This reality, in his view, is fully consistent with the professionalism of the staff and the dedication of the management and shareholders to the global public good.

Therefore, we can reasonably expect a pickup in borrowing from the IMF during the next five years. What will be the content of the adjustment programs—the associated conditionality? At an abstract level, the policy conditions associated with borrowing from the IMF should be tailored to the nature and the origins of the shocks, disturbances, or policy miscalculations that give rise to the need to borrow from the Fund. For the 13 countries that have experienced financial crises, from Mexico in 1994 to Brazil in 2002, the range of economic and financial conditions prior to the crises is large (Roubini and Setser 2004, 28–29).[3] If only two country-specific dimensions—sovereign debt and external positions—are considered, Mexico (1994) and Thailand (1996) had large current account deficits and small stocks of sovereign debt—external plus internal. Russia (1997) had a large stock of sovereign debt and a current account surplus. Ecuador (1998) had a large current account deficit and a large stock of sovereign debt. To these two dimensions could be added currency mismatches, the exchange rate regime, the condition of the financial system, and many more. Global economic and financial conditions provide an additional overlay.

Critics from developing countries, for example, Buira (2003), observe that the principal IMF response to the myriad of circumstances that may contribute to a country's need to seek IMF financial support has been a complex elaboration of conditions on borrowing with a bias toward prompt external adjustment combined with limited financing built on optimistic assumptions about the restoration of access to financing from global financial markets.

In partial response to the first criticism about an excess of policy conditions, the IMF in 2002 adopted revised conditionality guidelines that emphasize country ownership of policies, parsimony in conditions, policies tailored to circumstances, appropriate coordination with other multilateral institutions, and clarity in the conditions themselves (IMF 2005i). Notwithstanding well-intentioned efforts to limit the scope of conditionality, each country's program in the end is different because its economic and financial circumstances differ, and the setting of policy conditions requires judgments, which means relying on discretion rather than rigid rules.

On the other side, critics argue that current practice results in "insufficient ambition" in IMF prescriptions for economic policy changes and reforms; IMF staff and management rely too heavily on the preferences and judgments of the national authorities.[4] Almost all observers agree that the fundamental challenge lies in determining what changes in policies will be effective in addressing a country's specific needs. Too little research has addressed this complex and vexing issue. However, it is clear that simple

3. The full list of countries is Mexico, Thailand, Indonesia, Korea, Malaysia, Russia, Brazil, Ecuador, Pakistan, Ukraine, Turkey, Argentina, and Uruguay.

4. Timothy Geithner remarked on this before the Bretton Woods Committee on June 10, 2004.

rules, for example, "it is mostly fiscal," do not do the trick. Moreover, it has yet to be established, but nevertheless is highly improbable in my view, that simple tests of degrees of ownership (political commitment to programs) or of the strength of institutions can explain much of the variance in policy performance under IMF programs.

The second criticism—the limited scale of financing based on false assumptions about the restoration of market access—challenges the hypothesis of the catalytic role of IMF programs: a strong economic program with its policy content endorsed by the IMF, even if the actual size of the Fund's financial support is small, will be associated with a prompt recovery of market access. Careful theoretical and empirical examinations of this hypothesis (Cottarelli and Giannini 2002; Mody and Saravia 2003) support the conclusion that the catalytic effects of IMF programs are limited. One important reason is that each country's case tends to be different, if not unique.

If the IMF cannot rely on the catalytic effects of its modest financial support for a country's program of economic adjustment, what should be the scale of IMF lending to countries? Answers to this question are usually couched in terms of a country's IMF quota, but such responses are complicated by inconsistencies in the size of countries' IMF quotas relative to their economic and financial development, as noted in chapter 4 on IMF governance. Answers are further complicated in the face of capital account crises, which are associated with a cessation or reversal of access to international capital markets by a country's borrowers in the public sector, private sector, or both.[5]

If a country faces an illiquidity crisis, which is often difficult to distinguish ex ante from an insolvency crisis, it is likely that its IMF program will have to be overfinanced ex ante if the country is to emerge from its crisis with a minimum of adverse economic and financial effects on that country and on the international financial system. Some would qualify this last statement and argue that the country can always declare a standstill on its external financial payments via capital controls and exchange restrictions. In recent years, no country has resorted to such extreme measures on a comprehensive basis in the context of a liquidity crisis.[6] Comprehensive controls were used in the Argentine case in 2001 and 2002 when it turned into a solvency crisis, but on the basis of that case it is questionable whether the standstill option would meet the test of minimizing economic and financial effects on a country in a liquidity crisis.

5. The cessation or reversal of capital inflows (a "sudden stop," as described by Calvo 1998) can be associated with latent or actual developments in internal policies, the external economic and financial environment, or both.

6. The Korean case and the Brazilian case are examples of limited exercises in this direction. Roubini and Setser (2004) advocate greater use of such tools.

The IMF has long had a policy of limiting a member's access to borrowing from the Fund to 100 percent of quota for one year and 300 percent of quota in total, but the Fund could approve exceptions. In recent years, with the advent of capital account crises, exceptional access has been approved in a small number of cases.[7] Those cases have been controversial within the Fund, among its members, and in the views of outside observers. In response, the IMF in 2002 and 2003 adopted and revised an exceptional access framework (EAF) that established certain analytical and procedural presumptions that should be applied to these cases.[8] Some (Goldstein 2005a; Roubini and Setser 2004) question the IMF's conscientiousness in applying this policy.

It is important not to exaggerate the relevance of exceptional access to IMF lending overall. Since 1994 only nine members of the IMF have been granted such access, albeit a number of them on several occasions. As of July 28, 2005, only 3 of the 14 current SBAs and EFFs involved exceptional access, those for Argentina, Turkey, and Uruguay. Only two other countries that previously had exceptional access to IMF resources had IMF credit outstanding on May 31, 2005: Brazil and Indonesia. Fourteen other emerging-market and developing countries had credit outstanding to the IMF as of that date. Korea, Mexico, Russia, and Thailand had repaid the IMF.

On the other hand, when the Executive Board approves exceptional access, the resulting program potentially ties up a substantial amount of the IMF's lending capacity because of the size of the programs. Some would argue that this situation argues for an expansion of IMF financial resources; others counter that doing so would increase inappropriately the number of programs with exceptional access. This subject is considered in more detail in the next section of this chapter.

7. One response to the capital account crises of the 1990s was to create the SRF under which countries can borrow larger amounts for shorter maturities at higher interest rates. These interest rate surcharges were later generalized in two forms: (1) the level of borrowing and (2) the time period covered by the borrowing. Surcharges now apply to EFF and CFF borrowing as well as SRF borrowing. Their interaction is complicated, and they have given rise to concerns about, and presumptive evidence of, arbitrage across facilities (IMF 2005b).

8. The analytical presumptions are (1) exceptional balance of payments pressures normally associated with a capital account crisis, (2) a rigorous analysis demonstrating debt sustainability, (3) a strong presumption of an early return to the capital markets, and (4) a strong program of policy adjustment accompanied by the political and institutional capacity to implement the program. The procedural presumptions are (1) an elevated burden of proof on IMF management and staff in presenting the recommended program, (2) early consultation with the Executive Board as the program is developed, and (3) required ex post evaluation of the program within a year after its end (IMF 2003). These elements have subsequently been tweaked somewhat in their application, but the basic framework remains as described. The framework is to be applied to IMF programs that involve exceeding the normal access limits of 100 percent of quota per year and total outstanding credit from the Fund of more than 300 percent of quota.

This introductory discussion of IMF facilities suggests the following basic questions: What should be the role of the IMF as an international lender? Should the IMF develop special programs to assist developing countries that are not experiencing financial crises but have large sovereign debts? Should special lending programs be developed for countries that are "good performers" as part of the array of IMF facilities or as the IMF's only facility? To what extent should the IMF offer or promote nonborrowing programs of policy support without financing? Should the IMF continue to offer special borrowing arrangements for low-income countries? The balance of this chapter elaborates on some of these questions and provides some answers to them. It covers (1) the IMF's role as an international lender, (2) in particular, its role with respect to members with large sovereign debts, (3) its lending to good performers, (4) programs of IMF support without the use of IMF financial resources, and (5) IMF programs with its low-income members.

The IMF as an International Lender

This is not the place to review the voluminous literature on the role of the IMF as an international lender to countries and whether it should be a lender of first, last, final, or highly limited resort. A sample of three recent contributions with differing views is Roubini and Setser (2004), Bedford, Penalver, and Salmon (2005), and ECB (2005).[9] The debate, which appears to be far from over, revolves around three issues: (1) limits on access to IMF financial resources, (2) private-sector involvement in the financing, and (3) the IMF's role in debt restructurings. A background issue is the changing nature of international financial markets, making international credit more available to some countries, but not necessarily on a continuous basis.

With regard to access limits, one central issue involves distinguishing cases of illiquidity from cases of insolvency (in the special case of countries, which in fact cannot be subjected to bankruptcy proceedings or the functional equivalent) and deciding whether the IMF has a role to play in preventing the former type of cases from turning into the latter. Although improved debt sustainability analyses and a greater understanding of the insidious effects of currency mismatches have aided in distinguishing liquidity cases from solvency cases, no consensus exists about the scale of IMF lending in such circumstances. Some favor strict absolute limits on IMF lending regardless of the circumstances, others favor constrained discretion close to if not identical with the current EAF, and still others see little merit in any limits.

9. IMF staff have been active contributors to this literature. See, for example, Giancarlo Corsetti, Bernardo Guimaraes, and Nouriel Roubini (2003), Olivier Jeanne and Charles Wyplosz (2001), Olivier Jeanne and Jeromin Zettelmeyer (2002), and Steven Morris and Hyun Song Shin (2003).

To the extent that one favors large-scale (exceptional access) lending by the IMF in reasonably well-defined circumstances, the analytical issues that the advocate must address are whether doing so involves an unacceptable increase in moral hazard with respect to the debtor or the creditors and whether more IMF lending improves a country's longer-term prospects by addressing the immediate problem or worsens them by piling up more debt (Rajan 2005b).

On the moral hazard issue, most observers agree that debtor moral hazard, while a theoretical possibility, is not a serious problem in light of the short-term political consequences of most crises.[10] On creditor moral hazard, again few disagree with the theoretical possibility, and many argue that it could be a serious issue. Olivier Jeanne and Jeromin Zettelmeyer (2004) construct a model that demonstrates that IMF lending creates no moral hazard as long as the Fund lends at actuarially fair interest rates and the borrowing country seeks to maximize the welfare of its taxpayers. Supporters of the moral hazard view of IMF lending must challenge these assumptions. However, within the context of the Jeanne-Zettelmeyer model, IMF lending may lead to large capital flows and better terms. Disagreement remains with respect to interpreting the empirical evidence associated with IMF lending over the past decade.[11] Even if one accepts that there is concrete evidence of a moral hazard effect of IMF lending, has that moral hazard created a serious distortion to international lending in the direction of favoring such lending to developing countries in the context of many other distortions? That is the crux of the issue.

At the abstract level of ex ante IMF policy, few would disagree with the characterization offered by Managing Director de Rato early in his term and since then often repeated: "[W]e clearly also need a Fund that can say 'No' selectively, perhaps more assertively, and, above all, more predictably than has been the case in the past."[12] What is notable about this statement is not its clarity but the qualifications: selectively, more assertively, and more predictably. De Rato's view does not differ substantially from that of his predecessor Horst Köhler (Camdessus, de Larosière, and Köhler 2004):

> The IMF is not a lender of last resort in the traditional sense; it isn't capable of providing an unlimited amount of financing. Once a crisis hits, the IMF needs to be

10. A more reasonable concern is the risk of supporting programs that are too timid in their policy content or may not be adequately implemented, contributing to further crises.

11. Jeanne and Zettelmeyer (2004, 15) survey the empirical literature and conclude: "Without exception, the tests performed in this literature are incapable of distinguishing whether the effects of the IMF on market variables (to the extent that any are found) are a sign of moral hazard or simply an indication that the IMF is doing its job."

12. Managing Director de Rato made these remarks in a speech, "The IMF at 60—Evolving Challenges, Evolving Role," at the IMF/Bank of Spain conference, Dollars, Debt and Deficits—60 Years after Bretton Woods, on June 14, 2004.

> able to act quickly, and its involvement must be predictable to ensure that the private sector can play its part.[13]

How should the IMF strike the balance? Goldstein (2005a, 399–400) would move the pendulum further toward making it more difficult for the IMF to say yes. He would amend the Articles of Agreement to require supermajorities to approve exceptional access. He would also amend the Articles to require the managing director to sign off "explicitly" that any decision to grant exceptional access meets the requirements of the IMF's policy; at present there is only a strong presumption that any decision submitted to the Executive Board by IMF management is consistent with the IMF's conditionality guidelines and other policies, including access policy. Not only Rajan (2005b) but also Babb and Buira (2005) surprisingly favor tighter rules and less discretion. Rajan believes that discretion favors the borrower, and Babb and Buira believe that the borrower tends to be disfavored.

The relation between IMF lending and private-sector creditors during crises has been controversial at least since the 1980s. Contrary to the conventional wisdom, this is an area of evolution not revolution. Thus, Jacques de Larosière (Camdessus, de Larosière, and Köhler 2004) opines:

> The IMF cannot, and should not, provide all the financing for balance of payments problems; it has to count on private flows to do the bulk of the financing (heavy lending by the IMF to a few countries has become a serious issue for the institution and the system). Moreover, the IMF must develop a close relationship with the private sector and not turn a blind eye to it. . . . This was the rule in the 1980s. It still should be.

Roubini and Setser (2004) propose a comprehensive framework to address the role of the IMF during financial crises, the scale of its lending, and the participation of private-sector creditors: (1) distinguish promptly between liquidity and solvency situations, (2) adopt appropriate adjustment measures to match external financing with the nature of the crisis, (3) use large-scale IMF financing in a variety of circumstances, including in conjunction with coercive debt restructurings as necessary, (4) avoid the trap of countries (for example, Russia and Turkey) that are too strategic to fail, and (5) recognize that the IMF has a central coordinating role in the management of crises. Roubini and Setser recommend that the IMF create a crisis lending facility with lending limits of 300 percent of quota for one year and total lending of 500 percent of quota, which they regard as more realistic than the traditional limits of 100 and 300 percent of quota. However, they would allow these limits to be overridden with prespecified criteria.

13. Recall that Summers in a 1999 speech at the London School of Business also argued that the IMF has to be selective in providing its financial support.

The ECB (2005) task force favors the "effective" use and "predictable" commitment of all parties in debt crises (sovereign debtor, creditors, IMF, and creditor governments) to use available instruments (bond exchanges, rollover agreements, standstills, and, with less effect, capital controls and private contingent credit lines), with domestic creditors also bearing a part of the burden. They conclude from their review that crisis management practices have largely followed a case-by-case approach. In somewhat of a contradiction, they nevertheless favor efforts to improve the predictability of the process, including by reinforcing good relations between a debtor country and its creditors according to the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" (also known as the code of conduct) that first was agreed to in the fall of 2004 between a group of emerging-market countries and a group of representatives of private-sector creditors; a slightly revised version was issued in March 2005. The principles cover transparency and information flows, continuous debtor-creditor dialogue, good faith actions by debtors and creditors, and fair treatment.[14]

The central banks of Canada and England with support from a number of other commentators and institutions in the past have favored absolute limits on access to IMF financing in conjunction with standstills on debt repayments as the appropriate mechanism to deal with external financial crises and the issues of moral hazard and predictability.[15] Bedford, Penalver, and Salmon (2005), commenting more recently in a Bank of England publication, place greater emphasis on market-based mechanisms for facilitating sovereign debt restructurings with further improvements in bond contracts beyond the widespread adoption of collective action clauses (CACs) and wider adoption of the code of conduct. They also favor more rigorous and informed application of the IMF's framework for exceptional access to IMF financial resources and a review of the IMF's policy on lending into arrears (LIA), when a member country has arrears to external private-sector creditors. With respect to LIA, they want the IMF to

14. The IMF (2005f, 14) asserts that the draft principles in the code of conduct "are broadly consistent with many of the expectations from Fund policies aimed at the prevention and resolution of financial crises." Among the identified exceptions are (a) linking continuation of trade and interbank lines to continued debt service by the sovereign debtor, (b) requiring the debtor to engage with a creditor committee, (c) the absence of consideration of voluntary standstills on litigation, (d) the resumption of partial debt service as a sign of good faith on the part of the borrower, and (e) the presumption that if a country's sovereign debt to the private sector is sought to be restructured the debtor must at the same time seek to restructure debt with all bilateral official creditors (reversing Paris Club comparability). The same document (IMF 2005f, 16) welcomes the code of conduct but dryly observes that "many market participants were not aware" of the code or principles and others argued that it was yet to be tested and lacked precision on a number of points.

15. Although the two central banks have not formally adopted policy positions on these issues, their leaders have tacitly endorsed the approach espoused by Andrew Haldane and Mark Kruger (2001), two senior members of their respective staffs.

publish its debt sustainability analysis but not to specify the financial parameters of its program until the debtor has reached agreement on them with its private-sector creditors. If the IMF were to adopt this last proposal, it would amount to a partial reversion to its policy in the early 1980s when programs were not approved by the IMF until a critical mass of creditors had agreed to the financing presumptions in the program, which at that time were initially agreed between the country and the IMF.[16]

A more radical change advocated by some (mostly IMF bashers on the right) in the context of the Argentine case would be to eliminate the IMF's de facto preferred creditor status—the presumption that the IMF will be paid in full even as other creditors are not. This would not only fly in the face of the logic of the IMF as a lender of final resort but also would effectively kill political support for the IMF in many industrial countries, as some advocates of such a position would like.

Note also that many of the proposed approaches to countries' external financial crises presume that those crises principally involve sovereign debt issued under international law, for example, the IMF's proposed Sovereign Debt Restructuring Mechanism (SDRM). This has been the exception rather than the rule. Of the 13 major country cases through 2002, only Argentina principally involved sovereign debt, as well as, possibly, the contagion case of Uruguay. Moreover, by the time 76 percent of the designated portion of Argentina's sovereign debt was restructured in mid-2005, domestic law governed more than half of its sovereign debt de facto or de jure. I wrote (Truman 2001), immediately after the SDRM proposal was initially floated, that the proposal was too much (for the international financial system to accept at the time) and too little (it might be useful in a few cases, but only on the margin). My forecast was unusually accurate. The SDRM was cut back and put on the shelf. It did vastly accelerate the adoption and acceptance of CACs.

The Argentine case, of course, ultimately involved a sovereign default; widespread defaults on private-sector obligations to foreign and domestic creditors (including banks); a collapse of the domestic banking system; and restrictions on capital flows, domestic access to foreign exchange, and access to bank deposits. Thus, in reconsidering the appropriate role of the IMF as an international lender in this context, one should also reconsider the IMF role in crisis prevention with respect to balance sheet mismatches, the appropriateness of capital controls at least in crisis prevention, and other approaches to modulate booms and busts in international lending.

Finally, the IMF's role as an international lender is linked to its role in restructuring situations. If the IMF determines before or after a crisis

16. That practice was changed in 1989 to one of IMF lending into arrears to banks because over time the previous policy of requiring a "critical mass" of private-sector support was regarded as giving the creditor banks too much leverage in the context where the debtors generally were meeting their obligations. The IMF's LIA policy was extended in 1998 to bondholders.

breaks that a country faces a solvency crisis, the Roubini-Setser approach would call for a debt restructuring, perhaps a coercive restructuring accompanied by IMF lending to ease the burden on the country.[17] We have already seen that Bedford, Penalver, and Salmon (2005) want the IMF to stay out of the way and let "market mechanisms" operate.

In my view, the flaw in arguments that the IMF should not interfere with the market is that in crisis or near-crisis situations market mechanisms will likely break down, and the system does not have a natural replacement to play a coordinating role. Collective action clauses in sovereign bond contracts governed by international law are not a substitute where a large proportion of the debt does not take that form. Even where international bonds dominate, clauses promoting intercreditor coordination can be expected to have a limited impact because they do little to alter the leverage between the debtor and the creditors as a group. Once the debtor has defaulted, the creditors have essentially no leverage to force action. In the Argentine case, where the stakes were high, legal efforts have so far failed (Gelpern 2005).

It follows that it is reasonable for the IMF, as a collective institution, to address this market failure by playing a coordinating role. This is the view of Roubini and Setser (2004), and I fully agree with them. The resulting restructuring inevitably will have a political dimension, which is not surprising since one of the parties is a government and because of the necessarily political foundations of the IMF (Tarullo 2005). Moreover, one cannot duck the fact that the IMF has a financial interest in the outcome even if it has de facto status as a preferred creditor.[18] The issue is whether the alternative to the former traditional procedures would produce superior outcomes. I have my doubts.

In the case of Argentina after 2001, the IMF at Argentina's insistence but with the general support and often the vigorous encouragement of the G-7 countries abandoned its practice of more than 25 years of acting as a coordinator and umpire in debt settlements. That practice evolved during the debt crises of the 1980s, when Jacques de Larosière led the IMF, through the capital account crises of the 1990s, when Michel Camdessus was its leader.[19] In contrast, Argentina's 2003 IMF program did not establish any parameters for the country's offer to its bondholders—an omis-

17. Roubini and Setser (2004) do not exclude standstills, rollovers, or restructurings in the case of liquidity crises, with the IMF playing a coordinating role.

18. As noted earlier, many critics of the IMF call for the abandonment of its preferred creditor status. Roubini and Setser (2004, 253–54) successfully demolish their arguments.

19. IMF policy was not perfectly suited to every case, but it evolved. Some argue that the slow evolution of the 1980s and the delayed establishment of the policy of lending into arrears prolonged the debt crises of that period, which were global and not limited to Latin America. My view from the trenches was that the responsible officials of few countries wanted debt reduction much before it was on offer in the Brady Plan in 1989.

sion that Argentina exploited. Only belatedly did IMF management and the G-7 articulate a verbal formula describing a successful restructuring. It was defined as a restructuring that was "sustainable" and "comprehensive." Since the restructuring left Argentina with a public-sector debt ratio of more than 75 percent of GDP, one can doubt whether the result is sustainable. Since 24 percent of the relevant debt was not treated, it is certainly not comprehensive. By its own criteria, the IMF's noninvolvement produced a failure. Argentina may have failed as well. The perception is that greater IMF involvement would have provided a better deal for bondholders. In fact, IMF involvement might have produced an endorsement of deeper debt reduction.

Could the IMF have played a more forceful role? Of course it could have done so even though the Argentine government expressed no interest in the IMF playing such a role. The IMF was bluffed into supporting Argentina's economic program and effectively a partial rollover of Argentine obligations to the IMF. The Fund and its larger members had a choice. They failed to insist upon either of the two related conditions that Timothy Geithner in remarks before the Bretton Woods Committee on June 10, 2004, recommended in such situations: a credible medium-term adjustment program and a credible and monitorable framework for achieving a viable debt restructuring.

Notwithstanding these criticisms, many have applauded the IMF's nonrole in the Argentine debt restructuring. The US government was a leading supporter of that posture. To date, US government officials have expressed no regrets, although Randal Quarles (2005) both praised the progress to date and argued that more work needs to be done with respect to the residual defaulted debt. Allan Meltzer, in testimony on June 7, 2005, before the Subcommittee on International Trade and Finance of the US Senate Committee on Banking, Housing and Urban Affairs on the subject of IMF reform, praised the IMF for its noninvolvement and argued that its policy was "a big step forward." Reuters reported on July 29, 2005, that Managing Director de Rato insisted that the Fund should have no role in the negotiations between the Argentine government and its creditors. One can only speculate how de Rato is going to square his statement with the view that Argentina must have a strategy to deal with the remainder of its defaulted debt as part of any new IMF program. The IMF played a much more active role in the rescheduling of the external debts of the Dominican Republic in 2004; perhaps it has begun to learn its lessons.

Only time will tell about many aspects of the Argentine case. To date the largest sovereign debt default in history has passed without definitively answering any legal and policy questions surrounding it (Gelpern 2005). Argentina has faced rather limited legal consequences from its default and its bond exchange. Gelpern sees the associated documentation as progressive, not revolutionary. The next act in this debt drama again involves Argentina and the IMF despite the IMF's posture to date of noninvolvement.

Will the IMF management and a majority of its members once again blink and approve a program with Argentina without a plan to achieve comprehensive and sustainable settlement of its defaulted debt? If the answer is yes, this will only reinforce the principal conclusion so far from this sorry experience: Once a country has defaulted, the country—not its creditors—has most of the leverage. As a result of its noninvolvement posture, the IMF effectively allowed itself to be manipulated by the defaulting country into a posture perceived as against the country's creditors without articulating its position. This result, if it stands, will not enhance the stature of the IMF as part of the international financial architecture.

Support for Members with Large Debts

Countries that successfully emerge from financial crises and IMF programs with large stocks of sovereign debt (internal and/or external) and countries with large stocks of sovereign debt, for example, above 30 percent of GDP, that have not experienced financial crisis are particularly vulnerable to internal and external shocks that precipitate a crisis or another crisis. What should the IMF role be with respect to such countries?

One alternative is to monitor the countries and their performance via Article IV consultations, coaxing and cajoling them to adopt policies that place debt ratios on a convincing downtrend. Those countries that have emerged from a crisis might face a higher-than-normal bar as they seek to obtain additional IMF financial support at least until they have paid down a substantial fraction of their earlier IMF loans. Those countries that have yet to face crises would be dealt with the same way as the first group of countries, except that the bar to IMF lending might be lower.

At the other extreme, following Roubini and Setser (2004), the IMF could actively encourage and financially support debt restructurings that promise significant reductions in debt stock. Such preemptive restructuring would be difficult to sell to the market, but the long-run benefits to the countries might well offset the short-term costs. In effect, this was the approach attempted under the Brady Plan restructurings of commercial bank debt in the early 1990s.[20]

An intermediate alternative has been suggested by Derviş and Özer (2005): establishment in the IMF, in cooperation with the World Bank, of a Stability and Growth Facility (SGF) to help emerging-market economies with strong economic policies and large sovereign debt ratios achieve sustainable growth as they work down their debt ratios and to protect them

20. The Brady restructurings resulted in limited if any reductions in debt stocks as valued by the market at the time, but the gap between face value and market value was recognized, and repayments were reprogrammed.

from financial crises unrelated to their current economic policies. In effect, the IMF would provide financing against external debt shocks, creating demand for a bigger IMF.

Derviş and Özer suggest that countries such as Brazil, Ecuador, Indonesia, the Philippines, Turkey, and Uruguay might now qualify as long as their policies were judged ex ante to be strong enough. The proposal involves elements of both prequalification in terms of economic policies and insurance against unforeseen shocks. In principle, it would allow countries that experience, for example, a sharp drop in exports because of a global economic slowdown to run countercyclical fiscal policies, or at least not procyclical fiscal policies, in the context of a decline in domestic economic activity.

Many questions would have to be answered before the establishment of such a facility. One important question would be the likely need for additional IMF financial resources and how those resources might be assembled, which is the topic of the next chapter.

IMF Lending Programs for Good Performers

The SGF proposal outlined above is one variant on a number of proposals that would involve prepositioning IMF lending programs for countries that are "good performers." It does not require much imagination to sketch out other variants on this theme.

The first set of questions in connection with such proposals involves the definition of good performance. What objective indicators would be used to establish good performance? Candidates might include fiscal positions, average marginal and effective tax rates, debt positions of the government and country, exchange rate regimes or performance, international reserves, inflation rates, and condition of financial sectors, to name a few possibilities. Identifying good performers could be linked to IMF Article IV consultations or other IMF surveillance activities. Countries could automatically qualify, or they could apply for certification. Recertifying and decertifying countries presumably would involve the same procedures, but how those procedures would operate and with what frequency are other important questions involving political issues as well as internal IMF bureaucratic issues.

A second set of questions involves the conditions or context in which access to the facility could be activated. Would they be prespecified and objective as well? This would imply that access would be essentially automatic. Alternatively, the Executive Board might be expected to review evidence assembled by the IMF staff and endorsed by the management before funds were released.

A third set of questions is whether the IMF should lend only to countries that had qualified by meeting a (large or small) set of conditions. The

IFIAC (2000) majority endorsed the IMF playing essentially a quasi lender of last resort exclusively to emerging-market economies that had met a short list of four preconditions (Williamson 2001): (1) freedom of entry and operation for foreign financial institutions; (2) well-capitalized commercial banks; (3) regular, timely, and comprehensive publication of the maturity structure of sovereign and guaranteed debt; and (4) an unspecified indicator of fiscal probity.[21] Nothing was included with respect to the size of sovereign debt stocks, current account deficits, exchange rate regimes, inflation rates, or a number of other variables many would consider relevant to economic and financial stability. C. Fred Bergsten, who was a dissenting member of the Meltzer Commission with respect to this issue, points out (in testimony before the Subcommittee on International Trade and Finance of the US Senate Committee on Banking, Housing and Urban Affairs on June 7, 2005) critically that the suggested criteria would have permitted continued IMF lending to Argentina in the summer of 2001 but would not have permitted the Fund to lend to Brazil in 2002. Goldstein (2003, 238–44) also presents a detailed critical analysis of the IFIAC proposal.

The CCL provided a country in principle with an opportunity to seek preapproved financial support and a limited amount of automatic access. However, even this modest step in the direction of an insurance facility was tightly circumscribed. Many influential members of the IMF, in particular many European members, opposed the concept because they wanted slower disbursements and stronger policy conditions. No IMF members chose to apply for a CCL. The result was that the CCL was not renewed in 2003.

However, the idea of some type of IMF insurance facility is not dead. Most of the new ideas differ from the CCL in that the CCL used an application mechanism, and under most of the insurance type of schemes countries would be prequalified without formally applying. Daniel Cohen and Richard Portes (2004) have made such a proposal. Tito Cordella and Eduardo Levy Yeyati (2005) have as well. Barry Eichengreen (2004) expresses support for an Enhanced Monitoring Facility that appears to be a cross between the CCL and a full-blown insurance facility. Rajan (2005a) can be interpreted as endorsing consideration of such a facility as part of an IMF move toward greater reliance on rules than discretion.

Ralph Chami, Sunil Sharma, and Ilhyock Shim (2004) analyze the theoretical case for an IMF coinsurance arrangement and find it lacking in the face of information asymmetries and time-consistency weaknesses. On the other hand, such flaws affect most other elements of macroeconomic policymaking, and policy is made nonetheless.

21. In extremis, a threat to the stability of the global financial system, the IFIAC said the IMF should be able to lend to other countries that had not prequalified.

At the more practical level, Timothy Geithner, in his remarks before the Bretton Woods Committee on June 10, 2004, laid out five key elements of a credible IMF insurance mechanism: (1) a policy framework that can be counted upon to restore confidence, (2) a scale of financing calibrated to need (potentially substantial), (3) flexibility to respond to external circumstances and the borrower's policy effort (implying scope for the front-loading of large amounts of financing), (4) use in the context of restructuring efforts, and (5) a more credible capacity for the IMF to withstand arrears in repayments. The Geithner elements clearly involve aspects of the IMF's operations that extend beyond relatively narrow issues of prequalification.

What are the prospects for a new effort in this area reaching fruition? UK finance minister Brown (2005) expressed some sympathy for the idea. His French counterpart, Breton (2005), supported it. The G-24 (2005) expressed cautious support for exploring the idea of a precautionary facility as long as it was adequately financed to deal with capital account crises. This is an idea whose time may not have come, but it is not dead either.

Support Without Lending

The IMF has long wrestled with the issue of how to support countries with strong or strengthening economic policies that do not need financial support or cannot afford financial support because of the financial cost of borrowing even from the IMF.[22] In effect, the IMF by approving such an arrangement would be providing a signal to the market or to other investors and donors. The IMF now has, and in the past has experimented with, similar instruments taking the form of (1) precautionary arrangements that permit a country to borrow even if borrowing is not expected,[23] (2) staff-monitored programs that involve no IMF resources and often have been used as precursors to regular programs, and (3) enhanced surveillance or monitoring by the staff or Executive Board sometimes in connection with programs that have recently ended.

One issue with respect to such mechanisms is how they should be linked with normal surveillance mechanisms, for example, Article IV consultations. Wouldn't the IMF become just another rating agency (Jack Boorman suggested this in remarks in London in November 2004), and what would be its value added? Another issue is whether the signal to the market or to other investors and donors tends to absolve those receiving the signal from doing their own due diligence—another type of moral haz-

22. See IMF (2004e) reporting on the Executive Board's discussion of this topic in September 2004 and related documents.

23. As of July 28, 2005, 3 of the 14 operational SBA or EFF arrangements were precautionary: those for Colombia, Croatia, and Paraguay. Often the proportion has been larger.

ard. A third issue involves the black-or-white character of off-on signals, when the true situation almost always involves shades of gray. A related very important issue is the implication of turning off a signal once it has been turned on. This, in turn, relates to the standards that are to be applied: Are the standards higher or lower for a regular standby arrangement or a precautionary standby arrangement or for a low-access arrangement even though the standards in the latter cases in principle are the same as in the former? Are standards in signaling mechanisms the same as those associated with upper-credit-tranche SBA and EFF arrangements or are they lower?

A final set of issues involves whether the signaling mechanism would be voluntary and whether it would be limited to one category of countries, for example, low-income countries or emerging-market countries, or would it be available for all categories of countries. If the use of the mechanism were voluntary, would there be any volunteers? How should their volunteering be interpreted?[24]

A special type of IMF support for a country, where only limited IMF resources would be involved, is a mechanism whereby the Fund provides an instrument to help a member cope with a negative external shock such as a drop in the price of a commodity that represents a large share of its export earnings by linking repayments to the IMF to an external index. The facility would assist the country to avoid procyclical fiscal policies.

Kristin Forbes (2005) has proposed such a mechanism for dealing with external shocks. Her proposal bears a family resemblance to the CFF, which provides countries a modest amount of access to IMF financing with low conditionality in the context of negative external shocks. The terms for access to the CFF have been tightened in recent years, which has contributed to sharply reduced use of the facility compared with the 1970s and early 1980s. Buira (2005a, 23–24) suggests that a more representative governance structure at the IMF might lead to a reversal of these trends.[25]

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24. The answer to the first question appears to be yes. The Nigerian government indicated in the summer of 2005 its interest in utilizing such a mechanism as the basis for obtaining a write-down and rescheduling of its bilateral official debt. The Paris Club indicated its willingness to accept such a policy support instrument as the basis for such an agreement with Nigeria. The Paris Club press release of June 28, 2005, states that Nigeria would be receiving exceptional treatment in the interest of resolving Nigeria's long-standing arrears to Paris Club creditors. Normally, Paris Club agreements are predicated upon an IMF standby arrangement or the equivalent. We will see whether the exception becomes the rule. It is noteworthy in terms of the second question that Nigerian government officials have been quoted as saying that this form of IMF support will not involve conditions on Nigerian economic and financial policies.

25. It is of some note in connection with the CFF and related facilities that the G-8 finance ministers meeting in London on June 11, 2005, agreed that "the IFIs [international financial institutions] have a role in helping address the impact of higher oil prices on adversely affected developing countries and encourage the IMF to include oil prices in the development

At the IMFC meeting in April 2004, US Secretary of the Treasury Snow (2004) reopened IMF consideration of a mechanism (a policy monitoring arrangement) through which the IMF could provide support for members without lending:

> To strengthen its policy role, we favor the development of a new form of engagement for countries that do not have a financing need. Under this proposal, the IMF could assess an economic program prepared by the country itself and signal its view to donors, MDBs [multilateral development banks], and markets. Such a nonborrowing vehicle for close engagement would benefit both poor countries and emerging-market countries, as it will show that a country has clear ownership of its policies and is strong enough to stand on its own feet.

In April 2005, the G-7 and the IMFC indicated their support for the US proposal in the context of the IMF's engagement with low-income (PRGF-eligible) countries. Part of the rationale is that these countries cannot afford to borrow even on highly subsidized PRGF terms, and the proposed mechanism would be analogous to a grant of policy endorsement without financial resources.

At the April 2005 meeting of the IMFC, Germany's minister of finance, Hans Eichel (2005), indicated his support for the establishment of a policy-monitoring arrangement to assist countries in graduating from IMF financial support as long as the terms involved upper-credit-tranche conditionality and regular reviews by the Executive Board. The Canadian finance minister, Ralph Goodale (2005), also expressed support for the idea to strengthen surveillance relationships with developing countries in general, those with higher incomes as well as low incomes per capita.

Acting Under Secretary Quarles (2005) reported to the US Congress on progress in promoting the US initiative with respect to nonborrowing IMF programs. In his remarks, he left open the possibility that the mechanism would be available to all members of the IMF, not just to low-income members. Time will tell whether the mechanism will be generalized, but such a "policy support instrument" that does not involve IMF lending was put in place for low-income countries shortly after the 2005 IMF annual meetings.

Support for Low-Income Countries

IMF support for low-income countries, defined for these purposes as PRGF-eligible members, takes many forms.[26] They participate, of course,

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of facilities to respond to shocks." In November 2005, the IMF Executive Board established such an exogenous shock facility for low-income members and the United Kingdom and several other governments announced they would help finance it.

26. In September 2004, Managing Director de Rato, in remarks on June 14, 2004, at the IMF/Bank of Spain conference, Dollars, Debt and Deficits, stressed the IMF's partnership role in supporting its low-income members.

directly and through their representatives in all IMF activities. They all are covered by IMF surveillance. They receive technical assistance from the IMF. By definition they are eligible to borrow from the PRGF and to receive related forms of highly subsidized financial support. In principle, they are also eligible to borrow from other facilities, including the CFF, the EFF, and regular SBA. Those low-income countries that are also in the category of Heavily Indebted Poor Countries (HIPC) have, since 1999, been potentially eligible for partial reduction of their debts to the IMF and other international financial institutions, and a subset of them are now expected to be in line for 100 percent reduction of their debts to the IMF.[27]

It was not always the case that low-income countries had special IMF facilities. In 1975, when 49 of the current 77 PRGF-eligible countries were members of the Fund, 28 of them had credit outstanding to them from the Fund on regular financial terms. For the most part, the absolute poverty of these countries was no lower in 1975 than it is today. At that time, the international community was less sensitive to the buildup of their external debts, more optimistic that low-income countries would be able to grow out of their debts, or more concerned that special facilities distorted the universal character of the Fund.

Another important change during the past 30 years has been the progressive shift of the IMF from balance of payments lending into longer-term, structural adjustment lending, which accelerated in the late 1980s (Bird 2003, 2–10). First, the IMF in 1975 established a Trust Fund with some of the proceeds from its gold sales for lending to low-income countries. In 1976 the EFF was created. In early 1986, a Structural Adjustment Facility (SAF) replaced and absorbed the Trust Fund. In 1987, the SAF was transformed into an Enhanced Structural Adjustment Facility (ESAF). However, "structural adjustment" had a bad ring to it. Moreover, the NGO community criticized the ESAF because, with some reason, it saw structural policy conditions being imposed on countries merely so that they could qualify for loans that were largely employed to refinance old loans from the IMF. Thus, the ESAF morphed into the PRGF where, in principle, the borrowing country through the participatory drafting of its PRSP has a greater say in the policy conditions. This process is described as an effort to improve ownership and performance. To some observers it is a manifestation of IMF and World Bank policy failure.

The transformation of the nature of IMF lending to low-income countries into structural lending, by one name or another, has meant that the IMF increasingly has become involved with policy issues that had been principally the responsibility of the World Bank. Similarly, the Bank has

27. The G-8 proposal for 100 percent reduction of debts of certain HIPC borrowers from the IMF has implications not only for those countries but also for the IMF's involvement with them and potentially for the IMF's financial structure because of the involvement of the IMF's gold. The IMF Executive Board reached agreement on this new "multilateral debt relief initiative" on November 7, 2005.

become more involved in and conscious of the macroeconomic and financial policies of countries receiving World Bank loans. Consequently, the Fund and the Bank have been called upon to collaborate more intensively and with mixed results.[28]

Three issues are on the agenda for IMF reform with respect to its support for low-income members: Should the IMF continue to lend to these members? Should the IMF's involvement in PRGF lending be terminated? If IMF participation in PRGF lending is terminated, what type of lending arrangements for low-income countries, if any, should take its place?

The Bush administration, aggressively following up on initiatives of the Clinton administration with respect to the development agenda for low-income countries (HIPC relief and greater reliance on grants), has included on its expanded agenda a number of elements involving the IMF's support of such countries. Secretary Snow (2004) at the April meeting of the IMFC advocated that (1) the IMF continue to lend to poor members but only for balance of payments needs; (2) development needs should be met by development banks and bilateral donors, not the IMF; (3) the IMF should marshal grants to support strong performers and those facing macroeconomic setbacks; and (4) low-income countries with strong fundamentals should move beyond PRGF borrowing to nonborrowing engagement with the IMF.

The US-supported elements are part of an ongoing debate about the IMF with respect to low-income members. The basic argument for continued intensive IMF involvement with its low-income members is that good macroeconomic policy is crucial to economic development, growth, and the reduction of poverty. The management and staff of the IMF are not inclined to back off from engagement with its low-income members. In their view, the IMF is the accepted international arbiter of such policies and must be continuously engaged in their support and evaluation. Furthermore, if the IMF is to play its role effectively, it needs to use its "own money" as leverage.

In April 2004, before the IMFC meeting, the Executive Board (IMF 2004b) expressed its continued support for the IMF's "important role in low-income member countries in terms of surveillance, policy advice, financing and technical assistance." Most directors preferred the continued availability of small PRGFs. Many directors did not support precautionary PRGF arrangements—an alternative to nonborrowing support.

The spring 2005 IMFC communiqué devoted five paragraphs exclusively to the IMF and its support for low-income countries, demonstrating little appetite to disengage from lending to low-income members. The

28. This collaboration and the issues that give rise to the need for it are not limited to the low-income countries. Structural issues are part of IMF-supported programs with most members, and the Bank since the 1980s has been—some would say excessively—conscious of the macroeconomic and financial context of lending to all of its borrowers.

French finance minister, Thierry Breton (2005), explicitly said that the existing PRGF is a suitable tool for the IMF as a universal institution to use to support low-income countries.

With respect to collaboration between the Fund and World Bank on country programs and conditionality, the IMF executive directors (IMF 2004c) concluded that the evidence supported renewed support for the existing operational framework for such collaboration. At the same time they stressed that there was no room for complacency with respect to country ownership and tensions over the coverage of conditionality and the scope and pace of reforms.[29]

All observers do not accept the status quo with respect to the IMF's role in the PRGF. Allan Meltzer, in testimony on June 7, 2005, before the Subcommittee on International Trade and Finance of the US Senate Committee on Banking, Housing and Urban Affairs, consistent with the majority recommendation of the 2000 report of the IFIAC that he chaired, stated simply that the PRGF should be closed. The Council on Foreign Relations (1999) report implied as much in its recommendation that the Fund and Bank should refocus on their respective core activities. C. Fred Bergsten, a member of the IFIAC, stated before the Subcommittee on International Trade and Finance of the US Senate Committee on Banking, Housing and Urban Affairs on June 7, 2005, that he would prefer to transfer the PRGF to the World Bank because the Bank's primary mission is poverty reduction. Nancy Birdsall and John Williamson (2002) recommend that the PRGF be transferred from the IMF to the World Bank to make the PRSP process the unambiguous responsibility of the Bank and to achieve some administrative savings. David Bevan (2005), commenting on a choice among (1) the status quo, (2) dropping the balance of payments facade associated with IMF lending to the low-income countries through the PRGF and adopting a more realistic IMF program of 25-year financial support, and (3) the IMF's getting out of the business of long-term loans, favors the third option. One wonders whether the prospect of 100 percent IMF debt reduction for a subset of the HIPC borrowers from the IMF under the PRGF will not and should not lead to a reassessment of this issue by the IMF's membership as a whole, leading to the third option.

If the PRGF were transferred to the World Bank, a question would remain whether the IMF should get completely out of the business of lending to low-income countries. Some say yes. Others argue that the possibility of lending to meet traditional, short-term, balance of payments needs should not be excluded. That appears to be the position of Canada's finance minister, Ralph Goodale (2005), who expressed support for limiting the PRGF to providing "rapid assistance to alleviate short-term external payments

29. The underlying document was based on a survey of Fund mission chiefs and Bank country directors. No doubt some of them were forthright in their responses, but one wonders whether there were not incentives to support the status quo.

distress" for low-income members of the IMF. This is a reasonable position, and such lending to very poor countries might also be subsidized.

What about ensuring sound macroeconomic policies in low-income countries? One approach would be that the IMF should continue to conduct its surveillance of the policies—macroeconomic and financial-sector policies—of its low-income members. The World Bank in its IDA lending should take account of the IMF's views. Where the Bank staff agrees with those views it should say so in its documentation and where it does not it should also explain its views. Continued Article IV consultations and ex post evaluations of IDA lending should over time induce more de facto coordination than occurs de jure today. The Bank would learn from its mistakes and pay for them. One problem some might reasonably argue is that the shareholders that would pay are also the shareholders in the IMF.

All of these issues are yet to be resolved.