Working Paper Series

WP 08-11 DECEMBER 2008

On What Terms Is the IMF Worth Funding?

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Abstract

In the first decade of the 21st century the International Monetary Fund (IMF) faced crises of legitimacy, relevance, and budgetary finance. It now confronts what likely will be the worst global recession since World War II, potentially huge demands for its financial assistance with limited resources, and calls for it to play a more central role in the international financial and regulatory systems. At the same time, the incoming Barack Obama administration must decide what to do about the modest package of IMF reforms that was completed in the spring of 2008. The package requires US congressional approval to go into effect. This paper reviews the recent, slow progress on IMF reform and makes recommendations to the Obama administration against the background of that record, the emerging global recession, and continuing financial turmoil. I recommend that the IMF package be reopened to include a doubling of IMF quotas and an amendment that will permit the Fund to swap special drawing rights (SDR) with major central banks to finance its short-term lending facility. I also recommend a special allocation of 50 billion SDR. If these proposals are turned down by the G-20 at its meeting in April 2009, I reluctantly recommend that the Obama administration seek congressional approval of the IMF package as it now stands because a failure to do so would seriously undermine the Fund as a central multilateral institution.

Keywords: International Monetary Fund, current account adjustment, exchange rates, financial turbulence, global recession, financial supervision and regulation

JEL Codes: F02, F32, F33, F42

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Author's note: This paper was prepared for a conference titled "The Global Monetary and Financial System and its Governance" held in Tokyo, Japan on November 11–12, 2008. I gratefully acknowledge the Tokyo Club Foundation for Global Studies for its financial support. I also thank Lewis Alexander, C. Fred Bergsten, Ralph Bryant, Benjamin J. Cohen, Scott Morris, and John Williamson for very helpful comments on the initial draft. None of them is responsible for the views expressed.

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Since the middle of this decade, the International Monetary Fund (IMF) has faced triple crises of legitimacy, relevance, and budgetary finance. IMF members endeavored to address these crises against the background of sharply diminished demand for IMF financial assistance as a consequence of a sustained period of global expansion despite, or because of, rising global imbalances. During the first 12 months of the global turbulence that started in August 2007, many observers noted disapprovingly that the Fund was on the sidelines. Some noted more critically that it was likely to remain there either by the intent of its members or by the design of the institution. Since September 2008, the Fund has been thrust back into the lending business amid some calls that it should also play a more central role in the supervision and regulation of the global financial system.

In this paper, I take stock of these developments and answer the question that will face the new Barack Obama administration: On what terms is the IMF worth funding? My answer to this question is not as straightforward as it would have been six months ago.

In the spring of 2008, after several years of intense discussion and a number of other policy changes at the IMF, an internationally agreed package of measures was approved and submitted to members for their ratification or acceptance. For the United States, the package involves (1) acceptance of an increase of about $7.5 billion (SDR 4.97 billion at $1.50 per SDR) in the US quota in the Fund; (2) approval of an amendment to the IMF Articles of Agreement and the US Bretton Woods Agreements Act that will increase the basic votes of each member of the Fund, fix permanently the share of basic votes in total votes, and provide for an extra alternate executive director for any constituency group of countries in the Fund with at least 19 members; (3) approval of a second amendment to the IMF Articles that will expand the powers of the IMF to invest certain of its financial resources; and (4) authorization for the US secretary of the Treasury to vote to approve the sale of a portion (12.97 million ounces, or 12.5 percent) of the IMF's 103.4 million ounces of gold, which is worth about $80 billion (at a market price of $800 an ounce).[1]

Action by the US Congress is needed for any of these measures to go into effect because they require approval by 85 percent of the weighted votes of the members of the IMF, and the current US voting share in the Fund is 16.77 percent. The George W. Bush administration submitted this package to the Congress on November 12, 2008 in a letter from Treasury General Counsel Robert Hoyt to House Speaker Nancy Pelosi and another identical letter to the President of the Senate Richard Cheney. The governments of the other members of the Fund, including, importantly, European members of the Fund with more than 30 percent of the voting power, also must act on the first three elements of the package

1. The first two elements of the package are linked in that the first cannot go into effect without the second. As a practical matter, the last two elements are also linked in that the expanded investment powers for the IMF will not be of much use if the IMF does not have the authority to invest the proceeds from the gold sales. Furthermore, although the US Congress could act separately on the four elements, or separately on the two pairs of elements, the four elements most likely would be voted upon as a package.

before they can become effective, but in most cases such actions are more routine than in the United States.[2]

Six months ago, I would have written that the package of measures requiring congressional action should be endorsed by the incoming administration and resubmitted to the Congress and that the Congress should vote its approval. Although the package and other changes at the Fund over the past several years fall short of what I would have liked, rejecting them would pose an existential question. Given the broad endorsement that the package had already received and would likely automatically receive from other countries, if the United States were to reject the package or fail to ratify it, this country would be turning its back on the Fund as the preferred locus of multilateral approaches to the solution of common problems. Without US support, the IMF would not disappear, but its role as a major institution of global governance promoting economic growth and financial stability would be further reduced. One qualification to this earlier answer remains relevant: I assumed that negative US congressional opinion on China's exchange rate policies would be mollified by further substantial appreciation of the renminbi (RMB) against the dollar, as well as other currencies, by the time any final votes were taken.

Writing in late November 2008, I would further qualify my answer. My principal recommendation to the incoming Obama administration is to explore with other countries reopening the package on an expedited basis. The new administration should seek to include in the expanded package: (1) a further change in the formula used to guide the allocation of quotas in the Fund in the direction of giving less weight to the traditional industrial countries, (2) a doubling of IMF quotas with the allocation of increases based on the revised quota formula and a parallel doubling of the amounts that the IMF can borrow from members under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), (3) a consequent further adjustment of voting shares in the Fund of at least five percentage points away from the traditional industrial countries, and (4) an allocation of SDR 50 billion (about $75 billion).[3] I also recommend (5) that the Obama administration seek authorization for the Federal Reserve to swap unlimited amounts of US dollars for SDR issued by the Fund for up to two years and an amendment of the IMF Articles of Agreement to allow the Fund to swap SDR for the national currencies of the United States and other countries issuing currencies that are heavily used in international finance. These national currencies would be used to finance a short-term liquidity facility in the IMF to assist member countries in supporting the international operations of financial institutions chartered within their jurisdictions. The aim should be completion of congressional action on the entire package by the end of 2010.

2. The two amendments of the Articles of Agreement also require approval by three-fifths of the members of the IMF before they can go in to effect.

3. Only item 2 requires congressional action. The US quota in the IMF is currently SDR 37.1 billion (about $55.7 billion) and its GAB/NAB commitment is SDR 6,640 million (about $10 billion).

This paper, first, reviews progress on IMF reform over the past several years. The second section examines the role of the IMF in the unfolding global financial crisis and how that should affect the answer to the question posed in the title of this paper. A final section returns to the title question.

My review of IMF reform loosely follows the recommendations in my strategy for IMF reform (Truman 2006b). That strategy was based on a conference held at the Peterson Institute for International Economics in September 2005 (Truman 2006c). At that time, there were other IMF reform proposals, including one by a previous IMF managing director, Michel Camdessus (2005), and another by the then-current managing director, Rodrigo de Rato (IMF 2005a). There have been others since, for example, by the current IMF managing director Dominique Strauss-Kahn (2008) and others calling for broader reforms of the international architecture such as World Bank president Robert Zoellick (2008) and British Prime Minister Gordon Brown in the *Washington Post* of October 17.[4] However, my agenda provides a framework to discuss progress on reform issues during the past three years.

Before proceeding to the review of recent IMF reform accomplishments, it is useful to remind ourselves what we mean when we refer to the IMF. The Fund, first and foremost, consists of its member countries as represented on the 24-member executive board or on the "advisory" International Monetary and Financial Committee (IMFC). In particular, if the members cannot reach consensus on IMF reform or on the role the Fund should play in the international economy and financial system, the Fund as a functioning institution will be severely hampered. Even without consensus, the Fund is not completely stuck because the management of the institution, in the person of the managing director, can propose, prod, embarrass, and otherwise try to lead the members of the organization to endorse proposals that promote the IMF's objectives in the world economy and financial system. In doing so, the managing director can be substantially helped, or hindered, by the imagination and technical quality of the work of the IMF staff.

THE STATE OF PLAY ON IMF REFORM

In 2005, I identified six components of an IMF reform agenda: (1) substantial progress on IMF governance; (2) greater attention to the policies of a broader group of systemically important countries, in particular their exchange rate policies; (3) reestablishing the central role of the Fund in external financial crises; (4) refocused engagement with low-income members; (5) attention to the capital account and the financial sector; and (6) the need for additional IMF financial resources.[5] This list did not include financing the administrative budget of the IMF, in contrast with its lending operations. However,

4. Gordon Brown, "Out of the Ashes," *Washington Post*, October 17, 2008, available at www.washingtonpost.com (accessed on December 9, 2008).

5. I argued that the first three items in my six-part agenda were relatively more pressing.

Mohamed El-Erian (2006) addressed the issue at the conference, and I will cover the topic under the sixth heading below.

IMF Governance

The principal focus of the recent IMF governance debate, and in fact the debate for at least 15 years, has been on the formulas that traditionally have been used as the basis for IMF quotas and, in principle, for periodic increases and adjustments in quotas. IMF quotas determine the amount of a country's own currency a member must lend to the Fund to finance its lending operations, are the basis for the amount a member may borrow from the Fund, and the principal component of absolute and relative voting power in the Fund. The distribution of voting power in favor of the traditional industrial countries derives from the history of the Fund and the application of the basic formulas as it evolved until the late 1970s when it was frozen (Truman 2006a, Cooper and Truman 2007).[6] On these twin issues, there have been some changes, but it is debatable whether these changes represent significant progress.[7]

With respect to the formula, the IMF executive board approved a new quota formula that replaced a combination of formulas (IMF 2008b). The single new formula is simpler to understand and at least some of the variables included are appropriate. The formula is a weighted linear combination of four variables: a member's share of global gross domestic product (GDP) with a weight of 50 percent, openness (trade in goods and services) with a weight of 30 percent, variability of current receipts and net capital flows with a weight of 15 percent, and international reserves with a weight of 5 percent. A "compression factor" reduces the relative shares of a handful of countries with the largest shares and boosts the shares of all other countries.

GDP appears as the weighted sum of two measures: GDP at market exchange rates (60 percent) and GDP at purchasing power parity (PPP) rates (40 percent). Thus, the new formula has five variables. Moreover, the GDP variables are the only ones that are free from criticism, although even here the weights that have been assigned to the two measures are controversial. As detailed by Ralph Bryant (2008a and 2008b) and by Richard Cooper and Edwin Truman (2007), the openness variable is not the conventional measure of trade as a percent of GDP, but rather it is each country's share of total trade in goods and services, reinforcing the influence of each country's economic size.[8] The variability measure also is not scaled by a measure of a country's economic size, so it also tends to "reward" large countries over

6. See also Bryant (2008a, 2008b).

7. For example, I advocated (Truman 2006a) a reduction in the combined voting share of the 26 traditional industrial countries by 10 percentage points from more than 60 percent to about 50 percent. The proposed change produces a quarter of this amount.

8. The measure has the added weakness that it fails to exclude intra–euro area trade.

small countries. Finally, in today's world, where the size of a country's reserve holdings is often a sign of the extent to which it has been impeding the international adjustment process, it is questionable whether that variable should be included in the formula at all.

After two and a half years of extensive, but not particularly imaginative, work by the executive board and the IMF staff, the resulting new quota formula was decidedly disappointing. The formula points in the wrong direction. At the time of its adoption, the new formula implied that the share of the 26 traditional industrial countries should increase by 2.2 percentage points vis-à-vis those of the other 159 members of the Fund.[9]

With respect to adjusting IMF quota and voting shares, the good news and the bad news is that the executive board ignored the formula in recommending quota adjustments. The result was that the advanced countries' combined quota share in the Fund is proposed to be reduced by 1.4 percentage points compared with where it was in 2005.[10] Under the agreed proposal, the combined voting share of the advanced countries would be reduced 2.6 percentage points, but almost half of that is due to the one-time tripling of basic votes.[11] Although a political and fairness case can be made for increasing the number of each member's basic votes (which have not been adjusted from the founding of the IMF in 1944), under the agreed proposals, the overall result for countries that are small in economic size is modest. The voting share of the 138 poorest members of the Fund would increase by a combined 0.52 percentage points, while their quota share would decline by 1.47 percentage points.

Some argue that the reforms should have done something about the US veto in the Fund, which is not an across-the-board veto but only allows the United States to block a short list of institutional changes that require an 85-percent majority vote. This could have been done by lowering the US voting share below 15 percent.[12] Alternatively the 85-percent majority requirements could have been reduced to 80 percent. My view has been, and remains, that until the Europeans agree to a substantial reduction of their combined voting share in the IMF from the current European Union share of more than 30 percent to something close to the US share, reducing the US voting share below 15 percent is a nonstarter. As a result of the proposed changes the EU voting share would decline only marginally from 32.5 percent to 30.9 percent. The Fund would remain a European-dominated institution.

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9. The new formula implies a set of pro forma quota shares for these countries, that is 1.8 percentage points less than the old formulas, but the old formulas had been ignored. The actual combined quota share of this group was 4 percentage points below what was implied by the old formulas.

10. The quotas of four members (China, Korea, Mexico, and Turkey) were adjusted in 2006 in the first round of the quota-reform effort, resulting in a slight reduction in the voting shares of the traditional industrial countries. The United States and a few other countries magnanimously gave up part of the increases in their quotas to which they were "entitled" under the application of the new quota formula, but this just underscores the weakness of the formula and the scope for blocking future progress.

11. A member's voting power in the IMF consists of a certain number of basic votes (to be raised from 250 to 750) plus one vote for each SDR 100,000 of its quota.

12. The US voting share is to be lowered by 0.3 percentage points to 16.732 percent compared with where it was in 2005.

Why were the Europeans able to work their way to prevent a meaningful shift in IMF power and influence in the Fund away from them, in particular given the overall lack of coherence in their national positions? One answer is that the two European managing directors (Rodrigo de Rato and Dominique Strauss-Kahn) who oversaw the process did not push hard for change because they needed European support on other issues. In particular, the staff was not encouraged to put on the table quota formulas that would point to significant change. A second answer is that the United States, which did push hard for and was open to substantial change, was not ready to go to the mat with the Europeans and raise the issue to the highest (i.e., presidential) political level. A third answer is that the other members of the Fund, which hold about 40 percent of the voting power and thus in principle were able to block any set of proposals, lacked the cohesion to do so and enough of them were bought off by the contents of the final package. My own answer is all of the above plus a lack of consensus in the membership about what was needed to enhance the IMF's legitimacy and why. The crisis of legitimacy was a rallying cry without well-directed content.

Some argued in the spring of 2008 that these proposed changes in the formula, in basic votes, and in actual quotas are just a first step, and the process will continue. Since it took 30 years to bring about these changes, one could be excused if one were skeptical about whether the members of the Fund will return to these issues to make substantial further adjustments in the near future, absent a cataclysmic event that transforms the debate. The issue is whether the global financial crisis and associated world recession provides that catalyst.

A second high-profile governance topic for the IMF has been the process by which it chooses its senior management—the managing director and three deputy managing directors. By convention, the managing director is a European and the president of the World Bank is a citizen of the United States. There have been various efforts to break this convention; see Miles Kahler (2001, 2006) for descriptions of those efforts. In 2007 Managing Director Rodrigo de Rato resigned, in the middle of the IMF reform effort he had initiated in 2005, and was replaced by Dominique Strauss-Kahn. His appointment came shortly after Robert Zoellick replaced Paul Wolfowitz as president of the World Bank. In both of these transitions, the convention held, though in the case of Fund, as has been the case in several previous elections, the election was contested. That has never happened in the World Bank.

On October 12, the Development Committee of the World Bank and IMF declared: "There is considerable agreement on the importance of a selection process for the President of the Bank that is merit-based and transparent, with nominations open to all Board members and transparent consideration of all candidates." This agreed approach, which is nonbinding, would only align the Bank's actual practices with those of the Fund during its last three elections of managing directors. Nevertheless, the US-European consensus may well be renounced or destroyed before the next elections, scheduled for 2012 at the latest.

The third governance topic is representation on the 24-member executive board, which is dominated by 7–10 Europeans depending both on how you count Europeans and on the day of the meeting.[13] Many critics and observers inside and outside Europe have endorsed a total or partial consolidation of European representation in the Fund (Ahearne et al. 2006).[14] As a facilitating step, the US government in early 2008 proposed (McCormick 2008) amending the IMF Articles so that all executive directors would be elected, along with a progressive reduction in the size of the board to 20 members from the current 24.[15] Nevertheless, the Europeans blocked any serious discussion of this issue. The only change that has been proposed is to amend the Articles of Agreement to provide for an additional alternate executive director in constituencies with more than 19 member countries.

This list does not exhaust the agenda for IMF governance reform. The Independent Evaluation Office (IEO) of the International Monetary Fund (2008) issued a critical evaluation of the effectiveness and efficiency of the governance structures of the IMF including the executive board, management, and the IMFC. In partial response, in September 2008, managing director Strauss-Kahn appointed a committee of eminent persons under the chairmanship of South African minister of finance Trevor Manuel "to assess the adequacy of the Fund's current framework for decision making and advise any modifications that might enable the institution to fulfill its global mandate."

One proposal favored by former managing director Michel Camdessus (2005) is the creation of a Council with formal decision-making power to replace what was once called the Interim Committee and is now called the International Monetary and Finance Committee.[16] The Development Committee, under this type of approach, might well become a body relating solely to the World Bank rather than its current status as a joint committee of the governors of the two institutions. The 2008 IEO evaluation of IMF governance endorsed the Council proposal as a device to force ministers to pay more attention to their responsibilities vis-à-vis the IMF. Such a device falls in the category of leading a horse to water without being able to force him to drink. Finance ministers in general are chosen to manage their own economies, are preoccupied by such domestic issues, and do not have the time, space, inclination, or experience to think in great detail about issues of the global collective good.

A final topic under the heading of IMF governance is how much of that governance should be

13. Does Europe include Switzerland or just the European Union? In some constituencies the alternate executive director comes from Europe while the executive director does not; for example, he may come from Mexico or Venezuela in a case where the alternate is from Spain.

14. I have proposed a multistep consolidation of European representation (Truman 2006a).

15. The Articles require that the five members with the largest quotas select rather than elect their executive directors. In fact, there are now a total of eight single-country constituencies (China, Russia, and Saudi Arabia in addition to the G-5 of France, Germany, Japan, the United Kingdom, and the United States).

16. The amendment of the Articles of Agreement that went into force in 1979 provided for the establishment of a Council.

exercised by outside bodies such as the G-7, the newly invigorated G-20, a slightly smaller group like the F-16 (Bergsten 2006), a new G-14 (Zoellick 2008), or one or more Gs but always with a secretariat supplied by the IMF (Strauss-Kahn 2008).[17] That there will be some type of steering committee for the IMF and global economic and financial topics more broadly is demanded by efficiency, as even Strauss-Kahn has admitted. That it should be broader than the G-7 is increasingly obvious. Exactly what form it should take is a more difficult question. As Bergsten (2006) argues, the size and effectiveness of any new steering committee is linked to the future of the European Union and its representation in international forums.[18] My expectation is that the meeting of the G-20 leaders in Washington on November 15, 2008, preceded by the meeting of the G-20 finance ministers and governors in Sao Paulo, Brazil on November 8–9, will be remembered more for marking the beginning of the end of the G-7 at both levels than for any resulting financial reforms. Crisis brings progress!

Policies of Systemically Important Countries

It follows from the observation that the G-7 is no longer an appropriate steering committee for the international economy and financial system that the list of systemically important countries should be lengthened.[19] For some time, many observers have argued that the IMF should be more assertive in its role as a global umpire. Much of the focus of such criticism has been to encourage the Fund (meaning members but also its management) to pay more attention to member countries' exchange rate policies (Goldstein 2006, Williamson 2006).

What does it mean to call for the IMF to be a "better global umpire"? Different countries and observers will offer different interpretations. At one level, a better global umpire would do a better job enforcing agreed rules, in particular when those rules are cast in the IMF Articles of Agreement as obligations of members of the Fund, which is the case for exchange rate obligations: to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members" (Article IV, section 1 (iii)). These are strong obligations, but the management and staff of the Fund in recent years (through at least mid-2007) had failed to enforce them.[20] The responsibility for that failure lies in part with the Fund's member countries. Consensus on the interpretation of those obligations had dissipated, if it ever existed. Moreover, some countries had their own agendas. The members of the European Union wanted

17. Bergsten's "F" was intended to distinguish meetings at the level of finance ministers from meetings at the leader level, which would be designated with a "G."

18. See Bradford (2008) for a review of some of these representational issues at the leader level.

19. I argued this position in *A Strategy for IMF Reform* (Truman 2006c).

20. See IEO-IMF (2007) and Mussa (2008).

to build a fixed exchange rate regime (and later a common currency) and kept the IMF at arm's length when the exchange rate mechanism (ERM) came under stress in 1992 as well as in 2008 when pressures were building on the currencies of EU members that are not yet in the euro area. The issuers of the G-3 currencies (the US dollar, euro, and yen) have blocked discussions in the IMF executive board of the global exchange rate arrangements for more than a decade.

In areas of the IMF's responsibility other than exchange rate policies and their economic effects, the obligations on IMF members are generally less well defined.[21] An example is the obligation to cooperate in the pursuit of common economic and financial objectives via participation in the surveillance activities of the Fund—bilateral, regional, and multilateral. To be successful in these areas, the members of the Fund must, first, share a consensus on the role of the Fund; second, recognize a common interest in preserving and protecting that consensus; third, be willing to allow Fund staff and management to call them to task about their associated obligations and commitments; and fourth, tolerate those processes even when doing so is politically inconvenient. For its part, the management and staff must play its assigned role consistently over time and across member countries. For the umpire, not only are the rules important, but their consistent application is as well.

Over the past several years, IMF members (via the executive board) and management (via the staff) have endeavored to update the IMF's surveillance role, in particular, with respect to the systemically important countries: expanding the list of such countries, revamping the 1977 decision on surveillance over the foreign exchange policies of members, addressing the problem of global imbalances, and establishing a set of surveillance priorities.

With respect to expanding the list of systemically important countries, the IMF management expanded the country coverage of its staff-level Consultative Group on Exchange Rates (CGER) to include a number of emerging-market members, and the staff published a report on their methodology for doing this work (Lee et al. 2008).[22] The IMF staff also started to incorporate into Article IV documents its judgments about whether a member's exchange rate was undervalued or overvalued, but many members deleted or scaled back this material before the reports were released to the public. In general, my unscientific impression is that there has been somewhat of an increase in the critical content about countries' economic and financial policies in Article IV documents with limited impact in particular in the case of exchange rate policies.

21. One exception is the obligation to provide certain information to the Fund. Not all members are scrupulous in this area either.

22. The IMF did not take the advice of John Williamson (2006): to establish a set of reference exchange rates for major currencies to guide the IMF in conducting its surveillance of exchange rate and other economic policies of members. William Cline and Williamson (2008) endeavored to plug this hole by publishing a set of fundamental equilibrium exchange rates for major countries and currencies consistent with internal macroeconomic balance and external imbalances.

On revamping the 1977 decision on exchange rate surveillance, the executive board reached agreement on a revised decision in June 2007(IMF 2007b).[23] It introduced two new concepts, "external stability" and "fundamental misalignment," into the review of members' exchange rate policies.

The decision has been severely criticized for not breaking any new ground and confusing, rather than clarifying, the nature of the exchange rate obligations of members under the Articles of Agreement. The decision sidesteps issues of multilateral surveillance and policy consistency and essentially gives a pass to any country whose exchange rate is floating, such as Japan, but nevertheless may be frustrating the functioning of the balance of payments adjustment process. Stanley Fischer (2007) has been critical of the decision for placing too much emphasis on external stability and too little on other policies, such as fiscal policies, that may affect internal balance and external adjustment.

More importantly, more than a year later the new decision has produced no tangible results on exchange rate policies. It is widely understood that the IMF staff have identified for the executive board situations that, under the new decision, merit consideration of the implications of a country's exchange rate policy has for its own external stability or that may involve fundamental exchange rate misalignment, but the board has declined to accept the staff's judgment. In addition, the conclusion by the executive board of several countries' Article IV consultations has been delayed, including in the important and sensitive case of China.

In response to some of these conceptual and procedural concerns, the executive board in August 2008 agreed to a clarification that involves inter alia the option of a board decision to authorize an ad hoc consultation with a member in cases where a member may not be observing the principles for guidance of its exchange rate policies that have been adopted by the Fund or where its exchange rate may be fundamentally misaligned (IMF 2008a).[24] We do not yet know whether this process will ever be used or yield meaningful results.

With respect to global imbalances, in the spring of 2006 the management of the Fund initiated a "multilateral consultation" involving China, the euro area, Japan, Saudi Arabia, and the United States. The Fund, in effect, dealt itself into the policy coordination business essentially for the first time since the collapse of the Bretton Woods system of fixed exchange rates.[25]

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23. This action implemented one of Goldstein's (2006) triad of recommendations in the area of exchange rates.

24. This action partially implements one of Goldstein's (2006) suggestions that the IMF management should be more active in the use of ad hoc and special consultations, but the twist is that the suggested procedure involves the executive board, which may be a good thing if it produces any concrete results, rather than just involving the management and staff. The Fund has not acted on the third element of the Goldstein triad: issuing a semi-annual report on members' exchange rate policies based on a reference exchange rate framework.

25. The IMF management did not accept my 2006 recommendation to hold a collective consultation with major Asian countries on exchange rate issues. My view at the time was, and still is, that such a broad approach might produce more results in terms of relaxing exchange rate policies than focusing on China's policies alone.

However, as far as one could tell, the management of the Fund exerted no pressure on the participants to make new, specific policy commitments. The participants' resulting statements of policy intention in April 2007 were not new and not news. In some respects, they were less explicit than those contained in the G-20 Accord for Sustained Growth issued in Melbourne, Australia in November 2006, which followed the release by the IMFC in September 2006 of a policy strategy for all countries.

The proposed measures envisaged a process of "immaculate adjustment," in other words adjustment without significant exchange rate changes. The only mention of exchange rates was by Saudi Arabia, which said that it would not alter its peg to the US dollar, and by China, which again said that its "exchange rate flexibility will gradually increase." For the United States, Japan, and the euro area, there was no mention of exchange rate adjustment. This is not *Hamlet* without the Prince, it is *Hamlet* set in Never-Never-Land.

In hyping up the limited achievements of the multilateral consultation process, the IMF management's earlier warnings about the risks of external adjustment were turned upside down. In place of a concern that there would be too little in the way of preemptive policy actions, the first deputy managing director John Lipsky (2007) declared, "excessively precipitous policy actions undertaken with the sole aim of immediate and substantial reductions in imbalances could be unnecessarily disruptive to global growth and could even undermine financial market stability." It is rare to hear a responsible official charged with promoting policy adjustment worrying about a decline in the US budget deficit that is too large, an appreciation of the Chinese RMB that overshoots, or economic reforms in the euro area or Japan that are too rapid. At the time, the IMF staff (2007c) claimed the results "would in combination constitute a significant further step toward sustaining solid economic growth and resolving imbalances." In other words, nothing new needed to be done to reduce the imbalances, which would take care of themselves.

Let's look at the recent record of adjustment in global imbalances. In 2006, at the start of the multilateral consultation, the US current account deficit was 6.0 percent of GDP. In October 2008, the IMF (2008g) projected that the US deficit would reach 3.3 percent of GDP in 2009—a decline of 2.7 percentage points—and 2.8 percent in 2013. China's current account surplus in 2006 was 9.4 percent of GDP, rose to 11.3 percent in 2007, and in October 2008 was projected to decline to only 9.2 percent in 2009—a net decline of 0.2 percentage points—and to rise back to 9.9 percent in 2013. The subsequent collapse in energy prices and plunge of the global economy into recession may alter these estimates and forecasts, but the failure of China to adjust while the United States has adjusted is palpable.

Where is the major imbalance in the global economy today? It would appear to be in China. What has happened to China's real effective exchange rate since it moved to a more flexible exchange rate regime in July 2005? From June 2005 through February 2008, the RMB had appreciated 15.6

percent on the broad index calculated by the Bank for International Settlements. Through November 2008, it had appreciated a further 10.3 percent, largely because of the US dollar's 12.3 percent real effective appreciation over this period. (The RMB only rose 4.2 percent against the dollar from the end of February through the end of November.) It should be noted that William Cline and John Williamson (2008) estimated that the RMB would have to appreciate in real effective terms almost 20 percent from February 2008 as part of a balanced global set of exchange rate adjustments in which the Chinese current account surplus would be cut in half.[26] These facts, along with the additional consideration that the Chinese authorities have been able to persuade the IMF management and their executive board colleagues to delay the completion of China's 2007 Article IV consultation for more than a year, point to the conclusion that IMF members, management, and staff have been ineffective in discharging their responsibilities with respect to the global adjustment process and exchange rate policies.

Finally, with respect to IMF surveillance more generally, as a part of the IMF executive board's triennial surveillance review, it approved a statement of surveillance priorities under the prodding of certain of its members, the United Kingdom in particular (IMF 2008c, 2008e). It remains to be seen what this initiative will produce in substance; the laundry list of priorities is rather long. The four detailed economic priorities (resolve financial-market distress, strengthen the global financial system, adjust to sharp changes in commodity prices, and promote the orderly adjustment of global imbalances) and four detailed operational priorities (risk assessments, financial-sector surveillance and real-financial linkages, multilateral perspective, and analysis of exchange rates and external stability risks) appear to rule out very little.

Today, we hear three interpretations of the IMF's stewardship over the global economy and exchange rates over the past several years: (1) The Fund has unfairly and inappropriately focused on the position of China and a few other countries. (2) The Fund has been distracted from focusing on its primary mission of the promotion of global growth and, in particular, financial stability by the United States, which has been using the IMF to pursue a bilateral agenda to force the Chinese authorities to appreciate their currency. (3) The Fund has been totally ineffective. How should one evaluate these three interpretations?

The first interpretation contains a small grain of truth. The IMF has focused insufficiently on the exchange rates and policies, including policies other than exchange rate policies, of a broader group of

26. Cline and Williamson also called for substantial real effective appreciations from their February 2008 levels for the Singapore dollar of 24.7 percent (it appreciated 1.4 percent through November), Taiwan dollar of 9.0 percent (actual 0.6), Hong Kong dollar of 8.2 percent (actual 5.7 percent), and Japanese yen of 5.7 percent (actual 20.4 percent). In the case of the Korean won, their analysis called for a real effective depreciation of 3.5 percent from the February 2008 level, and it had depreciated by 29.4 percent through November. The comparable figure for India was a depreciation of 3.6 percent against an actual depreciation of 6.8 percent. These divergent movements in Asian exchange rates relative to the Cline-Williamson norms do not bode well for the global adjustment process going forward.

countries, starting with Japan and including the euro area and the United States. In its 2008 Article IV report on the United States released in July 2008, the Fund staff declared that the US dollar was somewhere between slightly undervalued and 30 percent overvalued. A year earlier, the Fund staff also reported that the dollar was overvalued by 10–25 percent, and US authorities disputed the reliability of the models producing those estimates. The US authorities' protest, in particular under the circumstances, undermined their broader case for more effective surveillance of exchange rates by the IMF. However, unlike the Japanese authorities, the US authorities did not insist that the estimates of the dollar's overvaluation be deleted from the published version of the report. The 2008 Article IV report on Japan released in July 2008 merely reported that the yen was undervalued and that the Japanese authorities also disputed the relevance of the staff's models.

The second interpretation, distraction from focusing on global financial stability, has been heard from those who from the beginning did not like the idea of the IMF criticizing their own exchange rate policies, in particular within the European Union but also in Asia, and therefore favored deflecting the Fund from focusing on the exchange rate policies of other countries. It is interesting that some of the same people who urged the United States to seek multilateral solutions to problems subsequently complained when the US authorities did so. However, there is no substance to the basic accusation. With approximately 3,000 employees until the recent staff cuts, the Fund has had ample staff resources to focus on both exchange rate policies and financial policies.

The third interpretation, ineffectiveness, sadly, is the most compelling. Managing director Strauss-Kahn was dealt a weak hand in the flawed revision of the 1977 decision on exchange rate surveillance and the in failure of the IMF staff and management in previous years to discharge their obligations under the IMF Articles, which in turn led members of the Fund not to comply with their own obligations under the Articles.[27] In effect, the management of the Fund downplayed substantially its umpire or regulatory role with respect to the exchange rate policies of members. It had failed Mervyn King's (2006) test of "ruthless truth telling."

One consequence is that the incoming Obama administration faces an uphill battle in pushing any IMF legislation through the US Congress unless the IMF (members, management, and staff) is dramatically more effective in persuading the Chinese authorities that it is in their interests as well as those of the system to allow a substantial further real appreciation of the RMB against most currencies as well as against the dollar. However, it is also evident from the adjustments in real effective exchange rates within Asia since February 2008 that the task of persuading the Chinese authorities has become dramatically more difficult.[28]

27. See IEO-IMF (2007) for the particulars of the failings.

28. See footnote 27.

Nevertheless, absent significant movement before the end of April 2009, when the new team at the US Treasury is scheduled to release its first semiannual report to the US Congress on International Economic and Exchange Rate Policies, and based on the position of candidate-for-president Obama, the Treasury's report is almost certain to conclude that the Chinese authorities have been "manipulating" the value of their currency to obtain or maintain a competitive advantage.[29] Under the legislation mandating the report, such a finding would trigger bilateral discussions between the United States and China, which of course have already been underway since late 2003 and most recently in the US-China Strategic Economic Dialogue.

More seriously, the finding of "manipulation" by the US Treasury will set up a fundamental conflict between the views of the IMF executive board and management and those of its largest member. This would be a no-win situation for China, the United States, and in particular the IMF. Interested bystanders can only hope for constructive action sooner rather than later: bilaterally, multilaterally, and through the efforts of other members of the IMF. It might start with an IMF-sponsored special consultation on exchange rate relations within Asia.

The Central Role of the Fund in External Financial Crises

"The IMF remains bedeviled by philosophical disputes about the scale and scope of its lending and crisis-related activities. These disputes distract the institution from its role as a global lender of final resort." I wrote these words in late 2005 (Truman 2006b, 532). However, until recently this statement had no operational significance because many countries were paying down their financial obligations to the Fund. IMF credit outstanding under the general resources account (GRA), which is financed out of IMF quota subscriptions, peaked on an end-of-year basis at $98.9 billion in 2003. By the end of 2005, it was down to $43.2 billion. As of September 30, 2008, it was $11.5 billion, but only two of the 23 countries with credit outstanding from the Fund had active programs with the institution (Gabon and Georgia).[30] Until very recently, the IMF had been out of the new lending business for several years.

The global financial crisis and unfolding global recession have changed all that. It is unfortunate that during the interim, members of the Fund were not able to reaffirm the IMF's central role in international financial crises, including in work-out situations and in establishing an insurance type of facility for countries with strong policies and a temporary need for external liquidity assistance.[31]

Given that IMF management backed off from its extreme, hands-off posture in the Argentine

29. If the Chinese authorities actually bring about a depreciation of the RMB against the dollar from its level at the end of November, a course on which they may have embarked in early December, the case will be all the stronger.

30. Three other countries had active programs but had not drawn upon them: Honduras, Iraq, and Peru.

31. These were my recommendations three years ago (Truman 2006c).

restructuring when they handled the Uruguay and Dominican Republic cases, there is some hope that if the coming global recession and associated emerging-market external financial crises produce a need, the IMF management will discharge its traditional role in mobilizing collective action among the creditors as well as actively providing advice to the debtors about the economic and financial implications of the arrangements they are being offered.

With respect to new financing vehicles, such as an insurance facility, members of the Fund have wrestled for the past decade with questions of the desirability and usefulness of a semi-automatic credit facility that would be available to countries with strong policies. In 1999, the contingent credit line (CCL) was created as a component of the supplemental reserve facility (SRF), which had been established two years earlier. The CCL provided for a specified amount of financing to be automatically available to countries that had previously been approved to receive it if conditions changed. Despite some interim tinkering with the CCL, no member signed up, and the mechanism was not renewed in November 2003. Nevertheless, discussions about a new liquidity instrument continued (IMF 2008c, 2008e). On October 11, the IMFC (2008) called for decisions on an "accelerated basis in those areas where there is strong consensus—such as the establishment of a new liquidity instrument—and on the full range of [lending and access] issues by the time of the 2009 annual meetings."

With respect to the insurance or liquidity facility, the traditional tension has been between those members who oppose any semiautomatic IMF lending (and in some cases any lending at all) without strong policy conditions associated with the lending and those who see such an insurance arrangement as a desirable addition to the IMF's arsenal of lending instruments in the 21st century. By mid-October, we had reached a point at which it appeared that a number of countries were being sideswiped by the global financial turbulence and no facility of this type was in place. We also witnessed the actual and potential emergence and use of bilateral or regional lenders or arrangements as substitutes for such a facility in the Fund.

In my view such a trend toward bilateralism and regionalism weakens the international financial system unless such arrangements are firmly anchored in the IMF via a parallel-approval or take-out process. In most cases, the borrowers see the arrangements as a substitute for IMF assistance that comes with conditions on economic and financial policies. At the political level, bilateral lenders underappreciate the financial risks involved and the political challenges associated with imposing even minimal economic and financial conditions on bilateral or regional lending.

Thus, the inability of the members of the Fund to agree on a semi-automatic disbursing facility during a period of calm meant that it was not there when the storm broke. Fortunately, the management and staff of the Fund were in a position to move quickly to force a consensus when the financial turbulence spilled over and became a full-blown global financial crisis in the second half of October as the world economy plunged into almost certain recession.

On October 29, the IMF executive board approved a new short-term lending facility (SLF) for a period of two years. Countries with very sound economic and financial policies and underlying fundamentals plus sustainable external and internal debt positions on the basis of their most recent Article IV consultations can draw up to five times their IMF quotas for three months with up to two three-month rollovers. The executive board notionally set aside an initial $100 billion out of its estimated total forward lending capacity of about $200 billion as of the end of September.

On the same date, the Federal Open Market Committee (FOMC) of the Federal Reserve System approved $30 billion in reciprocal swap arrangements with each of four emerging-market countries: Brazil, Korea, Mexico, and Singapore. It remains to be seen whether any country draws on the SLF and how that facility interacts with the Federal Reserve swap arrangements. (I will return to this topic in the next section of this paper.)

Given that countries can in effect prequalify for the SLF on the basis of their previous Article IV consultations, the issue in drawing on the facility is the associated stigma and the risk that doing so will trigger a further run on the country. Some are also concerned that the SLF will divide the membership of the Fund between those that qualify to draw and those that do not. Such distinctions are inevitable, and it should be noted that as of the end of November five countries had signed up for regular IMF programs.[32] Moreover, there should be the presumption that if any country cannot repay the IMF's SLF on the agreed terms, it will need to apply for a regular IMF program. Under current conditions of collapsing commodity prices and global demand, it also would be reasonable to refurbish the IMF's compensatory financing facility to provide quick-disbursing financing on a smaller scale than the SLF to those countries facing export shortfalls, as suggested by Morris Goldstein (2008b).

Refocused Engagement with Low-Income Members

The IMF's involvement with its low-income members has received extensive criticism, in particular from the NGO community, which often criticizes the Fund for focusing too much on macroeconomic stability and too little on economic growth and the reduction of poverty. Over the years, there also has been extensive criticism of the lack of collaboration (or presence of excessive competition) between the World Bank and the IMF with respect to these countries.[33]

For obvious political reasons, the Fund in recent years could not afford to pull out entirely from engagement with low-income countries; the authorities in these countries want the financial assistance

32. By the end of November, the IMF executive board had approved new traditional stand-by arrangements under existing expedited procedures providing financing of about $42 billion to Hungary, Iceland, Pakistan, the Seychelles, and Ukraine.

33. In 2006, I wrote, "the Fund should be more selective and focused in its engagement with its low income members, ready to assist them in areas of its comparative advantage, reluctant to add to their debts, and respectful of the skills and opportunities offered by institutions centrally involved with development issues" (Truman 2006b, 534).

the IMF might provide and, preferably, endorsement of their policies without strings. However, the Fund has pulled back from full-force engagement with its low-income members. Along with the Bank, it established a review group under the chairmanship of former Brazilian finance minister Pedro Malan to review Bank-Fund collaboration. The resulting report (IMF 2007d) is a sensible document that points in the direction of more cooperation and less competition across 19th Street in Washington, DC. To an outside observer, the Fund and the Bank appear to have been diligent in implementing the recommendations of the Malan Report.[34]

Following the implementation of, first, the Heavily Indebted Poor Countries (HIPC) initiatives and, later, the Multilateral Debt Relief (MDR) initiative, the debts of many low-income countries to official agencies, including debts to the IMF and the World Bank, have been substantially reduced. Some NGOs and parliamentarians continue to press for more debt relief, but at this point debt relief primarily is an issue for a few countries that have not yet qualified for existing programs. A more important issue is restraining the accumulation of new debt, for example, to purchase arms or that is otherwise thrust upon countries by bilateral lenders on commercial terms.

A total of 35 member countries have been assisted in their debt-relief programs through the IMF, 33 countries under the HIPC initiatives and an additional 2 countries among the 25 assisted under the MDR initiative. In recent years, again facilitated by benign conditions in the global economy as well as better policies, IMF credit outstanding to members under the Poverty Reduction and Growth Facility (PRGF) and related arrangements, which are financed primarily by loans to the IMF outside of its quota resources, had been reduced by 40 percent from an end-year peak of $10.5 billion in 2003 to $6.1 billion at the end of September 2008. Only 23 members had active PRGF programs, less than a third of the eligible total. A few countries have converted to, or established, "programs" under the Fund's new Policy Support Instrument (PSI) created in October 2005, which involves IMF endorsement and oversight of a member's policies, but no funding. To date six countries have taken advantage of the PSI: Nigeria, Uganda, Cape Verde, Tanzania, Mozambique, and Senegal, in order of the date of their participation. No country has participated in the past year. Nigeria's participation provided cover for a Paris Club debt-relief program.

The test of whether the IMF can continue its more balanced approach to its involvement in low-income countries will come with the pending slowdown in the global economy. Will the Fund, again, be drawn, or forced by the policies of high-income members, into stepping up its engagement to the point of unbalanced intrusion? I hope not.

Some observers favor the "transfer" of the PRGF and associated lending entirely to the World Bank.

34. For Managing Director Strauss-Kahn's view on the Fund's activities in low-income countries, see IMF (2008e.)

I doubt that is necessary as long as the IMF does not pass its tin cup to replenish significantly the PRGF's financing capacity. It would be preferable to allow the IMF's subsidized development-related lending to wither away except with respect to genuine short-term balance of payments needs. Otherwise, the IMF's involvement in the policies of low-income countries should be limited to advice on macroeconomic and financial policies conveyed during Article IV consultations and used to condition IDA and other lending by the World Bank Group.

The Capital Account and Financial Sector

"Capital account and financial-sector issues are central to the IMF's role in the 21st century. Technology, demography, and policy have converged to stimulate and release unprecedented global flows of capital" (Truman 2006b, 536). It was obvious three years ago that the IMF needed to make another attempt to reorganize its work on financial-sector and financial-stability issues. The global financial turbulence that emerged in August 2007 and escalated with virulence a year later confirms that judgment.

Following the report of the McDonough Group (IMF 2005b), the Monetary and Capital Markets Department was established and its semiannual Global Financial Stability Report has been gradually transformed into more of a forward-looking document along with quarterly updates. For example, this group produced early estimates of the size of potential losses by financial institutions from the global financial meltdown, estimates that were regarded as exaggerated at the time but that since have been confirmed as on the low side.

Nevertheless, criticism of the IMF's work in this area continues with some justification. See, for example, IEO-IMF (2006) for a set of judgments roughly coincident with those of the McDonough Group, and the more recent conclusion of the International Monetary and Financial Committee (IMFC-IMF 2008): "Work should also be undertaken toward a revamped Financial Sector Assessment Program that is better integrated with the Fund's surveillance mandate." (I return to this topic in the next section.)

A related issue is whether the IMF Articles of Agreement should be amended to clarify the IMF's role with respect to the capital accounts of members. Three years ago, I concluded (Truman 2006b, 563) that it is not essential to do so. However, in light of recent developments including calls for a more active role for the Fund on financial-market issues, it would be appropriate to revisit this contentious topic. The point should not be to compel all member countries immediately or even expeditiously to open their capital accounts. That should be set only as an ultimate goal. Meanwhile, the IMF would be provided with an updated mandate to assess and guide progress toward this objective in light of each country's economic and financial development. As argued by William Cline (2008), the risk is that the considerable benefits of financial globalization will be undervalued and the world will fall back on widespread capital controls in overreaction to the international financial crisis. An associated risk is an increase in financial protectionism under the guise of prudential regulation.

Finally, to complete this short review of the Fund's recent record on financial issues, I note with approval and satisfaction the institution's impressive contribution in facilitating the work of the International Working Group (IWG) of Sovereign Wealth Funds (SWFs) in expeditiously reaching agreement on a set of Generally Accepted Principles and Practices (GAPP) for SWFs (IWG 2008) that will help to defuse the issue of the role of these government investment vehicles and make the world safer for them. It is important that the IWG push forward on implementing the GAPP, using the IMF as its secretariat, to help to contain financial protectionism. Members of the OECD should also do more to strengthen and open-up their foreign investment regimes.

Additional IMF Financial Resources

In 2006, as IMF members were actively repaying credit received from the IMF partly as a result of benign global economic and financial conditions as well as of improved policies, I noted, "Wise observers caution that those benign conditions are coming to an end, and the demand for external financial support from the IMF is likely to rise" (Truman 2006b, 537). My implicit prediction of an immediate need to augment IMF financial resources was somewhat off the mark. At the time, I endorsed the proposal of Desmond Lachman (2006) that the IMF executive board should put in place a mechanism so it can borrow from the private market as a temporary supplement to its quota resources.

I also advocated that at the conclusion of the 13th review of IMF quotas in January 2008, members should approve a general increase in IMF quotas as part of an overall package to rebalance IMF quotas.[35] Unfortunately, not only was the effort to rebalance IMF quotas woefully deficient, the IMF executive board (meaning the members of the Fund, we do not know the recommendation of the management and staff) concluded the 13th review and declined to recommend a general increase in IMF quotas. The result is that the Fund faces renewed demand to lend to members. Moreover, such lending will be scaled on the basis of the size of each member's quota that was approved a decade ago when the world economy was substantially less than half the size that it is today. Consequently, in the context of the current emergency the Fund, as of early October 2008, was set to revisit the contentious issue of access limits (IMF 2008c, 2008e) rather than proceed to use limits based on new quotas that were agreed in January this year.

It is true that the IMF's current financial resources for lending are substantial, an estimated one-year forward commitment capacity of about $200 billion as of the end of August 2008. It is also true that total IMF quotas will have been increased by 11.5 percent since 2005 if the second round of ad hoc

35. See also Cooper and Truman (2007).

quota adjustments (of about 9 percent) is approved by members, starting with the United States, whose approval is necessary if the major portion of the increase is to go into effect.[36] However, very few of the 54 countries that would receive increases in their quotas are likely to need to borrow from the Fund over the next several years.[37]

How serious is the impending financial crisis for emerging-market countries? In October 2008, the Institute of International Finance (IIF 2008) estimated that its sample of 30 emerging-market (and formerly transition) economies would continue to run a collective current account surplus in 2008 and 2009 as they have over the past several years, but the estimated collective surplus is more than accounted for by China and Russia.[38] The surplus for this group of countries was $435 billion in 2007 and was estimated at $378 billion this year and $338 billion next year. However, nondirect investment inflows were $596 billion in 2007 up more than 50 percent from 2006, and they were projected to fall about 15 percent this year and another 15 percent next year, for a total decline of $280 billion with an estimated drop of $266 billion in net flow from foreign commercial banks.

These estimates, now almost certainly out of date, illustrate the error of focusing on net flows (the current account surplus and associated capital account deficit) rather than on gross flows (gross capital outflows—official and private—that slightly exceed large gross capital inflows). In 2007, all regions, with the exception of Central and Eastern Europe, had combined current account surpluses, but many countries in those regions with current account surpluses were receiving large gross capital inflows that have now dried up or reversed. The use of large accumulated holdings of foreign exchange reserves is only a partial and second-best (because of its high opportunity costs) option in these situations. Thus, we can understand why many emerging-market economies reluctantly have been turning back to the IMF for financial assistance, but they are doing so when IMF financial resources are under strain.

The major concern is not that the IMF will run out of financial resources to lend. The GAB and NAB are largely available. The IMF can easily borrow $50 billion in the market without amending its Articles of Agreement. The Japanese authorities have offered to lend the Fund $100 billion, and IMF management can pass the hat around more broadly. However, this is a sloppy way to do business. The G-7 countries' policies to starve the Fund of financial resources in order to limit Fund lending, or in the misguided view that the days for large-scale IMF lending were over, have proved to have been destructive to the health of the institution and the international monetary and financial system. (I return to this issue in the next section.)

36. In 2006, a first round of ad hoc adjustments in the quotas of China, Korea, Mexico, and Turkey boosted total IMF quotas by about 2 percent.

37. An interesting fact reported in IMF (2008c, table 1) is that only 35 of 185 members of the Fund have never used IMF credit, and a few of these countries, such as Germany, have used the Fund for other types of financial transactions.

38. The IMF (2008g) projects a current account surplus of $785 billion for all emerging and developing economies, but China, Russia, and the Middle East group account for $1,023 billion. In 2009, the corresponding figures are $612 billion and $875 billion, but they are based on the assumption of an oil price of $100.50 a barrel.

To the extent that the IMF gets back into the lending business, the budgetary crisis that it has faced in recent years should ease.[39] However, as was argued persuasively in the Crockett Report (IMF 2007a), since the lending activities of the Fund account for less than 25 percent of the administrative budget of the IMF, it is inappropriate to finance all of the Fund's activities from earnings on those activities. This is the rationale behind the proposal to sell 12.5 percent of the IMF's gold, invest the proceeds (in effect as an endowment), and use the income on those investments to finance the nonlending activities of the IMF. As noted in the introduction, this sensible step cannot be taken unless the US Congress authorizes the Secretary of the Treasury to vote for the gold sale.

THE IMF AND THE GLOBAL FINANCIAL CRISIS

It is ironic that a year or so ago, it was fashionable to argue that the IMF was irrelevant both as a lender and in its surveillance activities, that benign conditions would prevail forever in the global economy and the international financial system, and that all systemically important countries had effectively self-insured against future external financial crises. The conclusion was that the IMF's administrative budget was strapped and the institution had nothing useful to do in either its lending or nonlending activities. Starting in mid-September this year, the criticism shifted to "Where has the Fund been?" The chorus of critics said: The IMF is not discharging its duty to protect the international financial system. Some added: We must remake the international financial architecture with a central role for the IMF.[40]

As noted earlier, a subtheme of the recent criticism is that the IMF has been distracted from focusing on the emerging crisis by the US insistence that the Fund focus on members' exchange rate policies. An alternative, newly fashionable view is that by not focusing sufficiently on global imbalances, the IMF contributed to the crisis. A third view is that the United States contributed to the global financial crisis by refusing to allow a review of the weaknesses in its financial system under the Fund's Financial Sector Assessment Program (FSAP).[41]

39. Meanwhile, under pressure primarily from the major creditor countries, managing director Strauss-Kahn has implemented a program to cut the staff by about 10 percent from 3,000. This has involved the loss of senior people, but almost certainly is healthy in the medium term because it allows the institution to reorient itself.

40. A number of these people were prime ministers and presidents of countries that had over the previous two years blocked meaningful IMF reform.

41. Because I was personally involved, I know that in 2000 the US government agreed to have an FSAP review. That decision was reversed by the Bush administration. This was a political mistake. The United States should not have held itself aloof from the FSAP program. As of the end of September 2008, 126 members of the IMF had participated or were completing their participation in the program, including 15 of the 19 countries that are regular members of the G-20. The exceptions were Argentina, China, and Indonesia, as well as the United States. Recently, the United States finally agreed to participate, and China also has signed up. It is highly doubtful that an FSAP for the United States conducted, for example, in 2003, when it most likely would have been scheduled, would have produced a diagnosis of either the problem of excessive leverage in the US financial system or flawed housing lending standards. However, the United States might have

How the IMF handles the current global financial crisis, including any additional roles its members assign to the Fund, no doubt will affect the future of the Fund and support for the institution, including by the United States.

Prognostication has been clouded by the fact that what started out as an episode of financial turbulence with adverse effects primarily on the financial systems and economies of industrial countries has become a global economic and financial meltdown that affects all countries and most likely will be worse than the 1981–82 period of global recession. In the associated global debt crisis, the banking systems of all major countries were also threatened with collapse. One consequence of the current crisis was the meeting on November 15, 2008 in Washington of the G-20 at the leaders' level. Although the meeting was more about British Prime Minister Gordon Brown's efforts win the upcoming UK election and French President Nicolas Sarkozy's effort to cement a position as Europe's chief actor, the summit and the promise of another one before the end of April 2009 have altered the trajectory of, and efforts to manage, the crisis.

Diagnosis of the Crisis

From the individual and collective pronouncements over the past few months, and from discussions with colleagues around the world, it is clear to me that there is no shared diagnosis of the origins of this crisis. I am, therefore, concerned about acting prematurely on the basis of incomplete information and a lack of shared understanding. My own point of diagnostic departure is as follows:

Macroeconomic policies in the United States and the rest of the world, to a substantial degree, were jointly responsible for the crisis we are now experiencing. In the United States fiscal policy contributed to a decline in the US saving rate and monetary policy was too easy, too long. In Japan the mix of monetary and fiscal policies distorted the global economy and financial system. After Japanese growth was restored, fiscal policy was tightened and monetary policy was put in the deep freeze at approximately zero interest rates. Thus, Bank of Japan policy also was too easy, too long, contributing to global financial imbalances via the carry trade. Finally, many other countries also had very easy monetary policies in recent years, including many other Asian countries, energy and commodity exporters, and in effective terms some countries within the euro area. The accumulation of impressive foreign exchange reserves in many countries also distorted the international adjustment process, taking the pressure off of the macroeconomic policies of the United States and other countries.

The result was not just a housing boom in the United States, but also housing booms in many other countries, some to a greater extent than in the United States.[42] However, in addition to housing booms,

received some benefit, and the international financial system as well.

42. See, for example, IMF (2008g) for a broader treatment of recent housing booms.

there was a global credit boom fueling increases in the prices of equities and other manifestations of financial excess.[43]

Financial sector supervision and regulation, or the lack thereof, also played a role. However, without the benign economic and financial conditions and the associated belief that "this time it is different," the crisis would have taken a different form. National policymakers and officials in international institutions did not serve themselves or the system well by acting as cheerleaders for the remarkable run of economic growth with few signs of a dramatic rise in inflation until early 2008.

Benign conditions lead to lax lending standards, just as the night follows the day. In principle, financial sector supervision could have helped to curb the excesses associated with relaxed lending standards, but it did not do so in the United States nor in many other countries around the world. This is not to say that there was no competition in laxity among supervisors.[44]

In some cases, including importantly the United States in this regard, but again elsewhere, regulation and supervision were incomplete. The rise of what is now known as the shadow financial system had been going on for decades in many countries: money market mutual funds, special purpose investment vehicles, hedge funds, private equity firms, etc. In many cases, these entities were highly leveraged and used short-term funding to finance longer-term investments. We saw a gradual shift over several decades in financial intermediation from banks to other financial institutions that were less well capitalized and subject to less supervision. The global financial system became overleveraged, particularly in the United States, but also to varying degrees in other countries. When the funding dried up, the structure collapsed, and the deleveraging began.

Part of the overall picture was new forms of financial engineering, but such innovations have been a feature of domestic and international finance for decades. In many cases, the associated innovations were poorly understood, resulting in a failure of risk recognition, which is a necessary precondition for good risk management. It is noteworthy that these new forms were a global phenomenon. They contributed to the market dynamics once the crisis got underway, but they were not "the cause" of the crisis.

Finally, some argue that the problems faced by the global financial system today reflect the fact that about 50 large financial institutions are global and lacked adequate supervision. In this view, these institutions were the cause of the crisis because no single national financial supervisor or regulator could possibly understand the full scope of their operations. True, some global financial institutions have failed, or the authorities have decided to rescue them. However, the cause of their failures was not that they had multiple national supervisors. Moreover, I would argue that the technical aspects of the failures

43. The Bank of England (2008) and Issing et al. (2008) offer similar interpretations of the macroeconomic contributions to the global crisis.

44. The US Treasury's (2008) Blueprint for a Modernized Financial Regulatory Structure released on March 31, 2008 started out as an initiative to bolster the competitiveness of US capital markets—to further deregulate them.

themselves have had remarkably little impact on the evolution of the crisis compared with the fact that they failed. Size has been a problem and complexity has led to some decisions to rescue particular institutions in whole or in part, but their global scope has not been a major contributing factor.

I have set out above my own summary diagnosis of this crisis not to assert that I have all the answers but to illustrate the range of issues on which there is little or no consensus among observers on what went wrong and which country or countries or institution or institutions should be fingered for the blame.

My views on what is required in the period immediately ahead are motivated by four observations that have little to do with the diagnosis of the causes of the crisis, which can and should wait: (1) The global economy and financial system are in the midst of a massive deleveraging process. (2) The increased globalization of the world economy and, more important, of the world financial system in recent decades means that countries can run but not hide from this and future crises. (3) The incidence and virulence of future crises may be reduced by decisions taken in the wake of this crisis, but those crises will not be prevented. (4) What is important now is to cushion the impacts of the global recession and to restore stability to financial markets.

These observations point to the need for a strengthened IMF as a central institution of global governance as well as in its financial activities. This process should start as soon as possible, because the Fund must be part of the solution to the immediate problems. These observations also point to the desirability of setting aside reform of national and international financial systems until the impact of those obviously needed reforms is no longer procyclical—exacerbating the deleveraging process and deepening the global recession.

The Role of the IMF—Immediate Recommendations for the Obama Administration

In the lead up to the 2008 annual meetings, the IMF was thrust into a central coordinating role. It also is clear now that the IMF will have a financing role in connection with the global recession and with the financial crisis. I urge the Obama administration, working with its partners, to focus in the short run on shoring up the financial role of the IMF and laying a better foundation for this aspect of the Fund's work in the future. Reform of the financial system can wait.

First, to meet the immediate financing needs of the IMF, to help restore confidence that the Fund can discharge its responsibilities as lender of final resort, and in the process to help address the institution's crisis of legitimacy, the Obama administration should propose, preferably before the next G-20 leaders' meeting, a doubling of IMF quotas and of the Fund's emergency borrowing arrangements—the GAB and NAB. My proposals would respond to the commitment of the G-20 summit on November 15, 2008, for immediate action to "review the adequacy of the resources of the IMF, the World Bank Group, and other multilateral development banks and stand ready to increase them where necessary."

Augmentation of the lending resources of the Fund is clearly necessary. This would produce an additional $250 billion in the IMF's capacity to lend. This was approximately the Fund's total lending capacity as the global recession hit. Note that the Federal Reserve System has already lent other central banks more than twice this amount under its reciprocal swap arrangements.

The Obama administration should not merely propose the doubling of IMF quotas, but also should advocate correcting the error that was made in the existing package of IMF reform measures. They should address the IMF legitimacy issue by advocating a meaningful redistribution of quota and voting shares in the Fund. This will require revisiting the flawed new quota formula that was adopted in the spring of 2008 so that it points toward reducing the combined share of the traditional industrial countries over time. Using the revised new quota formula to distribute quota increases for all members sufficient to double total IMF quotas should produce a further shift of at least five percentage points in voting power away from the those countries.[45]

Second, the Obama administration should endorse a special one-time allocation of SDR 50 billion, about $75 billion.[46] This would increase the existing stock (SDR 21 billion) by about 2.5 times.[47] Even though the distribution of SDR would be skewed toward the industrial countries, some of those countries might need the international liquidity. Moreover, at a time of concern about global deflation and loss of confidence, this step would provide an economic boost in some countries.[48] Finally, it would help to blunt any tendency of countries to seek to build even larger stocks of international reserves as even larger self-insurance mechanisms. To the extent that this tendency takes hold, it would further distort the international adjustment process and potentially the global trading system. Every country cannot devalue its way to a current account surplus at the same time, and if too many try to do so, the resulting trade wars would be highly disruptive. If countries want to pursue strategies of building huge holdings of international reserves in order to cushion the international adjustment, at least they should do so without distorting the system as a whole and SDR allocations offer a means of doing so.

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45. The US voting share should be reduced but not below 15 percent. It will be necessary to change the proposed amendment on basic votes to preserve the intended share of basic votes in total voting power as agreed in the spring.

46. The allocation of SDR should be immediate to have the intended confidence effect. Therefore, it would have to be distributed on the basis of current quota shares.

47. The Obama administration should also make a commitment to seek the ratification of the fourth amendment of the IMF Articles of Agreement. The amendment would provide for a special one-time allocation of SDR 21.9 billion. The IMF governors approved the amendment in September 1997. The initial motivation was to provide allocations of SDRs to members that had joined the Fund since the first allocations in 1970–72 or the second allocations in 1979–81, in particular Russia but also other countries. The United States was a strong supporter of the initiative. After the collapse of Russia's IMF program in 1998, the US administration lost interest and never submitted the amendment to the Congress. The IMFC, most recently on October 10, has repeatedly called for acceptance of the amendment. It is an embarrassment that the United States has not done so, and it would be consistent with the thrust of my other recommendations on IMF liquidity and legitimacy if the US authorities promised to remove their roadblock.

48. One of the standard arguments against SDR allocations is that they would be inflationary because the developing countries that received the allocations would in effect spend them in the industrial countries.

Third, the Obama administration should propose an amendment to the IMF Articles of Agreement that would allow the Fund to swap SDR for national currencies of certain (to be determined) members whose currencies are central to the functioning of global financial markets. The currencies would be used to fund the short-term lending facility that has recently been created by the Fund. This would centralize the responsibility and risk of extending the type of liquidity support that the Federal Reserve has been providing to other central banks over the past 12 months—more than $500 billion of such credit—and that other central banks such as the Swiss National Bank (SNB) and the European Central Bank (ECB) have been providing on a much smaller scale as well. This authority would help to support the central role of the IMF in the international financial system and discourage countries from setting up bilateral or regional arrangements in order to bypass IMF policy conditionality.

When this expanded IMF package is submitted to the US Congress the new administration would have to ask the Congress to authorize the Federal Reserve to engage on the other side of such swap arrangements.[49] I would recommend approving Federal Reserve authority to swap unlimited amounts with the Fund for periods of up to two years.

Although one can question the immediate need for this type of approach given that, in principle, the Federal Reserve swap arrangements and the new SLF are operating in tandem, incorporating this provision in the package sent to the Congress has two advantages. First, it builds a bigger package and obviates the need to go back for an authorization at a later date. Second, it clarifies the central, multilateral role of the Fund for the future. The extensive use of Federal Reserve swap arrangements, and similar operations by the SNB and ECB, have tended to encourage the development of regional, lower-conditionality substitutes for the IMF, which is not healthy for the longer run.

The Role of the IMF—International Financial Supervision and Regulation

I have argued above that work on the reform of the international system of financial supervision and regulation should be slowed down because the current focus on this area is having a negative, procyclical effect and because diagnosis remains incomplete and constructive change will take time. Nevertheless, a process of reform is underway.

In his remarks in advance of the annual meetings on October 10, 2008, managing director Strauss-Kahn signaled that he is prepared to seize the moment in the name of the Fund. He was implicitly critical of the work of the Financial Stability Forum (FSF).[50] The Fund is a member of the FSF, but it does not

49. The United States government cannot lend to the IMF without congressional authorization.

50. The G-7 finance ministers and central bank governors established the FSF in 1999 to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance. Its members include representatives of the G-7 countries, a number of other financial centers, the IMF, World Bank, OECD, and BIS, international standard-setting bodies such as the Basel Committee on Banking Supervision and Regulation, and

have a dominant role.[51] The FSF, as formally constituted, reports to the G-7 finance ministers and central bank governors.

In September 2007, the FSF was called upon by the G-7 to prepare a comprehensive set of recommendations for addressing the weaknesses that have produced the crisis that was then breaking and for strengthening the financial system going forward. After several interim reports, a final report with 67 recommendations was submitted to the G-7 in April 2008 with associated timelines for action in five areas: strengthened potential oversight of capital, liquidity, and risk management; enhanced transparency and valuation; changes in the role and uses of credit ratings; strengthened official responsiveness to risks; and arrangement for dealing with stress in the financial system.[52] In his report to the G-7 and IMFC in October 2008 (FSF 2008), FSF chairman Mario Draghi added four additional topics: monitoring and addressing the international interaction and consistency of emergency arrangements and responses; working to mitigate procyclicality in the financial system; reassessment of the scope of financial regulation to cover institutions, instruments, and markets that are unregulated (or lightly regulated); and integration with macroeconomic oversight and prudential supervision (so-called macroprudential supervision).

The IMF and FSF should make peace. This statement means that the IMF management, the G–7, and the major central banks and supervisory authorities should make peace. There is plenty of work for everyone. On November 13, 2008, managing director Strauss-Kahn and FSF chairman Mario Draghi wrote a joint letter to the G-20 ministers and governors before the G-20 summit meeting in Washington laying out the respective roles of the two organizations and promising to enhance their collaboration:

1. Surveillance of the global financial system is the responsibility of the IMF.
2. Elaboration of international financial-sector supervisory and regulatory policies and standards, and coordination across the various standard-setting bodies, is the principal task of the FSF. The IMF participates in this work and provides input as a member of the FSF.
3. Implementation of policies in the financial sector is the responsibility of national authorities, who are accountable to national legislatures and governments. The IMF assesses authorities'

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two BIS committees that are dominated by G-10 central banks.

51. Stanley Fischer, governor of the Bank of Israel and former first deputy managing director of the IMF, was more pointed in his remarks at the Per Jacobsson Foundation panel on October 12, 2008: "The Financial Stability Forum was set up after the Asian Crisis in a way that ensured the IMF would not be closely involved in this area [global financial stability]. . . . That was simply a mistake. The FSF is doing excellent work, but it is not a global institution as is the Fund" (IMF 2008f).

52. Other individuals and bodies have released competing or complementary reports, including Morris Goldstein (2008a). See Annex B to FSF (2008) for a list of documents and reports by official or semi-official bodies. Goldstein's ten recommendations cover some of the same ground as the FSF recommendations although some of his suggested reforms are deeper and more specific or cover different areas. For example, Goldstein calls for action on the macroeconomic dimension in the form of coordination between monetary and supervisory authorities during the build-up of asset-price bubbles; establishment of a clearing house for OTC derivatives; new standards for compensation; rationalizing the US financial regulatory structure; and reforms in US housing finance.

implementation of such policies through FSAPs, Reports on the Observance of Standards and Codes (ROSCs) and Article IVs.

4. The IMF and the FSF will cooperate in conducting early warning exercises. The IMF assesses the macrofinancial risks and systemic vulnerabilities. The FSF assesses financial-system vulnerabilities, drawing on the analyses of its member bodies, including the IMF. Where appropriate, the IMF and FSF may provide joint risk assessments and mitigation reports.

This outline of intended IMF-FSF collaboration raises many questions. Moreover, it is widely understood that the IMF management and staff would like to have a larger role than the letter implies. It is unrealistic that the FSF should come under the total purview of the IMF. The FSF is primarily a coordinating body. Its members include sovereign governments as well as independent central banks, and they participate voluntarily in the FSF's activities.

On the other hand, the link between the G-7 and the FSF should be severed because the G-7 lacks legitimacy. Henceforth, the FSF should report to the G-20 finance ministers and central bank governors. This could be arranged at the same time that membership of national authorities in the FSF is expanded, as has been agreed in principle. Placing the FSF nominally under the G-20 would help to limit the size of that expansion because the FSF itself would be responsible, to the extent that it makes its own agenda, to a broader group of countries. Some of the G-20 members might be satisfied with this indirect involvement in the activities of the FSF. At the same time, the recent informal practice of having the FSF report to the IMFC should be formalized.

What should be on the FSF's agenda other than those items that have already been placed there and how should that agenda relate to the work of the Fund? I would highlight five truly cross-border issues thrown up by the financial crisis that, in my view, have not received sufficient attention but that merit work by both the FSF and the IMF.

First is the issue of banks that are too large for the authorities of their home countries to support or rescue. The FSF and G-20 leaders' agenda calling for colleges of supervisors for all the systemically important financial institutions does not fully address this issue. Some banks, for example in Iceland, have proved to be too big for their countries, but those banks were not systemically important. This is not an easy or new issue. It first surfaced in the Herstatt and Franklin National banks crises in 1974 which led to (1) the formation of the Basel Committee on Banking Supervision, which nominally reports to the G-10 central bank governors, and successive understandings concerning the supervision of banks that operate in multiple jurisdictions and (2) the crafting in the Euro-Currency Standing Committee (now the Committee on the Global Financial System) of a loose understanding about lender-of-last-resort responsibilities for such institutions. These issues must be addressed, but reaching agreement on the appropriate treatment will take time, patience, analysis, and understanding.

Second is the issue of the resolution of failures of large cross-border financial institutions. This is an issue in the United States, where there is no procedure for resolving failed nonbank financial institutions. However, going forward, it is an issue for the global system in particular if the aim is to have more controlled failures and fewer rescues. The legal wrangles surrounding the recent Lehman bankruptcy echo those surrounding the failure of the Bank of Credit and Commerce International in 1991. However, in the meantime little has been done to resolve conflicts between how these failures are handled in different jurisdictions, although there has been some progress with respect to the purely market-related aspects, e.g., closing out financial contracts. Again, this is a contentious subject and one that will not be easy to resolve, but it should be on the agenda going forward.

Third is the issue of the provision of liquidity to internationally active financial institutions, in particular those that are large relative to the size of their countries. One potential mechanism is what I proposed above under immediate recommendations. Central banks issuing major international currencies should provide short-term financing to the IMF to help finance a permanent short-term lending facility.

The Fund traditionally advances credit to governments, and the governments use the foreign exchange borrowed from the IMF primarily to replenish their reserves. Secondarily, governments use the foreign exchange to meet their own foreign currency obligations, including debt obligations, and, to a limited degree, to support their currencies in the foreign exchange market. In the financial crisis of 2008–09, governments and their central banks, in industrial as well as developing countries, have used foreign exchange—reserve holdings as well as new borrowings—to help their domestic financial institutions to repay international creditors, in particular their interbank borrowings. In the future, with the ongoing globalization of finance, these needs are likely to continue if not increase. In general they should be met not through bilateral or regional arrangements among central banks but multilaterally through the IMF. This would be one use for a permanent short-term liquidity facility in the IMF. The design of such a permanent facility raises a number of questions about both country eligibility as well as about the facility's financing. However, such a facility would help to address the first issue of banks that are large relative to the size of their countries. It would be up to the borrowing country to make the difficult determination of whether an individual financial institution faced a liquidity crisis rather than a solvency crisis.

Fourth is the issue of coordinating responses to financial-system crises. In recent months, responses have been almost exclusively at the national level without reference to international norms and standards. A number of these, such as raising limits on deposit insurance and guaranteeing the debt of financial institutions, have had disruptive cross-border effects, serving to propagate the crisis rather than to contain it. What is needed in this area is to draw up new codes and standards for all countries. At the same time, the dozen existing international codes and standards should be revisited by the relevant standard-setting bodies that report to the FSF. Subsequently, this new structure of codes, standards, norms, etc. should be incorporated into the IMF surveillance activities.

Finally, IMF surveillance is probably the most complex issue growing out of this global financial crisis. It is clear, at least to me, that the crisis had its origins in macroeconomic policies, in microprudential policies, and in what are called macroprudential policies—prudential policies that have macroeconomic implications and vice versa. The challenge for policymakers at both the national and international levels is that there is no agreed conceptual framework to guide international cooperation in these three, related areas even if one assumes that all the relevant players would participate openly in the resulting structures. Moreover, the latter assumption is probably not wholly justified. The macroeconomic authorities, for example central banks, are not accustomed or particularly open to having their policies critiqued by international organizations such as the IMF or by regulatory groups such as the FSF. Similarly, the supervisory authorities are not accustomed or particularly open to having their own macroeconomic authorities, to say nothing of the IMF, critique the procyclicality of their actions or inactions. Again, there are no easy answers with respect to process. Equally if not more important, on substance there is no common understanding on a conceptual framework to use. The IMF as a global institution must play a major role in helping to implement whatever consensus emerges on these procedural and substantive issues if there is to be any chance that the world economy and financial system is to reduce the incidence and virulence of such crises in the future.

ON WHAT TERMS IS THE IMF WORTH FUNDING?

Returning to the question that motivated this paper: On what terms is the IMF worth funding? In particular, how should the Obama administration and US Congress proceed with respect to the IMF legislative package that was submitted to the Congress on November 12, 2008?

My conclusion is that the package can and should be substantially improved. In addition to or as a substitute for the elements in the package agreed in the spring of 2008, the new administration should seek international and subsequent domestic approval (1) for doubling of IMF quotas on the basis of a revised new quota formula along with a doubling of associated GAB and NAB commitments, and (2) for the Federal Reserve to swap dollars for SDR with the IMF. The United States should also propose and support an allocation of SDR 50 billion, which does not require congressional authorization. These steps would help the Fund to perform its role as lender of final resort and provide confidence to the global economy and financial system.

The new administration should also work to strengthen the role of the Fund in the global economic and financial system not only in its lending role but also in its surveillance role. Neither the IMF nor the FSF should be transformed into a global financial regulator. However, the FSF should be strengthened by having it report formally to the G-20, and the FSF and IMF should work cooperatively on a number of multilateral financial issues that I have detailed. The surveillance of macroeconomic, microprudential, and macroprudential policies should be improved. Here, both the Fund and the FSF have roles to play not only in conducting the surveillance but principally in trying to construct a better overall framework of analysis.

Over the next few months, if the Obama administration is unable to generate international support for an enhanced package along the lines I have proposed, it should revert to supporting the package that was agreed in the spring of 2008. The aim should be to pass the package of IMF legislation by the end of 2010 at the latest. Further delay would seriously undermine the IMF as a central multilateral institution.

Gaining congressional support for either type of package will not be easy. How difficult it will be depends in large part on whether the United States and China, with the help of the IMF, can work out their differences over China's exchange rate policies, as well as how effectively the IMF performs in the global recession.

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